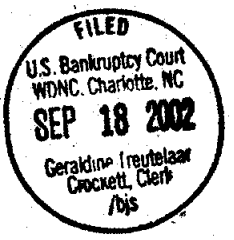
UNITED STATES BANKRUPTCY COURT
FOR THE WESTERN DISTRICT OF NORTH CAROLINA
WILKESBORO DIVISION

IN RE:	)	Case No. 98-50517
	)	Chapter 11/7
JOHN R. MULLINS,	)	
	)	
Debtor.	)	
	)	
BARRETT CRAWFORD, TRUSTEE, et al.,	)	
	)	
Plaintiffs,	)	Adv. Proc. 98-5038
vs.	)	
	)	
JOHN ROBERT MULLINS,	)	
	)	
Defendant.	)	



JUDGEMENT ENTERED ON SEP 18 2002

FINDINGS OF FACT AND CONCLUSIONS OF LAW

This matter was before this Court upon the April 11, 2002, motions of the Chapter 7 Trustee and the Bankruptcy Administrator seeking emergency appointment of a Chapter 11 Trustee and reconversion of this case to Chapter 7. The Debtor, John R. Mullins ("Mullins" or "Debtor"), opposes the motions.

PROCEDURAL POSTURE

The current motions were responses to the Debtor's extraordinary decision to convert to Chapter 11 after four years in a voluntary Chapter 7 case. Conversion, in turn, was motivated by the Trustee's impending recovery of a significant asset for the Estate, that being the stock of a related company, Mullins-South, Inc. ("Mullins-South"). After the Debtor lost a summary judgment motion which awarded the stock to his Estate and then failed to

post an appeal bond so as to obtain a stay, he converted his case to Chapter 11 on April 10, 2002. By converting his case, Mullins hoped to displace the Trustee and take over control of the Estate's assets.

The Court held an emergency hearing on April 16, 2002. At day's end, the Trustee was continued in service on an interim basis, and the remainder of the hearing was continued to April 22 to afford the Debtor due process.

At the April 22 hearing, the Court heard additional evidence and arguments regarding whether Mullins should remain in Chapter 11. At the conclusion of the hearing, the undersigned announced a bench Order reconverting the case to Chapter 7 and denying the Debtor a bankruptcy discharge.

With the need for an immediate decision, the Court made summary verbal findings and conclusions from the bench pursuant to Fed. R. Bankr. P. 7052, and entered a brief, written order on April 26, 2002. However, as stated in the bench Order, the Court intended to prepare more complete written findings and conclusions as time allowed, and upon entry, these would replace the verbal findings and conclusions. These are those written findings and conclusions.

Held: 11 U.S.C. § 726(a) affords a Chapter 7 debtor one opportunity to convert his case to Chapter 11. However, a converting debtor will not be permitted to remain in that chapter

where his conversion was made in bad faith and for an improper purpose. Under *Finney v. Smith*, 992 F.2d 43 (4th Cir. 1993), a case converted in subjective bad faith and under circumstances suggesting objective futility may be reconverted by the Bankruptcy Court to Chapter 7.

This Debtor's conversion is a transparent attempt to prevent the Trustee from recovering assets for the bankruptcy Estate and to block the Trustee's pending lawsuits against the Debtor and his insiders. As such, this conversion was made in subjective bad faith and is an abuse of process.

Objective futility also exists in this case because: (1) there is no existing business to reorganize; (2) the Debtor is apparently in poor health; and (3) the Debtor has conflicts of interest which render him unfit to act as a fiduciary for his creditors, particularly as to the assets of this Estate. Therefore, under *Finney*, this case should be reconverted to Chapter 7.

This conversion is only the latest of many bad faith acts by which this Debtor has attempted to block administration of his case and avoid paying creditors. These acts are an abuse of the bankruptcy system. Because warnings and lesser sanctions have failed to deter such behavior or to compel the Debtor to fulfill his statutory duties, the Court will deny the Debtor's bankruptcy discharge pursuant to 11 U.S.C. §§ 105 and 727 and FRBP 37(b)(2).

FINDINGS OF FACT

I. Prior Proceedings Relating to the Current Motions[1]

1. John Mullins filed this voluntary Chapter 7 case on April 18, 1998. Barrett Crawford was appointed Trustee for Mullins' Estate.

2. Mullins' Petition suggests that he is destitute and that this is a no-asset case. For example, his Petition, Mullins claims he owns only $2,350 of property and lives on a monthly income of $1,100. *See* Schedules B and I.

3. From the outset, the Trustee doubted that this was the case. Mullins stated lack of resources was at odds with the $4.2 million of business debts he had managed to accumulate.[2] Additionally, creditors informed the Trustee that Mullins had conveyed away millions of dollars of his assets before bankruptcy

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[1] The Court takes judicial notice of the record in the following:

a. this bankruptcy case, Case No. 98-50517, the related case of Mulco Leasing, Inc., Case No. 00-51548, and all associated adversary proceedings therein;

b. those prepetition civil actions pending in other courts involving the Debtor and the other defendants to these adversary proceedings; and

c. the public record in the relevant real property and judgment registries where the Debtor and other defendants have or had properties, particularly the Circuit Court of Tazewell County, Virginia, and the Register of Deeds for Avery County, North Carolina.

[2] The Debtor owes Ford Motor Credit ("FMC") $2,223,032, First Virginia Bank $655,288, and First Century Bank (f/k/a First National Bank Bluefield) $1,014,442.

to a combination of family members, family trusts, and shell companies.

4. Upon investigation, the Trustee discovered that the creditors' allegations were true. Over the next two years he would file a half dozen lawsuits against Mullins and forty other defendants (including the Debtor's relatives, family trusts, and a number of holding companies) seeking to recover these assets. *See* Adv. Proc. 00-5013, 00-5011, 00-5012, 01-5011, and 98-5038. These actions are pending in this Court.

5. Similar suits have been filed by individual creditors. *See* Adv. Proc. 98-5045 and 00-5031 and *In re Mulco Leasing*, Case No. 00-51548. These actions are also pending in this Court.

6. The above-referenced actions are founded on a common theme. They allege that: (1) the other defendants are alter egos of Mullins, Mullins' transfers were shams, and the assets belong to Mullins' Estate; or, alternatively, (2) if effective, these transfers were fraudulent as to creditors and are avoidable under the Bankruptcy Code and Virginia state fraudulent conveyance law.[3]

7. Mullins admits that he once owned substantial assets but denies nearly everything else alleged against him, including transfers of several real estate properties that appear of public

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[3] While these issues have not been tried, there is much evidence in the record supporting the Plaintiffs' contentions. Many of the transfers appear of public record and are adjudicative facts. Additionally, the case record as it exists today reflects most of the traditional badges of fraud as to these transfers.

record. *See, e.g.*, Mullins' Answer of June 15, 2000, Adv. Proc. 00-5013. He certainly denies making any improper dispositions of his assets.

8. In Adversary Proceeding 98-5038, the Trustee and creditors have also objected to Mullins' discharge, asserting that Mullins has concealed his assets and financial affairs; failed to disclose his assets and transactions to the Trustee; withheld financial information from the Trustee; made false oaths; and failed to cooperate with the Trustee.[4]

9. These actions are only now in the late phases of discovery. However, having heard many turnover and discovery disputes between Mullins and the Trustee, this Court can state without reservation that Mullins has done everything he could to prevent the Trustee from investigating his affairs and recovering his former assets. Be it providing information about his finances; turning over records and Estate property; providing responses to the Trustee's discovery requests; or even appearing at examinations and depositions, Mullins has resisted all of the Trustee's attempts to learn about his finances.

10. Mullins' resistance has forced the Trustee to seek from the Debtor documents and property that a debtor is legally obliged to produce and which ordinarily are voluntarily produced. Even

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[4] FMC has also filed a section 523 dischargeability suit against the Debtor alleging a prepetition fraud by Mullins pertaining to his former car dealership. *See* Adv. Proc. 98-5045.

then, Mullins has complied only when forced to do so. To date, he remains unresponsive to the Trustee, evasive, and often entirely unavailable.[5] This pattern has been replicated by the other defendants in the adversary proceedings.

11. Obviously, proceeding in this manner has been very expensive, and with no assets in the bankruptcy estate, a great burden to the Trustee and his attorneys.[6]

12. In April 2002, the Trustee finally got a break in the case. Contrary to the Debtor's assertions, the Trustee unearthed information demonstrating Mullins still owned the stock of Mullins-South on the date of bankruptcy, making the stock Estate property.[7] Because Mullins-South holds title to a number of Mullins' former assets, its recovery would provide substantial assets for creditors. Mullins-South's stock has been estimated to be worth more than $1.3 million.

13. Having discovered that Mullins still owned the stock of Mullins-South on the date of bankruptcy, the Trustee sought partial summary judgment and a declaration that the bankruptcy Estate owned the stock interest. *See* Trustee's Motion for Partial Summary Judgment of November 28, 2001, Adv. Proc. 00-5013.

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[5] *See* discussion regarding Mullins failure to attend depositions, *infra*.

[6] Until January 2002 there were no assets in the Estate. Even now, there are not enough assets to pay present administrative expenses. The Trustee has stated in court that his attorneys fees exceed $200,000.

[7] Mullins-South is one of the defendants in Adv. Proc. 00-5013 alleged to be an alter ego of the Debtor.

14. Mullins opposed the Trustee's motion. In his sworn affidavit, Mullins states that he transferred Mullins-South's stock to his Children's Trusts years before bankruptcy.[8] *See* John Robert Mullins' Affidavit of January 11, 2002, Adv. Proc. 00-5013. Mullins' sons, Bobby and Charles Mullins, also opposed the Trustee's motion.[9]

15. However, the Children's Trusts' records do not mention any stock gifts, and three of the five trustees disclaimed knowledge of the same. Because the trust instrument requires that any gifts to the Trusts be accepted in writing and by act of a majority of the trustees, the alleged gifts failed as a matter of law. Thus, the Court granted the Trustee's Motion for Partial Summary Judgment and held that the bankruptcy Estate owned Mullins-South. *See* Order Granting Trustee/Plaintiff's Motion for Partial Summary Judgment of March 6, 2002, Adv. Proc. 00-5013.

16. Mullins and his sons (collectively "Appellants") appealed that ruling and requested a stay pending appeal. *See* Motion for Leave to Appeal and Motion for Stay of Order Pending Appeal of March 14, 2002, Adv. Proc. 00-5013. This Court granted the motion on the condition that before that stay would issue, the

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[8] The Children's Trusts are Virginia spendthrift trusts settled by Mullins in the mid-1980's. Structurally, the Children's Trusts are five subtrusts existing under a single trust document. Mullins' adult children are beneficiaries, and with one exception, trustees of these trusts.

[9] Bobby and Charles Mullins are two of the five co-trustees for the Children's Trusts and are also named defendants in this action.

Appellants must first post a bond.[10] Appellants' attorney was called upon to draft that order.

17. Two weeks passed without the Appellants tendering an order, posting a bond, or relinquishing control of Mullins-South to the Trustee.

18. At this point, the Court held a telephonic hearing to discuss this situation. In that hearing, Appellants' counsel advised that his clients had failed to obtain a bond. With the summary judgment order now one month old, the Court reiterated to the Appellants that the summary judgment order was effective and unstayed.

19. After the summary judgment ruling was entered, the Trustee held a Mullins-South's shareholder meeting, elected new officers, and thereafter attempted to assert control over the company. The Trustee was rebuffed in this effort by Mullins-South's management and counsel. Consequently, he filed a show cause/contempt motion against the company President, Bobby Mullins. *See* Motion for Order to Show Cause of March 22, 2002; Amended Motion for Order to Show Cause of April 5, 2002, Adv. Proc. 00-5013. This motion was pending at the time of the conference call.

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[10] The Court denied the motion as to Mullins. The Debtor was not a "person aggrieved" by the decision, and as a debtor in an insolvent estate, he lacked standing to appeal a decision concerning an estate asset. *See In re Richman*, 104 F.3d 654(4th Cir. 2001).

With no bond, stay, or stock turnover, the Court advised the attorneys that it was setting a contempt hearing.

20. Upon learning this, Appellants' counsel informed the Court that Mullins was contemplating converting his case to Chapter 11. The Trustee, of course, was vehemently opposed to this conversion.

21. Mullins did, in fact, file a notice of conversion to Chapter 11 on April 11, 2002.

22. Pursuant to 11 U.S.C. § 1107, conversion of the case would make Mullins a debtor-in-possession and displace the Trustee --a most ironic twist. As debtor-in-possession, Mullins would control a bankruptcy estate that consisted entirely of the Mullins-South stock (which the Debtor had been trying to exclude from the Estate) and the Trustee's law suits against Mullins and his family.

23. Seeking to prevent the conversion, the Trustee and Bankruptcy Administrator filed the current motions and sought an emergency hearing.

II. Prebankruptcy Period

24. The litigation stemming from Mullins' attempt to convert his case is only the latest battle in a long war waged by Mullins against his creditors.

25. In the mid 1980's, Mullins was a successful businessman residing in Richlands, Virginia. At that time, Mullins was a man of means, whose assets included a car dealership (Bob Mullins Ford

Lincoln Mercury, Inc.), an office building (The Mullins Professional Building), a motel (The Mullins Motel), and a residence in Banner Elk, North Carolina. Mullins also indirectly owned other assets through closely held corporations, such as an adult entertainment club in Lexington, Kentucky.

A. Mullins incurs several large debts and begins to transfer assets out of his name

26. During the second half of the decade, Mullins' empire began to fall apart. By 1990, two local banks, Richlands National and First National Bank of Bluefield (the "Banks"), obtained judgments against Mullins totaling $1.3 million.[11] In addition, the secured creditors on one of Mullins' major assets, the Mullins Professional Building (the "Professional Building") declared a default under their note and initiated a foreclosure sale.

27. In 1991, FMC accused Mullins' car dealership of being out of trust on its floor plan financing. In an attempt to keep FMC from repossessing its inventory, the dealership filed bankruptcy. When the dealership's reorganization failed, FMC sued Mullins in Virginia state court on his $2.2 million personal guaranty of its debt. FMC dismissed the state court action and refiled the case in the United States District Court for the Western District of Virginia in 1995. When FMC filed a motion for summary judgment in

[11] Richlands National, now First Virginia, obtained judgments for $256,257 and $57,536 and First National Bank of Bluefield, now First Century, procured judgments for $799,576, $148,000, $46,174.49 and $20,691. These judgments were all liens on the Mullins Professional Building.

the District Court case, Mullins filed this bankruptcy case in order to stay the proceeding.

28. As Mullins' fortunes declined, assets began to migrate out of his name. Many of these assets were deeded to several family trusts which Mullins had established for his children, including the Children's Trusts. Mullins retained a life estate in at least one of these trusts, The Charles Robert Mullins Trust.

29. Similarly, during this time, Mullins established a number of holding companies which received transfers of his property. These companies are owned/controlled by Mullins, his family members, their trusts, or by each other. Several of the holding companies have eventually been dissolved or allowed to become inactive.

30. Mullins' assets have moved among the trusts, the holding companies, and Mullins' relatives in a dizzying variety of transfers. Some of these parties own other entities; some own former Mullins' assets; and others hold secured debt on those assets. These parties have on numerous occasions transferred property between them without any apparent consideration and even foreclosed on one another's assets.

31. There are too many of these transfers to list, and not all of the particulars are in the record. However, the net effect of these transfers is simple: (1) on the date these transfers began, Mullins had considerable assets; (2) on the date he filed bankruptcy, Mullins had virtually no assets in his name; (3)

Mullins' creditors currently remain unpaid; and (4) his former assets are held by insiders.

32. To obtain a flavor for these interrelationships and transactions, one need only consider the transfers of the Professional Building.

B. Transfers of the Professional Building

33. In 1982, Mullins obtained industrial revenue bond/note financing for approximately $1.3 million to acquire and renovate the Professional Building. A deed of trust secured the $1.3 million debt, and the Banks had another $1.3 million in liens against the Professional Building. In total, Mullins owed approximately $2.6 million on the property.

34. In September 1990, Mullins defaulted on the debt, and the mortgage holders instituted foreclosure against the Professional Building.

35. On December 17, 1990, and only two days before the foreclosure sale, Mullins deeded the Professional Building to a newly formed company, Orange Ventures, for no consideration.

36. The same day, Orange Ventures redeeded the building to another newly formed company, Mulco Leasing ("Mulco"). Mullins was the 100 percent shareholder of both Orange Ventures and Mulco. Two days later, Mulco blocked the foreclosure sale of the Professional Building by filing Chapter 11 in the Western District of Virginia.

37. Mulco eventually confirmed a plan that proposed to reinstate all of the secured debt on the Professional Building,

including the mortgage and the liens. However, Mulco soon defaulted, and in light of subsequent events, the default was apparently no accident.

38. In early 1995, Mullins set up a Florida corporation called Vero Investments, L.L.C. ("Vero"). At some point in 1996 or 1997, Vero bought the mortgage on the Professional Building at a discount. As mortgage holder, Vero then filed its own foreclosure action against the building. Vero set the sale for December 5, 1997.

39. If completed, this "friendly" foreclosure sale would have cut off the Banks' $1.3 million in liens against the Professional Building; Vero would gain title to the property; and Mullins would continue to enjoy the beneficial ownership of the property.[12]

40. The Banks tried to prevent Vero's foreclosure by filing an involuntary bankruptcy against Vero in the Western District of Virginia on December 5, 1997.

41. The involuntary petition invoked section 362 and should have stayed the foreclosure sale. However, the foreclosure trustee, Gerald Dechow, proceeded with the sale, allegedly at Mullins' insistence. Vero placed a bid at the foreclosure sale and acquired the Professional Building.

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[12] The Trustee contends that Vero is but another strawman of the Debtor. In fact, at the time Mullins filed bankruptcy, 99 percent of Vero was owned by a family trust established by Mullins.

42. Rather than having the sale set aside, the Banks agreed with Vero that the foreclosure sale be deemed valid but subject to the Banks' liens and their right to seek equitable subordination of Vero's interests in the Virginia Bankruptcy Court. *See In re Mulco Leasing, Inc.*, 7-98-0099 (Bankr.W.D.Va. May 28, 1998).

43. The Banks filed their subordination action, but before it could be tried, that action and Mulco's bankruptcy case were transferred to this Court. *See In re Mulco Leasing, Inc.*, 7-98-0099 (Bankr.W.D.Va. October 16, 2000).

44. Vero then sought to have Mulco's bankruptcy case dismissed. If allowed, the dismissal would have destroyed the Banks' subordination action and left Vero as the undisputed owner of the Professional Building. This Court ultimately denied Vero's dismissal motion. *See* Order of June 8, 2001, Case No. 00-51548.

45. Consequently, the Professional Building has been left in limbo. Vero argues that it lacks the resources to maintain the property and can not sell or borrow against it because of a *lis pendens* placed on the property by Mullins' Trustee. Because it no longer belongs to Mulco's Estate, Mulco's Trustee is also unable to sell the property. The parties have been unable to agree on the maintenance or sale of the Professional Building.

46. If the Professional Building transfers seem hopelessly complex and without legitimate purpose, there are many others just like it. However, the overall effect of these transfers is simple.

Mullins went from having several million dollars in assets in his name in the 1980's to not even owning his clothing at the date of the bankruptcy filing. Meanwhile, his creditors remain unpaid.

III. Mullins' Failure to Cooperate with the Trustee and to Turn over Records and Property During his Bankruptcy Case

A. The first meeting of creditors

47. Mullins' section 341 creditors meeting was originally set for June 1, 1998. The Trustee was unable to conclude the same as so many questions arose about Mullins' filing and assets. Instead, the Trustee asked Mullins to provide a number of financial documents and information within two weeks and continued the first meeting until June 30. *See* Proceedings Memo of June 1, 1998, Case No. 98-50517.

48. Mullins did not provide the requested information as he had agreed to do. Moreover, he did not have much of this information at the continued first meeting on June 30, 1998. The meeting could not be concluded and was again continued until July 20, 1998. The Trustee once again asked Mullins to provide the missing documents and information. *See* Proceedings Memo of June 30, 1998, Case No. 98-50517.

49. At the third continued hearing on July 20, 1998, the Debtor again failed to provide the information requested by the Trustee. *See* Proceedings Memo of July 20, 1998, Case No. 98-50517. It was obvious that Mullins had no intention of providing the necessary information to the Trustee, so the Trustee adjourned the

first meeting and reconciled himself to seeking this information through litigation.

50. The next day, the Trustee and several creditors filed Adversary Proceeding 98-5038 objecting to Mullins' discharge.

B. Mullins' subsequent failure to turn over records

51. At a hearing on the Defendants' Motion to Dismiss Adversary Proceeding 98-5038 conducted on March 3, 1999, Mullins' attorney represented to the Court that the Debtor would provide the records which the Trustee had requested at the first meeting. He did not.

52. Consequently, the Trustee moved on June 2, 1999, for an order requiring Mullins to provide these records. The records being sought were basic financial records of Mullins and his related entities, including tax returns, business records, bank statements, canceled checks, documentation evidencing transfers of assets and money, and ownership documents for the variety of small corporations owned or controlled by the Debtor. Obviously, such records are necessary to the administration of a bankruptcy case or to determine the debtor's eligibility for a discharge. They are also documents which a debtor is required to produce to the Trustee pursuant to 11 U.S.C. §§ 521 and 727.

53. Buttressing his turnover motion, the Trustee sought document production from the Debtor in Adversary Proceeding 98-5038 as well as to depose Mullins on June 25, 1999.

54. As before, Mullins was uncooperative. Citing his poor health, Mullins professed to be unable to sit for the June 25, 1999, deposition, so it was reset for July 28.[13] Mullins could not do it then either. Ultimately, Mullins was unavailable throughout 1999 and 2000 allegedly due to his poor health. In the end, the Trustee was not able to take Mullins' deposition until October 2000, and only then because the Court required his appearance. *See* Order Granting Plaintiffs' Motion to Compel and Setting Deposition of Debtor of August 17, 2000, Adv. Proc. 98-5038.[14]

55. When finally deposed, Mullins was less than forthcoming about his affairs--portions of his deposition testimony introduced at prior hearings are most unenlightening, considering Mullins is a businessman testifying about his own finances. Mullins responded to a great many questions about his assets with a variant of "I don't know."

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[13] Mullins is 74 and claims to suffer from Hepatitis B. Mullins' Virginia doctor has provided a note to the Court indicating that he has chronic anxiety and is to avoid stressful situations. However, although Mullins does not appear to be in good health, his infirmities tend to flare up when the Trustee seeks to take his deposition. For example, in the Summer of 2000, Mullins continued to maintain that he was unable to sit for his deposition due to poor health. However, in a letter to his attorney on June 14, 2000, Mullins pressed for the immediate deposition of FMC witnesses and indicated that he intended to fly to attend the deposition. *See* Exhibits to Plaintiff's Motion to Compel Deposition of Debtor of June 30, 2000, Adv. Proc. 98-5038.

Additionally, Mullins' practice has been to assert his health problems in order to excuse his appearance, after he fails to attend a deposition. *See, e.g.*, Mullins' Motion for a Protective Order of March 11, 2002, Adv. Proc. 00-5013.

[14] To avoid overlap and in consideration of the Debtor's health, in the August 17 Order, it was stipulated that discovery in one of these adversary proceedings could be used in the others.

56. Given this type of deposition response and the Debtor's failure to produce financial documents, much about the Debtor's finances remains unknown to the Trustee.

IV. Mullins' Continued Failure to Disclose Assets: the Mulco Leasing Stock

57. One of the reasons the Trustee has been insistent about obtaining Mullins' records is because he had independently learned that Mullins had not disclosed all of his assets in his Petition.

58. The Bankruptcy Code requires a debtor to list all of his assets in his petition. For example, Item 12 of Schedule B calls for the debtor to disclose stock and businesses in which he has an ownership interest. Despite owning several sizeable stock interests at the filing date, in his Schedules, Mullins claims to own no stock.

A. Mullins' unscheduled Mulco stock

59. One asset not disclosed by Mullins was the stock of Mulco. Mullins was the 100 percent owner of Mulco; however, his Petition fails to list this interest.

60. Mullins' failure to list his Mulco stock was not because he forgot about the stock. On the Monday after filing bankruptcy on Friday, Mullins wrote to one of his attorneys: "In fact, I own no stock except for Mulco Leasing, Inc...."[15] Obviously, Mullins

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[15] As noted below, the April 21, 1998, letter was produced at a hearing held after the Court announced its bench ruling on these motions. Because this is a section 105 ruling and this correspondence bears directly on the Debtor's good faith in this case, the Court has incorporated it into this ruling.

was aware of his ownership interest in the Mulco stock on the date of his bankruptcy filing.

61. The Trustee learned of the Mulco stock by questioning Mullins at the 341 examination in June 1998, at which point Mullins acknowledged owning Mulco. However, he testified that this was his only stock interest and that Mulco had filed a Chapter 7 bankruptcy. Mullins then scheduled the asset, but he made no effort to exempt it. *See* Mullins' Amendment to Schedule B of June 12, 1998, Case No. 98-50517. He would not claim an interest in the stock until the Trustee attempted to assert control over Mulco.

B. Mullins' attempt to block the Trustee from controlling the Mulco stock

62. In August 2000, the Trustee learned that Vero had filed a motion with the Virginia Bankruptcy Court seeking a dismissal of Mulco's case. As noted above, if successful, this motion would leave Vero as the undisputed owner of the Professional Building through its postbankruptcy "friendly" foreclosure.

63. Mullins' Trustee advised Bob Breimann, Mullins' Virginia bankruptcy counsel, who was also Mulco's bankruptcy attorney, that he opposed dismissal of Mulco's case. The Trustee also attempted to discharge Breimann as Mulco's attorney. Breimann responded by filing a motion in the Virginia Bankruptcy Court to declare that he (and thereby Mullins) spoke for Mulco in the case.

64. To establish his *bona fides* to the Virginia Court, Mullins' Trustee then obtained an order from this Court confirming

that Mullins owned Mulco. *See* Order of October 4, 2000, Case No. 00-51548. This was hardly a controversial order, as Mullins had not exempted the stock.

65. On arrival at the October 5 hearing in Virginia, Mullins' Trustee was surprised to learn that on October 2, Mullins had again amended his bankruptcy Schedules, valued the Mulco stock at $1, and purported to exempt it. The Trustee had not received prior notice of the amendment. In light of the amendment, Breimann argued to the Virginia Bankruptcy Court that Mullins, and not his Trustee, was entitled to speak for Mulco. *See In re Mulco Leasing, Inc.*, 7-98-00099 (Bankr.W.D.Va. October 16, 2000).

66. Having already heard several disputes between Mullins and his creditors, Judge Krumm realized the necessity that one court handle both the Mullins and Mulco cases. Consequently, he abstained from ruling on the dismissal motion and transferred the Mulco case to this Court. *See In re Mulco Leasing, Inc.*, 7-97-04760 (Bankr.W.D.Va. October 16, 2000).

C. Mullins is warned about his failure to schedule assets

67. Upon hearing Mullins' motion to exempt the Mulco stock, this Court felt compelled to allow the amendment to Mullins' Schedules, despite its tardiness.[16] However, only the amount claimed, $1, was exempt, not the entire asset. By this point, this Court had begun to question Mullins' good faith in this proceeding.

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[16] The law in this area strongly favors allowing a debtor such amendments.

However, having seen only the tip of the iceberg, the undersigned gave Mullins the benefit of the doubt and denied the Trustee's request for sanctions. However, this Court warned Mullins that it would take into account his failure to disclose this asset when it subsequently decided whether he would receive a discharge. *See* Order on Trustee's Objection to Amended Exemptions of January 19, 2001, Case No. 98-50517; Order Denying Motion for Reconsideration or to Alter or Amend of February 7, 2001, Case No. 98-50517.

V. Mullins' Failure to Disclose Assets: The FMC Counterclaim

A. The FMC counterclaim

68. In addition to failing to schedule his Mulco stock, Mullins failed to schedule his pending counterclaim against FMC. In the prepetition guaranty action filed by FMC against Mullins, Mullins filed a counterclaim against FMC for $25,000,000. Although this counterclaim was pending in U.S. District Court on the date of his bankruptcy filing, Mullins did not include it in his Petition. Mullins listed only FMC's claim against him.

69. In fact, Mullins did not schedule his counterclaim against FMC until November 18, 1999, or a year and a half after filing bankruptcy.[17] Even then, he did so only because the Trustee had learned of the counterclaim and was attempting to assert control over it.

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[17] In adversary proceeding 98-5038, the Trustee contends Mullins' discharge should be denied due to his concealment of the FMC counterclaim.

70. Upon scheduling the FMC counterclaim, Mullins moved to exempt it or, in the alternative, asked that it be abandoned to him. *See* Mullins' Motion for Leave to Amend Schedules of November 18, 1999, Case No. 98-50517. Contrary to his earlier averment in District Court that the counterclaim was worth millions, in this motion, Mullins asserted that the asset was of inconsequential value to the bankruptcy Estate and that its prosecution would be burdensome.

71. The Court denied Mullins' November 18, 1999, motion to exempt or abandon the counterclaim due to his failure to list the asset and his continuing refusal to provide the Trustee with the necessary information to evaluate the merits of the action. *See* Order Denying Motion to Abandon of February 8, 2000, Case No. 98-50517.

B. Mullins' refusal to provide information regarding the FMC counterclaim

72. When Mullins was finally deposed in November 2000, he was questioned regarding the documents that were the basis for his counterclaim. Mullins testified that he and his attorneys possessed this documentation, so the Trustee wrote Mullins' attorney, Breimann, asking for turnover of these documents. He received neither documents nor a reply.

73. Breimann's failure to produce any documentation or to reply to the Trustee's correspondence caused the Trustee to file another turnover motion in Mullins' base case seeking documentation

concerning the counterclaim. *See* Trustee's Motion for Turnover of February 12, 2001, Case No. 98-50517.

74. The Debtor opposed the Trustee's turnover motion arguing that because both FMC and the Trustee were suing him, he should not have to turn over these documents to the Trustee. Additionally, Mullins argued that since much of the documentation concerning this asset was held by his Virginia attorney, it was shielded from disclosure under the attorney-client and work-product privileges.[18]

75. The ability of a debtor in a voluntary case to block from his Trustee production of documents establishing an estate asset is doubtful, at best. After all, the Trustee legally "owns" the claim.[19] However, the issue was not reached because Mullins did not properly assert those privileges--he made only a blanket privilege assertion, rather than the specific, document-by-document assertion that the law requires. *See* Order of April 9, 2001, Case No. 98-50517.

76. This Court gave Mullins an opportunity to cure the deficiency. By ordering him to file a privilege log within fifteen

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[18] The wording of Mullins' response suggests that some of the documentation was not privileged. Nevertheless, Mullins did not produce any documentation to the Trustee.

[19] It would appear that the Trustee as the new "owner" of the counterclaim would also succeed to control over the privilege as well and be entitled to waive it so as to obtain information about the suit.

Alternatively, when a debtor voluntarily files a bankruptcy case, he accepts its statutory mandates of turnover and disclosure. Therefore, he likely waives any privilege as to information and documents required to be disclosed under the Code.

days. Additionally, the Court ordered Mullins to turn over to the Trustee any documents for which a claim of privilege was not timely and properly asserted. The hearing on the Trustee's turnover motion was continued to consider any properly asserted privilege claims and to allow Mullins' compliance as to the remainder of the Trustee's turnover requests.

C. The Court holds Mullins in contempt of court

77. Mullins all but ignored the Court's Order of April 9, 2001. First, he failed to file a privilege log within the fifteen day deadline or to serve it on the Trustee. The Trustee demanded this log from Mullins' counsel on April 27, 2001, but did not get a response. The Trustee then filed a motion to strike Mullins' Answer in the discharge objection suit.[20] *See* Trustee's Motion for (1) Striking Answer and Responsive Pleading, (2) Judgment on the Pleadings, and (3) Sanctions of May 7, 2001, Adv. Proc. 98-5038.

78. Only after filing the motion to strike Mullins' Answer did the Trustee receive a privilege log from Mullins. However, apart from being late, Mullins' filing was a privilege log in name only. It consisted of five short paragraphs which simply recited general types of documents which he considered privileged. For example, Mullins sought to withhold "all correspondence between attorney and client ... pertaining to the strategy outcome or

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[20] This was not only a sanctions request but akin to a motion for summary judgment. In the discharge objection suit, the Trustee contends that Mullins' improper withholding of information about the FMC counterclaim is grounds for denial of his discharge.

proceedings." No documents which might meet this criteria were specified. In sum, the privilege produced by Mullins totally ignored the direction of the April 9 Order for specificity as to documents for which a privilege was being claimed and the reasons why a privilege applied.

79. At the continued hearing on the Trustee's turnover motion, Mullins' attorney professed surprise that the Court considered the Debtor's submission to be inadequate. Additionally, Mullins' attorney claimed to be waiting for the Court to respond to his privilege log before making further disclosures despite the fact that the Court's April 9 Order expressly continued the hearing on the Trustee's turnover motion for the purpose of considering contested privilege claims.

80. Having failed on now two occasions to properly assert the privilege or to make turnover, the Court found Mullins to be in contempt of court and in violation of 11 U.S.C. §§ 521 and 542. The Court fined Mullins and ordered him to pay the Trustee's fees and costs. *See* Order of September 6, 2001, Case No. 98-50517.

81. In its Order, the Court warned Mullins that the "hide the ball" strategy he was employing would not be tolerated further. In addition, the Court opined that "Mullins' failure to produce documentation to the Trustee concerning the FMC counterclaim, and/or to follow this Court's Order by which his claims of

privilege to the same might be determined, constituted grounds for denial of his discharge under 11 U.S.C. § 727." *Id.*

82. At the continued hearing on this motion, the Trustee asked the Court to deny Mullins' discharge and default him in the pending adversary proceedings.

83. The Court declined to do so at that point, feeling that it should seek Mullins' compliance through lesser sanctions before imposing such a harsh penalty. However, the Court issued Mullins a stern warning regarding his tactics:

> [t]his record shows a pattern of obfuscation by Mullins about his finances and bad faith in regard to his bankruptcy case. Likewise, this failure to provide information to the Trustee causes severe prejudice to the estate. Without Mullins' information and documents, the Trustee cannot administer the estate. Potentially valuable assets may be lost as a result. Given the nature of this asset--a litigation claim against a creditor--if the Trustee cannot secure the information and documents evidencing that claim from the debtor or the attorney handling the action, (or at a minimum get a determination of whether they can be compelled), then whatever value that counterclaim may have will be lost. Third, this type of stonewalling by a debtor is a direct threat to the operation of the bankruptcy system as a whole. The bankruptcy system is dependant on debtors fully disclosing their financial affairs and their cooperating with the Trustee in the performance of his statutory duties. If, in a high profile case such as this, a debtor is permitted to withhold information; to fail to disclose assets; and to generally thumb his nose at his trustee and creditors, other debtors will take the hint. The bankruptcy system would devolve into a "catch me if you can" system, at the expense of the public and confidence is lost. Certainly, Congress never intended such a system.

Order of September 6, 2001, Case No. 98-50517 at ¶ 7 (emphasis added).

84. Only after the Court issued its Order of September 6, 2001, did Mullins produce records regarding his counterclaim against FMC. With these records in hand, the Trustee settled the counterclaim with FMC, recovering $30,000 for the estate. *See* Order of June 24, 2002, Case No. 98-50517. Mullins has never reimbursed the Trustee for his fees and costs incurred in settling the counterclaim with FMC.

VI. Mullins' Failure to Make Written Discovery in the Adversary Proceedings

85. Mullins' failure to produce documents to the Trustee regarding his counterclaims against FMC was being replicated in the adversary proceedings.

86. On August 26, 2001, the Trustee served his first interrogatories and requests for production of documents on the Debtor and his son, Bobby Mullins in Adversary Proceeding 00-5013. Neither the Debtor nor Bobby Mullins responded to the Trustee's discovery requests.

87. In December 2001, the Trustee's counsel called Mullins' attorney, Bob Price, on several occasions requesting responses. Price assured the Trustee's counsel that the responses were coming.

88. Nevertheless, one month later, the Trustee had not received the responses. On January 8, 2002, the Trustee's attorney wrote Price to once again demand responses.

89. This failure to respond to discovery requests was being mirrored by the other defendants who are united with Mullins against the Trustee. *See* Trustee's Motion to Compel of June 15, 2001, Adv. Proc. 00-5013.

90. The Court learned of this situation at a hearing on January 10, 2002, and issued a general order in the adversary proceeding which set an absolute response deadline of May 1, 2002, without excusing prior failures to make discovery or extending the time to do so. *See* Order on Case Administration of February 12, 2002, Adv. Proc. 00-5013.

91. The February 12 Order did not rectify the discovery problem. By February 27, 2002, the Trustee had motions to strike answers pending against most of the defendants in Adversary Proceeding 00-5013, based on their failures to respond to his discovery requests. Only after the motions to strike were set for hearing in June 2002, did the Trustee receive written responses from most of the defendants, including Mullins.

VII. The DiSanti Subpoena: Further Warning to Mullins Against Bad Faith Conduct

92. While these disputes were pending, in February 2002, the Court heard cross motions for sanctions between the Trustee on one side, and Mullins, his bankruptcy attorney, Bob Breimann, and Anthony DiSanti on the other. These motions stemmed from a *subpoena duces tecum* which the Trustee had previously served on

Anthony DiSanti seeking documentation concerning a foreclosure on Mullins' former residence. DiSanti had served as foreclosure trustee for that foreclosure.

93. Upon Breimann's recommendation, Mullins wrote DiSanti and directed him not to respond to the subpoena, asserting the attorney-client privilege.

94. When the Trustee went to the trouble of moving to compel production and forcing a hearing on the issue, Mullins simply walked away from his privilege claim--and just before the hearing began.

95. This led to the cross motions for sanctions. At the hearing, the Trustee argued that Mullins and Breimann had improperly interfered with a subpoena because: (1) a foreclosure trustee is not acting as an attorney, and thus, there is no privilege between the foreclosure trustee and either the lender or the borrower; and (2) Mullins had simply instructed DiSanti to ignore the Trustee's subpoena rather than move to quash it.

96. The Debtor narrowly avoided being sanctioned again. While his actions suggested bad faith, it was not entirely clear on this record. Neither Mullins nor Breimann is licensed to practice law in North Carolina, and the Court questioned whether they were aware of North Carolina law as it pertains to foreclosure trustees.

97. Even so, there was much to criticize in the way Mullins responded to the Trustee's subpoena. His privilege claim was

overly broad, claiming items in the public record. Also, Mullins made no effort to seek a ruling on his privilege claim, asserting it only by letter to DiSanti. Finally, when the Trustee brought to Mullins' attention the fact that there was no privilege, Mullins failed to withdraw his objection. Instead, he made the Trustee prepare for a contested hearing, only to walk away at the last moment.

98. Because of this, the Court's February 19, 2002, Order denying the Trustee's motion for sanctions reiterates to Mullins that he is on thin ice:

> Given his prior problems in this case, and because of the hint of misconduct in the current situation, it is necessary to warn the Debtor and counsel.
>
> Mullins may have meritorious defenses to this action and to the Trustee's discovery requests. However, he must frame his objections under the applicable procedural rules, present them in court, and seek a ruling. Rear guard actions will not be tolerated. In short, Mullins is warned to follow the rules.
>
> If, in fact, improper behavior is demonstrated in these cases, the Court will consider, among other alternatives, a denial of Mullins' discharge, [and] his default in these adversary proceedings....

Order of February 19, 2002, Adv. Proc. 00-5013 (emphasis added).

99. Like previous warnings, these admonitions went unheeded.

VIII. Mullins' Failure to Attend Scheduled Depositions and to Disclose Information

100. The Trustee noticed the depositions of several corporate defendants for February 6, 2002, in Adversary Proceeding No. 00-5013.

101. Thereafter, counsel for these defendants called the attorney for the Trustee to advise that Mullins, the Rule 30(b)(6) designee for these corporations, was not available on that date. The two attorneys agreed that Mullins' attorney would obtain an agreeable date for the deposition and notify the Trustee as to when Mullins would be available to be deposed (within a thirty day period).

102. However, Mullins and his attorney failed to provide the Trustee with an alternate deposition date, forcing the Trustee to renotice Mullins' deposition for March 11, 2002.

103. Eleven days passed without Mullins responding to the Trustee's notice. On March 8, 2002, the Friday before the Monday depositions, Mullins filed a motion for a protective order asking that the depositions not be held due to Mullins' alleged poor health and a need to complete physical therapy in Florida.

104. However, Mullins did nothing to seek a ruling on his motion prior to the date of the depositions. Rather, his attorneys noticed a hearing on the motion for March 21--ten days after the scheduled depositions. Mullins did not appear at the March 11

depositions. *See* Trustee's Motions to Strike of March 28, 2002, Adv. Proc. 00-5013.

105. Mullins' failure to appear for depositions was being repeated by his sons, Bobby and Charles. Charles Mullins was the Rule 30(b)(6) designee of other entities whose depositions the Trustee noticed. As with Mullins, these companies agreed to a deposition date, filed last minute motions for a protective order, noticed the hearings on the motions for a date after the depositions were scheduled to take place, and then failed to appear for these depositions. *See* Trustee's Motion to Strike Answer of Executive Valet Parking, Inc. and Enter Default of March 28, 2002, Adv. Proc. 00-5013.

106. In his Motion, Charles Mullins claimed to be unavailable because he was in drug rehabilitation in Florida. *See* Motion for Protective Order of March 11, 2002, Adv. Proc. 00-5013.

107. When the Court heard this matter, however, Charles Mullins changed his story. At the hearing on Charles' Motion for Protective Order, the Court was informed that Charles had been arrested on drug charges in Florida, and that the Florida court had ordered him not to leave the state.

108. Ultimately, when faced with having to pay the Trustee's travel expenses to conduct these depositions in Florida, Charles found that he could, in fact, travel to North Carolina. *See* Motion

for Relief from Order Entered March 29, 2002, of April 3, 2002, Adv. Proc. 00-5013.

109. Similarly, Bobby Mullins simply failed to attend the April 18, 2002, show cause hearing for contempt for Mullins-South's failure to turn over stock to the Trustee. Bobby's attorney reported that Bobby did not think he should miss work. This led the Court to find Bobby in contempt.

110. Ordinarily this Court would not consider Mullins to be responsible for the acts of his sons, Charles and Bobby. However, this is a most extra ordinary case. Here, the Trustee's lawsuits are premised upon the theory that Mullins controls the other defendants and "their" assets. There is much in the record to suggest that the Trustee's theory is entirely correct.[21]

IX. Mullins' Other Unscheduled Assets

A. Mullins' undisclosed interest in antique cars

111. At a hearing on April 22, 2002, the Trustee demonstrated that just days before filing his bankruptcy, Mullins placed four antique cars for sale at a car show. In a letter to his attorney, Mullins refers to these as "my antique/classic automobiles." The

[21] For example, at a follow-up hearing on June 20, 2002, Bobby testified as to his knowledge about Mullins-South's affairs. Although President of Mullins-South since 1997, Bobby Mullins appeared to know little about the company's affairs. This is a common characteristic among the other defendants. The evidence presented thus far shows that the person who has knowledge of these entities' affairs and makes decisions on their behalf is the Debtor, not the nominal officers, directors, or trustees.

documents by which they were offered for sale show "JR Mullins, Lexington Antique & Classic Auto" as seller/agent.

112. Mullins did not list these antique cars in his bankruptcy Petition. At the April 22, 2002, hearing, Mullins claimed that another related corporation, Capitol Clubs, owned these cars, and he was simply helping Capitol Clubs by selling the vehicles on its behalf. The documentary evidence presented at the hearing shows otherwise.

B. Mullins' undisclosed interest in Mullins, Inc.

113. The Trustee also recently learned that Mullins owns all of the stock of Mullins, Inc. Mullins also failed to disclose this interest in his Petition, or elsewhere. *See* Schedule B, #12. Mullins has never amended the Petition to correct this omission.

114. Mullins, Inc., in turn, owned and operated the Mullins Motel and Convention Center (the "Motel"). Thus, the Motel is another asset once owned by Mullins but not disclosed in his Petition. According to its 1997 tax return, Mullins' Motel had revenues that year of $287,226.

X. Evidence Presented at a Recent Hearing Suggests Mullins has Concealed Assets and Committed Perjury in this Case.

115. Mullins has denied any improper disposition of his assets, and his attorneys have promised the Court that when tried, all of these matters will be explained. If that is the case, then one must ask why Mullins is so opposed to making discovery of these

facts. One possible answer is suggested by a matter that arose after the hearing on the current motions.

A. Mullins' postpetition efforts to forge the Mullins-South stock transfer

116. The Trustee recently received a series of letters between Mullins and Breimann and Mullins and Gerald Dechow written in the year before and just after his April 1998 filing. The Trustee was not aware of this correspondence at the time of the reconversion hearing, but because it clearly demonstrates Mullins' efforts to subvert this case, it should be considered in this section 105 ruling.

117. On February 27, 1997, attorney Breimann wrote Mullins about FMC's pending summary judgment motion, suggesting that a threat by Mullins to file bankruptcy might help force a settlement with FMC. He then states:

> [I]n light of the time and attention which you have devoted to ensuring that no assets are in your name, I continue to wonder why a Chapter 7 bankruptcy proceeding wouldn't completely 'free you' from people like Ford. Inasmuch as whatever operations you presently purse are through a corporate entity, those corporate entities would not be affected, except to the extent that you might be the sole shareholder in them.

Exhibit O, Brief of Plaintiff of June 6, 2002, Adv. Proc. 00-5013.

118. Breimann's letter asks Mullins to consider the bankruptcy option but then warns of the need to get rid of Mullins' stock first: "[T]o protect your shareholder interest in corporations wherein you are the majority shareholder, or the only

shareholder, please note that any transfers of these shares must be one year in advance of the filing...." *Id.*

119. Ironically, with the letter, Breimann encloses a newspaper article about a debtor convicted of bankruptcy fraud. His handwritten note tells Mullins, "This, of course, is always a risk." *Id.*

120. On March 3, 1998, Mullins wrote to Dechow asking about assets in his name and attached a copy of Breimann's letter. *See* Exhibit P, Brief of Plaintiff of June 6, 2002, Adv. Proc. 00-5013.

121. On April 15, 1998, a member of Dechow's law firm responded to Mullins' inquiry about the Mullins-South stock. She stated:

> I have reviewed the minute book and the Mullins-South files in our office, but have not located any information indicating the shares you owned by tenants by the entireties with Phyllis Mullins were transferred to the children's trust, nor did I find any directive to transfer the shares.[22] Please provide us with the appropriate information to transfer the shares to the trust, if you choose to do so.

Exhibit Q, Brief of Plaintiff of June 6, 2002, Adv. Proc. 00-5013.

122. In an internal firm memo of the same date, TEK presumably, Kenyon wrote:

> J.R. Mullins called this a.m. regarding the fax Sherry sent him yesterday on Mullins-South stock ownership. He indicated that the 55,000 shares he owned with Phyllis Mullins should have been transferred to the children's trust 4 or 5 years ago. I have searched the minute book,

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[22] Phyllis Mullins is the Debtor's ex-wife.

> incorporation file and AR/AM file and found nothing indicating that the shares should have been transferred, and advised him of the same.

Exhibit R, Brief of Plaintiff of June 6, 2002, Adv. Proc. 00-5013.

123. Mullins filed his Chapter 7 Petition on Friday, April 18, 1998. On the following Monday, Mullins sent a letter to Dechow. *See* Trustee's Exhibit 1 from June 20, 2002, hearing, Adv. Proc. 00-5013. He instructed the law firm to review the records of his "related corporations" and to transfer his Mullins-South stock certificate to the Mullins Children's Trust. *See id.* Mullins also instructed the firm to back date the stock certificate so as to make it appear this happened before bankruptcy. *See id.*

124. In an effort to make reality conform to his wishes, Mullins then informed Dechow that "[a]ny other [stock] not already in the name of Mullins Children's Trust must also be transferred, as this corporation is owned entirely by this trust." *Id.*

125. Mullins then reviewed his other corporations and their ownership and informed Dechow that Orange Ventures was a defunct corporation and instructed him to make sure Mullins owned no stock in Mullins Motel, despite the fact that he did own that stock. *See id.*

126. Then, suggesting the end result, Mullins stated: "I own no stock except for Mulco Leasing, Inc., and some in Palmetto Land & Development, Inc." *Id.*

127. None of these stock interests is described in Mullins' Petition--not even those he told Dechow he should own.

128. In the April 20 letter to Dechow, Mullins explained why he needed these stocks transferred: "I, personally, filed Chapter 7, in North Carolina, this Friday past..., and I want all the books in precise order, in the event Ford wants to take a look at anything; I definitely don't want to be in a position for any criticism." *Id.*

129. This correspondence clearly demonstrates that: (1) before bankruptcy, Mullins undertook a systematic disposal of his assets; (2) at the time of bankruptcy, Mullins knew he was the owner of several stock interests which he failed to list in his Petition or to describe by amendment; and (3) after bankruptcy, Mullins attempted to falsify corporate records to conceal those stock interests, especially his ownership of Mullins-South.

130. Mullins' efforts to hide his assets continued over the course of this bankruptcy case. Mullins did not amend his bankruptcy Petition to correct these omissions, at least not until the Trustee learned of Mullins' ownership of a particular stock. Some of these omissions have never been corrected, even when Mullins has been reminded to do so. For example, the Trustee named Mullins, Inc. and Mullins Motel & Convention Center as defendants to Adversary Proceeding 00-5013, and they appeared as such for over two years. Mullins, as another defendant to that action, obviously

knew that these entities were owned by him and thus his Estate. He was obligated to disclose this information. He did not.

131. Even more prejudicial to creditors is the fact that Mullins has continued to maintain that he transferred the stock of Mullins-South before bankruptcy. For example, his opposition to the Trustee's summary judgment motion was founded on this assertion. Furthermore, in the Affidavit he filed in response to the Trustee's summary judgment motion, Mullins swears that he transferred the Mullins-South stock to the Children's Trusts in 1991 and 1994. Mullins even appealed the summary judgment Order which found this not to be the case. From his correspondence with Dechow, it is clear that he knew he was, in fact, the owner of this stock.

CONCLUSIONS OF LAW

I. Mullins' Attempted Conversion to Chapter 11 was Made in Bad Faith, and the Case Should be Reconverted to Chapter 7.

1. These matters pertain to the administration of the bankruptcy Estate and whether the Debtor is to receive a discharge. They are, therefore, "core proceedings," over which a bankruptcy court may enter final orders. *See* 28 U.S.C. §§ 157 and 1334.

2. Mullins seeks to justify his conversion to Chapter 11 under Code section 706(a). That section provides that "(a) The debtor may convert a case under [Chapter 7] to a case under chapter 11 ... at any time, if the case has not been converted under

section 1112, 1208, or 1307 of this title. Any waiver of the right to convert a case under this subsection is unenforceable." 11 U.S.C. § 706(a).

3. Certainly, section 706 affords a debtor a one time right to convert to Chapter 11. However, a conversion made in bad faith can do great harm to creditors. Recognizing this, and the fact that a single Code section must be read in harmony with other provisions of bankruptcy law, the Fourth Circuit Court of Appeals has recognized a corollary to a debtor's one time right of conversion.

A. The *Finney* Case

4. The law in this Circuit is that if the Debtor's conversion was made in subjective bad faith and under circumstances suggesting objective futility, a bankruptcy court may reconvert the case to Chapter 7, and on the briefest of notice. *See In re Finney*, 992 F.2d 43 (4th Cir. 1993).

5. *Finney* involved a Chapter 7 debtor who had failed to cooperate with his bankruptcy Trustee, making it necessary for the Bankruptcy Court to enter orders to ensure his compliance with the Trustee's requests. Additionally, Finney had made undisclosed fraudulent transfers of his property. *See id.*

6. When the Trustee recovered this property for the bankruptcy Estate, Finney tried to dismiss his case. The

Bankruptcy Court denied Finney's request and denied him a discharge due to these bad faith transfers of property. *See id.*

7. Finney then attempted to prevent the Trustee from selling his property by converting to Chapter 11 and becoming a debtor-in-possession. *See id.* Converting to Chapter 11 would have enabled Finney to displace his Trustee and regain control over the assets which he had fraudulently conveyed earlier in the case. Consequently, the Bankruptcy Court denied Finney's conversion motion, leaving him in Chapter 7. *See id.* Finney appealed the Bankruptcy Court's decision, and when the District Court upheld the Bankruptcy Court's ruling, Finney appealed to the Fourth Circuit. *See id.*

8. After carefully reviewing the District Court's decision, the Fourth Circuit adopted the lower court's reasoning, almost *in toto*. *See id.*

9. Judge Phillips' opinion holds that because section 706 provides an unwaivable right to convert, Finney could move to Chapter 11 notwithstanding his prior misconduct during the Chapter 7 case. *See id.* at 45.

10. However, this initial right of conversion did not mean Finney could remain in Chapter 11. Other Code sections are applicable, including 11 U.S.C. §§ 1112 and 105(a). *Finney* cites section 1112 which provides that "after notice and a hearing, the court may convert a [Chapter 11] case ... to a [Chapter 7] case ...

or may dismiss a [Chapter 11] case, whichever is in the best interest of creditors and the estate, for cause...." 11 U.S.C. § 1112(b). *See id.*

11. Additionally, section 105(a) may apply. That provision states that:

> [t]he court may issue any order, process or judgment that is necessary or appropriate to carry out the provisions of this title. No provision of this title providing for the raising of an issue by a party in interest shall be construed to preclude the court from, *sua sponte*, taking any action or making any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process.

11 U.S.C. § 105(a).

12. Applying these statutes to Finney's case, the Fourth Circuit found guidance in one of its earlier bankruptcy decisions, *Carolin Corp v. Miller*, 886 F.2d 693(4th Cir. 1989). *See Finney* at 45.

B. The *Carolin* test for bad faith

13. In *Carolin*, a newly formed corporate debtor filed a Chapter 11 petition in order to block the foreclosure sale of its sole asset. *See Carolin* at 695. The question posed to the Fourth Circuit in *Carolin* was whether the Debtor's bankruptcy case could be dismissed for a lack of good faith by the debtor. The Fourth Circuit determined that it could and should be dismissed. *See id.* at 694.

14. As an initial proposition, *Carolin* holds that bankruptcy petitions, indeed all pleadings filed in bankruptcy cases, must be filed in good faith. *See id.* at 698.

15. The Circuit then adopts the two-prong test of *In re Little Creek Development Co.*, 779 F2d. 1068 (5th Cir. 1986) and *In re Albany Partners, Ltd.*, 794 F.2d 670 (11th Cir. 1984) to demonstrate a debtor's lack of good faith. *See Carolin* at 700-01. This two-prong test requires a showing of: (1) subjective bad faith and (2) objective futility. *See id.*

16. Under the subjective bad faith prong, a Court looks to the debtor's real motivation for the filing. If he intended "'to abuse the reorganization process'" and "'to cause hardship or to delay creditors by resort to the Chapter 11 device merely for the purpose of invoking the automatic stay, without an intent or ability to reorganize his financial activities,'" the act was made in subjective bad faith. *Id.* at 702 (citations omitted).

17. The subjective bad faith standard insures that the debtor actually intends "'to use the provisions of Chapter 11 ... to reorganize or rehabilitate an existing enterprise, or to preserve going concern values of a viable or existing business.'" *Id.* (citations omitted).

18. Objective futility, on the other hand, looks to the real world prospects for reviving the debtor's business. It asks

"whether 'there is no going concern to preserve ... and no hope of rehabilitation, except according to the debtor's terminal euphoria.'" *Id.* at 701-02 (citation omitted). This element insures there is "'some relation to the statutory objective of resuscitating a financially troubled [debtor].'" *Id.* at 701.

19. As *Carolin* recognizes, there can be no bright line tests to make these assessments. While there are various indicia that suggest subjective bad faith or objective futility, there are no prerequisite elements and there are no "smoking guns." *See id.* Rather, a "totality of circumstances" inquiry is required. *See id.*

20. As Judge Phillips noted, the goal of the two-prong test is to determine whether the purposes of the Code would be furthered by allowing the Chapter 11 petitioner to go forward with his case. *See id.*

C. *Finney* applies the *Carolin* test to case conversions

21. *Carolin* only involved a motion to dismiss a corporate bankruptcy case. However, the *Finney* Court considered the *Carolin* test to be equally applicable to the reconversion matter before it. *Finney* holds that notwithstanding section 706, the Bankruptcy Court could reconvert Finney's case to Chapter 7 upon a showing of subjective bad faith and objective futility and upon the briefest of notice. *See id.* at 45.

22. Moreover, reconversion could be made upon the request of a creditor under section 1112 or instead by the bankruptcy judge acting *sua sponte* under Section 105. *See id.*

23. Applying these standards in Finney's situation, the Fourth Circuit found the debtor's recalcitrance and fraud during his Chapter 7 case, as well as his opportunistic conversion to Chapter 11 after the Bankruptcy Court denied his discharge, to be an "abuse of process sufficient to trigger § 105(a)." *Id.*

24. Moreover, the Fourth Circuit concluded that the Debtor's subjective bad faith had been established by the prior hearings in his Chapter 7 case and that no further hearing on this issue was necessary. The Bankruptcy Court could rely upon its earlier rulings. *See id.*

25. As to the objective futility prong, the Fourth Circuit found that Finney had not been afforded an opportunity to litigate this issue and remanded the matter so Finney could be heard regarding objective futility. *See id.*

26. However, the Fourth Circuit was realistic about the notice required for that hearing. The Court pointed out that section 102(1)(A) requires only "such notice ... and such opportunity for a hearing as is appropriate in the particular circumstances." 11 U.S.C. § 102(1)(A). Finney noted that the majority rule is that emergency hearings on reconversion motions require at least one days notice to the debtor. *See id.* at 46.

27. Mullins' case presents facts eerily similar to *Finney* and is controlled by that decision.

28. Like Finney, Mullins claims a right to convert his Chapter 7 case to Chapter 11. Under *Finney* and section 706, he certainly has that right.

29. However, as in *Finney*, it is also appropriate that this Court reconvert Mullins' case to Chapter 7. Mullins' actions demonstrate both subjective bad faith in making the conversion to Chapter 11 and objective futility as to his ability to reorganize.

D. Subjective bad faith

30. Although, Mullins argued that his conversion to Chapter 11 was motivated by the recovery of the Mullins-South stock which he could use to fund a plan and pay his creditors, the Court rejects this assertion.

31. The timing of the conversion to impede the Trustee's recovery of the Mullins-South stock; Mullins' persistent misconduct during this case; and his well-documented prepetition efforts to place his assets beyond the reach of his creditors make it clear that this conversion was intended to subvert creditors, not to benefit them.

32. This is a case of the most obvious abuse. Mullins has invoked the protections afforded by the Bankruptcy Code, but he has steadfastly refused to perform the duties it imposes upon him. Having disposed of all of his assets prior to bankruptcy to a

variety of insiders, Mullins has not only derided the Trustee's suggestions that these transfers were improper, but resisted every attempt by the Trustee to obtain the documents and information necessary to evaluate these transactions.[23] He has steadfastly refused to cooperate with his Trustee; he has knowingly failed to schedule (or to amend his Petition to add) substantial assets; he has refused to turn over financial records and to account for his property to the Trustee; and he has repeatedly failed to respond to discovery requests, appear at depositions, and otherwise to make discovery. In short, Mullins has continuously thumbed his nose at the Trustee and at this Court.[24]

33. As to his conversion to Chapter 11, the evidence shows Mullins attempted to falsify Mullins-South's corporate records to make it appear that this sizeable asset was transferred before

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[23] Mullins seems to believe that he has no obligation to demonstrate the fairness of these transfers, at least until the point of a trial. This is not correct. Obviously, the Trustee bears the burden of establishing a fraudulent conveyance/alter ego claim. However, in this case, the traditional badges of fraud are present and, if not rebutted, would satisfy the Trustee's burden of demonstrating fraudulent intent.

Additionally, these asset dispositions are insider transactions. As such, the Bankruptcy Code demands that they be closely scrutinized and places the burden of proving the fairness thereof on those insiders.

Finally, section 727 makes a debtor's failure to cooperate with his trustee or failure to be able to explain a lack of assets with which to pay his bills grounds for a denial of discharge. Thus, Mullins' intransigence supports this denial of discharge, without regard to whether the Trustee prevails on the alter ego/fraudulent conveyance claims.

[24] At the time this Order was being written, the Trustee had recently filed a new motion for sanctions after Mullins failed to appear at his deposition scheduled for August 22, 2002.

bankruptcy, when in fact it was not. Thereafter, Mullins attempted to mislead the Trustee and the Court as to the ownership of the Mullins-South stock.

34. When he failed to persuade this Court that the stock belonged to his Children's Trust, Mullins appealed--continuing the charade--even though he had no pecuniary interest in the stock. Meanwhile, Mullins' son Bobby was withholding the stock and corporate records from the Trustee, even though no stay pending appeal had been granted.

35. Finally, when these efforts failed, Mullins continued to play keep away with the stock by converting to Chapter 11. If permitted, this conversion would end any prospect of Mullins' creditors recovering any of his previously transferred assets, as Mullins would control those lawsuits.

36. Under *Finney*, conversion with the obvious purpose of keeping an asset from the Trustee in and of itself supports a finding of subjective bad faith. When added to these other facts, the evidence of subjective bad faith in Mullins' case is overwhelming. As in *Finney*, this is an abuse of process under section 105(a).

E. Objective futility

37. It is also obvious in this case that there is no real world prospect for a reorganization of Mullins' business.

38. First, there is no business. Having disposed of all of his assets, Mullins had no business at the time of his bankruptcy filing. He has no operations, no employees, and no customers. There is no going concern to protect. In fact, according to Mullins' Petition, he lacks even the most basic personal assets such as clothing, furniture, a house, or a car.

39. Even if he had a business, based on what Mullins and his attorneys have told this Court, he could not operate it. Mullins is in his mid-seventies and appears to be in poor health. He has indicated that he suffers from Hepatitis B and that this illness has the potential to turn into Parkinson's disease. Mullins has produced notes from his physician stating that he must live in a low altitude, stress-free, friendly environment and undergo regular therapy. In addition, Mullins has repeatedly used his poor health as an excuse to avoid attendance at depositions and other court ordered examinations. In fact, based upon his condition, Mullins claimed to be unavailable for a deposition examination for over one entire year. If Mullins is in fact this ill, he could not manage a reorganization. If he is not, he has misrepresented his physical condition to the Court and does not deserve the opportunity.

40. Another fact demonstrates objective futility in this case. Mullins finds new hope for his reorganization in the Mullins-South stock that was recently brought into his Estate. He believes that with this stock, and with the help of his family, he

can fund a plan. However, the Debtor has only the vaguest of ideas about how he could fund such a plan. He suggests he could sell some nonproductive assets or, possibly, borrow money from his son-in-law.

41. If these assertions seem plausible, it is only as abstract theory. However, the objective futility test is founded in reality, not theory. It looks to the real world prospects for reviving the Debtor's business. *See Carolin* at 698.

42. When one considers the assets of this Estate and what Mullins would have to do to administer them, it becomes obvious that there is no "real world" prospect of reorganization.

43. Due to Mullins' prepetition transfers, the Estate possesses only two types of assets: (1) the stock of related companies such as Mullins-South, and (2) the Trustee's pending lawsuits. As a debtor-in-possession, Mullins would have to administer these assets for his creditors' benefit.

44. However, Mullins has obvious conflicts of interest which would prevent him from doing so. Even a saint could not be expected to sue himself or his family members to recover fraudulent conveyances or to liquidate stock which his sons claim to own.

45. Mullins is certainly no saint. As noted above, Mullins has a well-documented record of avoiding his creditors, failing to disclose assets, refusing to make discovery, and attempting to prevent the entry of assets into the Estate.

46. Finally, Mullins suggestion that he implement a plan of reorganization by selling selected Mullins-South' assets is not practicable. Under 11 U.S.C. § 1129(a)(7), Mullins cannot confirm a plan that pays less than a Chapter 7 distribution absent the consent of his creditors. The Trustee proposes to sell all of Mullins-South's assets and seek recovery of Mullins' former assets. Since Mullins proposed to sell only some of the Mullins-South's assets, the Trustee's Character 7 liquidation would necessarily yield more for the Estate. Given the animosity between Mullins, FMC, and the Banks, he could not anticipate they would consent to a partial liquidation of assets. Thus, he cannot confirm a plan pursuant to 11 U.S.C. § 1129(a)(7).

47. Furthermore, Mullins' proposed plan would be unconfirmable under 11 U.S.C. § 1129(a)(3) which requires that a plan be proposed in good faith.

48. While objective reality insures that the statutory purpose of bankruptcy is met, Mullins' conversion attempt is nothing more than an effort to frustrate creditors, not to benefit them. Simply put, the fox cannot be given the job of guarding the hen house.

49. With a conversion undertaken in subjective bad faith and a reorganization being objectively futile, the case should be reconverted to Chapter 7.

II. Mullins' Discharge Should be Denied

A. The bankruptcy bargain

50. A debtor "has no constitutional or 'fundamental' right to a discharge in bankruptcy." *Grogan v. Garner*, 498 U.S. 279, 286, 111 S.Ct. 654, 659 (1991) (citation omitted). Rather, Congress intended that bankruptcy relief be reserved for those who are "honest, but unfortunate, debtors." *Grogan*, 498 U.S. at 287, 111 S.Ct. at 659.

51. To that end, Congress formulated a very simple bankruptcy bargain for those who seek refuge in this forum. As one court described it:

> À Chapter 7 case involves a *quid pro quo*: debtors receive a discharge and, in exchange, make full disclosure about their financial affairs, especially their assets, and surrender their nonexempt assets to the trustee for liquidation and distribution among creditors.

In re Jeffrey, 176 B.R. 4, 6 (Bankr.D.Mass 1994).

B. The statutory framework underlying the bankruptcy bargain

52. Congress has implemented its expectation of full disclosure and cooperation from debtors by placing upon them a number of statutory duties.

53. First, debtors are required to "file a list of creditors, ... a schedule of assets and liabilities, a schedule of current income and current expenditures, and a statement of the debtor's financial affairs." 11 U.S.C. § 521(1). Debtors make these disclosures in a detailed set of standardized forms: the

petition and schedules, which are filed under penalty of perjury. *See* FRBP 1008.

54. Second, debtors have an ongoing legal duty to amend their petitions to cure errors and omissions or to disclose subsequently acquired property. *See* FRBP 1009.

55. Third, debtors have a duty to cooperate with their Trustee, as necessary, to perform the Trustee's duties and to administer the Estate. This duty includes aiding the Trustee in the preparation of an inventory of estate assets, the examination of claims, and the administrations of the Estate. *See* 11 U.S.C. § 521(3); FRBP 4002.

56. Fourth, debtors are required to surrender to the Trustee all property of the Estate and any recorded information, including books, documents, records, and papers relating to property of the Estate. *See* 11 U.S.C. §§ 521(4) and 542(a). This surrender obligation lies without regard to whether debtors have been granted immunity from prosecution.

57. Fifth, debtors have a duty to inform the Trustee in writing as to the location of real property in which they have an interest and of persons holding money or property subject to their withdrawal or order. *See* FRBP 4002.

58. Finally, Debtors must appear and submit to examination under oath at a meeting of creditors and at such other times as ordered. *See* 11 U.S.C. § 343; FRBP 4002.

59. Strong sanctions are specified if a debtor fails to perform these statutory duties. Under section 727, a debtor is to be denied a discharge where he has: (1) "concealed ... recorded information, including books, documents, records, and papers, from which the debtor's financial condition or business transactions might be ascertained ..."; (2) knowingly and fraudulently withheld from the Trustee recorded information including books, documents, records and papers, relating to the debtor's property or financial affairs; or (3) refused to obey lawful Orders of the court. *See* 11 U.S.C. §§ 727(a)(3), 727(a)(4), and 727(a)(6).

59. Additionally, the ordinary rules of federal court litigation also pertain to debtors. As noted above, a variant of Rule 11, FRBP 9011, applies in a bankruptcy case and extends the "good faith/no improper purpose" requirement for litigation pleadings to all petitions, pleadings, motions, and other papers filed in a bankruptcy case.

60. Likewise, in contested matters and adversary proceedings, Fed. R. Civ. P. 37 applies. *See* FRBP 7037. Both Rule 37 and Rule 9011 mandate the imposition of sanctions against a violating party which range from the imposition of fees, costs, and fines to outright default in a proceeding. *See* FRCP 37.

61. Pursuant to *Carolin* and *Finney*, a bankruptcy court may deny a debtor's discharge upon request of a party under section 727

or may instead act *sua sponte* under section 105 in cases where a debtor has abused the bankruptcy system.

62. Finally, debtors are subject to criminal prosecution if they fail to meet their statutory obligations. *See* 18 U.S.C. § 152 *et seq.*

63. In short, the statutory scheme precludes debtors from using their bankruptcy case as a tool to delay or defraud creditors or to play a game of hide and go seek.

C. The case law supports denial of discharge for abusive filings

64. The intolerance of the federal courts for bad faith actions by a debtor is well documented. In addition to *Carolin* and *Finney, In re Kestell,* 99 F.3d 146(4th Cir. 1996), is a clear case in point.

65. In *Kestell,* the Chapter 7 debtor undertook three acts in connection with his bankruptcy case which cost him his discharge. First, he filed bankruptcy with the intention of discharging a domestic obligation owed to his ex-wife, while reaffirming his other debts. Second, he failed to schedule or to disclose, tax reimbursement money owed to him and which he collected postpetition. Third, and similarly, Kestell failed to disclose and turn over to the Trustee sick leave benefits to which he became entitled three months after bankruptcy. *See id.*

66. The Fourth Circuit held that these acts constituted a "substantial abuse" of Chapter 7 under section 707(b) as well as an "abuse of process," under section 105(a). *See id.* at 149. As such, the Fourth Circuit affirmed Kestell's denial of a discharge regardless of whether the money at issue ultimately turned out to be Estate property. *See id.* at 150.

67. In his opinion, Judge Wilkinson made a detailed review of the purposes and remedies of the Bankruptcy Code, beginning with the statement that "bankruptcy courts have traditionally drawn upon their powers of equity to prevent abuse of the bankruptcy process and to ensure that a 'case be commenced in 'good faith' to reflect the intended policies of the Code.'" *Id.* at 147 (citing 2 L. King, *Collier on Bankruptcy* § 301.05[1], at 301-5 to 301-7 (1996)).

Judge Wilkinson continued on:

> [s]uch a good faith requirement prevents abuse of the bankruptcy process by debtors whose overriding motive is to delay creditors without benefitting them in any way or to achieve reprehensible purposes. Moreover, a good faith standard protects the jurisdictional integrity of the bankruptcy courts by rendering their powerful equitable weapons (i.e., avoidance of liens, discharge of debts, marshaling and turnover of assets) available only to those debtors and creditors with 'clean hands.'

Id. (citing *In re Little Creek Development Co.*, 779 F.2d 1068, 1072 (5th Cir. 1986)).

68. The Fourth Circuit then reviewed the many Bankruptcy Code provisions which reflect congressional intolerance of debtors

who abuse the bankruptcy process, including sections 707(b) and 727. *See id.* at 147-48.

69. Among these provisions, and of particular relevance to Mullins' case, the *Kestell* Court then undertook an in depth analysis of section 105(a) which authorizes the bankruptcy court to, "*sua sponte*, tak[e] any action or mak[e] any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process." 11 U.S.C. § 105(a).

70. *Kestell* agreed with a leading treatise's characterization of section 105 as "'an omnibus provision phrased in such general terms as to be the basis for a broad exercise of power in the administration of a bankruptcy case. The basic purpose of section 105 is to assure the bankruptcy courts power to take whatever action is appropriate or necessary in aid of the exercise of its jurisdiction.'" *Kestell* at 148 (citing 2 L. King, *Collier on Bankruptcy* § 105.01, at 105-3 (1996)).

71. The Fourth Circuit then defined the contours of the section 105 power by describing what it is not. It is not, of course, unlimited, and cannot be invoked to "achieve ends contrary to other specific Code provisions." *Id.* at 148.

72. On the other hand, the section 105 power is not simply a duplicate of powers granted in other specific Code provisions. Rather, by its own terms, section 105 gives the court the additional power to "issue *any* order, process, or judgment

necessary ... to carry out the provisions of [Title 11], ... and to take any action, even at its own initiative, 'to prevent an abuse of process.'" *Id.* at 149.

73. What is an abuse of process in this context? *Kestell* cited two bankruptcy decisions which define the phrase: *In re Calder*, 93 B.R. 739, 740 (Bankr.D.Utah 1988), which defines abuse of process as "'maneuvers or schemes which would have the effect of undermining the integrity of the bankruptcy system'"; and *In re Burrell*, 148 B.R. 820, 824 (Bankr.E.D.Va. 1992), which defines abuse of process as the "'circumstance in which inaction by the court would undermine the integrity of the bankruptcy system.'" *Id.*

74. The *Kestell* Court then concluded that section 105 means what it says, recalling from prior Fourth Circuit decisions, that the Court has seen "'no reason to read into th[e] language [of section 105] anything other than its plain meaning that a court of bankruptcy has authority to issue any order necessary or appropriate to carry out the provisions of the bankruptcy code.'" *Id.* (citing *In re Walters*, 868 F.2d 665, 669 (4th Cir. 1989)).

75. *Kestell* noted that while section 105 gives the bankruptcy court contempt powers, it is not limited to that: "the plain meaning of Section 105 goes beyond contempt of court power. It also grants judges the authority to dismiss a bankruptcy

petition *sua sponte* for ineligibility, ... for lack of good faith, ..., or for one of the 'causes' enumerated in section 1112." *Id.* (citations omitted).

76. Then, in a statement of bankruptcy policy applicable to the current matter, the *Kestell* Court found that "the Bankruptcy Code, both in general structure and in specific provisions, authorizes bankruptcy courts to prevent the use of the bankruptcy process to achieve illicit objectives. The right of debtors to a fresh start depends upon the honest and forthright invocation of the Code's protections." *Id.*

77. Essential to an "honest and forth right invocation of the Code's protections" is the debtor's full and honest disclosure of his finances.

78. Turning to the facts presented by Kestell's case, the Fourth Circuit felt that both sections 707(b) and 105(a) applied.[25] *See id.* Kestell's behavior constituted both a "substantial abuse" under section 707(b) and an "abuse of process" under section 105(a). *See id.*

79. The Circuit Court's conclusion was premised upon Kestell's attempts to discharge his ex-wife's debt while making

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[25] Mullins' case does not fall under section 707(b) because it is not a consumer case. A debt incurred with a profit motive or in connection with a business transaction is not considered "consumer debt" for purposes of section 707. *Kestell* at 149, *see also* 11 U.S.C. § 101(8) (defining consumer debt as "debt incurred by an individual primarily for a personal, family, or household purpose"). However, Mullins' case is certainly a section 105 case so the *Kestell* analysis applies.

good on his other financial obligations, as well as his failure to list his sick leave benefit and tax reimbursement as assets and to bring them to the Trustee's attention when he received the money. *See id.* at 150.

80. The Bankruptcy Judge concluded on these facts that "'the sole purpose of [Kestell's] filing was to avoid the payment of the sums owing to his ex-wife on account of the state court judgment.'" *Id.* The Fourth Circuit found no reason to disagree--such a motivation was inappropriate. *See id.*

81. Kestell had argued that he did not know that the assets he failed to list and turn over were Estate property and, therefore, he should not be penalized. *See id.* The Fourth Circuit felt this was immaterial. A debtor's knowledge of this fact would be relevant to a section 727(a)(2) analysis but unnecessary to a decision under sections 105 and 707. *See id.* The only issue the Court needed to consider was "whether Kestell's handling of the two benefits, both of which were earned prior to the bankruptcy petition, evidenced a good faith invocation of the bankruptcy process." *Id.*

82. Finally, the Court noted that even if there were some question about whether the benefits were Estate property, Kestell was obliged to disclose the assets:

> [I]f Kestell was unsure at the time of filing whether the sick leave and tax benefits were part of the estate, he could have, at a minimum, disclosed to the trustee the

> fact that he had received these substantial funds so soon after the petition. This would have demonstrated his good faith efforts to comply with the bankruptcy process, and allowed a proper and open resolution of whether the funds should have been included as part of the estate.

Id.(citing *In re Krich*, 97 B.R. 919, 924 (Bankr.N.D.Ill.1988)).

83. In sum, the Fourth Circuit concluded that Kestell had abused the bankruptcy process, and, consequently, his discharge was properly denied.

D. Denial of discharge in Mullins' case

84. Although denial of discharge before trial is unusual, Mullins' extraordinary and unabated bad faith actions make it necessary in this case.

85. Three different provisions of law dictate this result: section 105, section 727, and FRCP 37. These provisions overlap and denial of Mullins' discharge is justified under any of them. However, at its core, this is a section 105 case.

1) Mullins' conduct in this bankruptcy case constitutes an abuse of process and an abuse of the bankruptcy system.

86. Even a conversion by right under section 706 can be an abuse of process if the debtor's motivation is improper. *See Jeffrey*, 176 B.R. 4 (Bankr.D.Mass. 1994) (holding that a Chapter 7 debtor commits an abuse of process when he fails to list his assets and, when they are discovered, makes a section 706 conversion so as to retain control of them).

87. Whether a debtor should be denied a discharge, has made fraudulent conveyances, or is an alter ego generally turn on questions of fact, and, therefore, are usually determined at trial.

88. However, this is one of those rare cases where getting to trial is, in fact, the problem. Mullins has demonstrated beyond reasonable argument that he has no interest in obtaining a fair trial on the merits. Rather, he has attempted in every possible

way to avoid such a trial, or if one must be had, to make it impossible for his opponent to prevail.

89. Effectively, Mullins' position is that if the Trustee is to try these actions, he will do so without the benefit of Mullins' financial information, documents, or discovery. In short, Mullins seeks to either play the game with a loaded deck or not to play at all.

90. Abuse of the sort displayed by the Debtor in this case cannot be tolerated--both because of the harm it causes other parties and the harm it inflicts upon the bankruptcy system. Under *Kestell*, Mullins should be denied a discharge for his abuse of process and abuse of the bankruptcy system under section 105.

91. Finally, there is no reason for the issue of Mullins' discharge to await a trial because the facts supporting that decision have already been established in this case.

2) Alternatively, grounds exist to deny Mullins' discharge under section 727.

92. There currently exists an action by the Trustee against the Debtor asserting a number of section 727 violations. *See* Adv. Proc. 98-5038.

93. As noted, many of the factual averments of the Trustee's Complaint have been established as facts beyond any reasonable dispute. For example, section 727(a)(4)(D) calls for denial of discharge to a debtor who has knowingly and fraudulently withheld

from an officer of the estate recorded information relating to his property. *See* 11 U.S.C. § 727(a)(4)(D). The Trustee has established Mullins' willful withholding of information regarding his property several times over.

94. Furthermore, pursuant to section 727(a)(5), the Court can deny a debtor's discharge where he fails to satisfactorily explain the loss of assets or deficiency of assets to meet his liabilities. *See* 11 U.S.C. § 727(a)(5). Not only has Mullins failed to explain the disappearance of his assets to the Trustee, he has fought to impede the Trustee's investigation into the same.

95. Based on the information the Trustee has learned since this hearing, it has also become obvious that Mullins has violated sections 727(a)(2)and 727(a)(4).

96. The letters between Mullins and Breimann and Mullins' postpetition correspondence with Dechow about his stockholdings speak for themselves. Based upon Breimann's warning, Mullins asked Dechow's firm to transfer and backdate, as necessary, his stock interest in Mullins-South in order to move it out of his name. Mullins made this request after he filed bankruptcy and after he failed to list these assets.

97. This correspondence also demonstrates that Mullins was aware at the filing date that he owned stocks which were not listed in his Petition. It is undisputed that several of these stocks

were scheduled only after the Trustee learned of them. Others remain unlisted, four years after this bankruptcy filing.

98. While Mullins may have some factual argument to make about whether these stocks should beneficially belong to someone else, the fact remains that he knew the stocks were in his name; he did not disclose them; and he attempted to conceal the interests after bankruptcy.

99. Mullins would excuse his failure to list these assets as an oversight and assert that his state of mind is a fact issue to be tried. It is not.

100. Mullins is correct in his assertion that in order to be denied a discharge under section 727, a debtor must have made an oath which he knew to be false, and the oath must have been made willfully and with the intent to defraud. *See Williamson v. Fireman's Fund Ins. Co.*, 828 F.2d 249, 251 (4th Cir. 1987).

101. However, "[a] reckless indifference to the truth is sufficient to constitute the requisite fraudulent intent" necessary to deny a discharge under section 727(a)(4). *See In re Ingle*, 70 B.R. 979, 983 (Bankr.E.D.N.C. 1987) (citing *In re Bobroff*, 58 B.R. 950, 953 (Bankr.E.D.Pa. 1986); *In re Shebel*, 54 B.R. 199, 204 (Bankr.D.Vt. 1985)).

102. Moreover, failure to schedule even a single asset constitutes grounds for loss of a discharge.[26] *See In re Cook*, 40 B.R. 903 (Bankr.N.D.Iowa 1984) (holding that the failure to disclose a sale of real estate for $5,000 is grounds to deny discharge). Mullins' failure to schedule so many of his assets reflects a reckless indifference to the truth, if not an outright intent to deceive.

3) Mullins' continued failure to make discovery in these adversary proceedings also supports his default in Adversary Proceeding 98-5038 as well as a denial of his discharge pursuant to Rule 37.

103. FRCP 37 gives a trial court the ability to impose sanctions for a party's failure to make discovery, including a default in all or part of the claims.

104. Where the sanction is a default, the trial court has less discretion than it would in imposing lesser sanctions, as a default eclipses a party's right to a trial by jury.[27] *See Mut. Fed. Sav. & Loan v. Richards & Assocs.*, 872 F.2d 88, 92 (4th Cir. 1989).

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[26] *See also In re Melnick*, 360 F.2d 918 (2d Cir. 1966) (debtor denied discharge for failing to reveal a real estate transfer which produced $273.72 for the Estate); *Mazer v. United States*, 298 F.2d 579 (7th Cir. 1962) (discharge denied for failure to disclose candy worth $150); *In re Zidoff*, 309 F.2d 417 (7th Cir. 1962) (discharge denied for failure to disclose furniture worth approximately $400).

[27] There is no right to trial by jury of a discharge objection, so this is a lesser concern than in jury cases. This Court, as trier of fact, has observed the Debtor's behavior, at least that which involves conduct during the course of this case.

105. However, as per *Richards*, a persistent failure to make discovery can result in judgment by default against the disobedient party, if a four-part test is met. *See id.* The four-part test is as follows: "(1) whether the noncomplying party acted in bad faith; (2) the amount of prejudice his noncompliance caused his adversary ...; (3) the need for deterrence of the particular sort of noncompliance; and (4) the effectiveness of less drastic sanctions." *Id.* This standard has clearly been met in this case.

106. The instant motions are based upon a bad faith conversion, not a failure to make discovery. However, Rule 37 is implicated here because this conversion follows a long line of abusive acts by the Debtor intended to interfere not only with this case, but with this litigation. Among these bad faith acts are multiple failures by the Debtor to disclose the particulars of his finances in his base bankruptcy case. Other examples of the Debtor's bad faith acts include his failure to make discovery in these adversary proceedings.

107. The prejudice to Mullins' opponent created by this stonewalling is also obvious. The Trustee and his professionals have been forced to incur large amounts of costs and fees trying to obtain information and documents from the Debtor.

108. Additionally, without this financial information, potentially millions of dollars of assets may be lost to creditors, as the Trustee can not successfully prosecute his recovery suits.

109. Finally, without full disclosure of his finances, Mullins' creditors may lose over $4.2 million in debts discharged by a Debtor who may not be entitled to a discharge at all.

110. It is important to note that the Court has tried less drastic sanctions, but they have failed. The Court has warned Mullins on a number of occasions against further misconduct; has ordered Mullins to pay opposing counsel's fees; and has found Mullins in contempt of court. None of these sanctions seems to make an impression--they have yielded only sporadic results, with the base problem remaining. Mullins still is not cooperating in discovery; he continues to fail to appear at depositions; and his finances still remain a mystery, except where the Trustee has independently located the information.

111. Fining Mullins any further is not a viable option. Mullins has yet to pay the Trustee the fees and costs already assessed against him.[28] That is not surprising. Few acts are more futile than fining a Chapter 7 debtor. This is particularly true where the debtor has intentionally disposed of his assets before bankruptcy.

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[28] Since the hearing on Mullins' conversion, Mullins was ordered to pay the Trustee's costs and fees for his failure to attend the March 2002 depositions. However, at the time the Court was drafting this order, not only was there a motion pending by the Trustee due to Mullins' failure to pay these fees, Mullins also had failed to appear at or seek to be excused from appearing at a deposition scheduled for August 19-23.

112. The Court has repeatedly warned Mullins that his future misconduct could result in a denial of discharge or default in these actions. These specific threats have also proved ineffective. After the Court issued these threats, Mullins undertook this bad faith conversion; failed to appear at several scheduled depositions; and continued to conceal his ownership of the Mullins-South stock.

113. Obviously, this type of behavior, if practiced regularly, would disable the bankruptcy system. The bankruptcy system works as well as it does only because debtors realize they must disclose their assets and cooperate with the trustee. If a debtor is permitted to stonewall and hide assets from his trustee and then stonewalls in discovery, the system fails. The bankruptcy court is made an unwilling accessory to a fraud perpetrated by a debtor on his creditors.

114. Allowing Mullins to continue in these practices would cause irreparable injury to the Trustee and to Mullins' creditors. The Trustee and his professionals are compensated only to the extent the Trustee is able to recover assets. In an insolvent estate, such as this one, a debtor's obfuscation greatly increases the work a trustee must perform and if there are no assets, the Trustee and his professionals go uncompensated for their work.

115. Even if there are assets in the Estate, usually they do not exceed creditors' claims. Thus, in an asset case, a debtor's

stonewalling is paid for by his creditors. Either way, the debtor's intransigence is a burden to other parties.

116. Finally, conduct such as this debtor's needlessly multiplies the workload of the Bankruptcy Court and wastes limited judicial resources.

117. At this point, there are only two civil sanctions the Court can impose on Mullins: (1) a denial of his discharge, effectively a default in Adversary Proceeding 98-5038; or, (2) his default in all of the adversary proceedings.

118. This Court will impose the former, lesser sanction, in hopes that the Debtor will modify his behavior, make discovery, and fulfill his statutory obligations, thereby allowing this action to reach a trial on the merits. However, if the Debtor does not modify his behavior, the Court will be forced to default him in all of the actions.

119. Based on the foregoing, the Court will reconvert this case to Chapter 7. To the extent possible given 11 U.S.C. § 706(a), that reconversion shall be made effective, *nunc pro tunc,* to the conversion date, April 11, 2002. Barrett Crawford shall continue to serve as Chapter 7 Trustee. The usual case procedures of conducting a new first meeting of creditors and setting deadlines for filing claims and objections to discharge or dischargeability would only add to the costs of this proceeding, without having any positive effect. The same are therefore waived.

Finally, the Movant's requests to appoint an interim Chapter 11 Trustee are mooted by the entry of this Order and are, therefore, denied.

SO ORDERED.

This the 18th day of September, 2002.

United States Bankruptcy Judge