UNITED STATES BANKRUPTCY COURT
DISTRICT OF SOUTH CAROLINA

IN RE:	C/A No. 22-03309-HB
Auto Money North LLC,	Chapter 11
Debtor(s).	**ORDER DENYING MOTION TO DISMISS**

THIS MATTER came before the Court for a hearing to consider the Motion to Dismiss this bankruptcy case pursuant to 11 U.S.C. § 1112 (the "Motion").[1] The Motion was filed by most of the named defendants in Adv. Pro. Nos. 22-80046-hb and 22-80047-hb (the "Movants"). Auto Money North, LLC ("Debtor")[2] filed an Objection to the Motion[3] in which AutoMoney, Inc. ("AMI"), MoneyLine Properties, LLC, Jolin Enterprises, Inc., and John and Linda Derbyshire (collectively, the "Derbyshires") joined.[4] The Subchapter V Trustee Christine Brimm filed a Response.[5]

Appearing at the hearing on the Motion were Thomas Waldrep, Jr., Jennifer Lyday, and Stanley H. McGuffin for the Debtor; Andrew Brown, James R. Faucher, and Josh Smith on behalf of Movants; Charles P. Summerall, IV, on behalf of AMI, Auto Money Title Pawn, LLC, Jolin Enterprises, Inc., MoneyLine Properties, LLC, and the Derbyshires; Christine Brimm, Subchapter V Trustee; and listening in by phone were Linda K. Barr for the United States Trustee and Frank B.B. Knowlton for Wells Fargo Bank, N.A. ("Wells Fargo").

Based on the evidence and testimony presented, the record in this case, the arguments

[1] ECF No. 581, filed Feb. 22, 2023. The Movants subsequently filed a Supplement to the Motion at ECF No. 994, filed Mar. 16, 2023.
[2] Although referred to as "Debtor" throughout, several of the factual events discussed herein occurred prior to the filing of the above-captioned bankruptcy.
[3] ECF No. 932, filed Mar. 15, 2023.
[4] ECF No. 950, filed Mar. 15, 2023.
[5] ECF No. 980, filed Mar. 15, 2023.

submitted, and for the reasons discussed below, the Motion is denied.

FINDINGS OF FACT

Debtor was organized in May of 2019 as a South Carolina limited liability company. John Derbyshire and Linda Derbyshire each hold 50% membership interests in Debtor and also own the stock of AMI. Other companies affiliated with Debtor and AMI include Auto Money Title Pawn, LLC, Jolin Enterprises, Inc., and MoneyLine Properties, LLC. Debtor is licensed and subject to regulatory oversight by the South Carolina Board of Financial Institutions, the South Carolina Division of Consumer Finance, , and the South Carolina Department of Consumer Affairs.

Debtor and AMI make or made loans commonly known as "title loans," which are short-term loan products secured by the title to the borrower's motor vehicle. Although located in South Carolina, both make or have made loans to North Carolina residents. To perfect the lender's interest in the title to a vehicle registered in North Carolina, a lien must be recorded on the title through the North Carolina Department of Motor Vehicles. Movants are North Carolina residents. North Carolina law allows a maximum Annual Percentage Rate (APR) of 30.0%. N.C.G.S. § 53-176(a). Debtor and AMI allegedly charged residents of North Carolina rates of interest on their car title loans that exceed this limit.

Beginning in August of 2019, lawsuits were filed in North Carolina by over 100 customers against AMI for violations of the North Carolina Consumer Finance Act. N.C.G.S. § 53-190 applies to "loans made elsewhere" and provides:

> No loan contract made outside this State in the amount or of the value of fifteen thousand dollars ($15,000) or less, for which greater consideration or charges than are authorized by G.S. 53-173 and G.S. 53-176 of this Article have been charged, contracted for, or received, shall be enforced in this State. Provided, the foregoing shall not apply to loan contracts in which all contractual activities, including solicitation, discussion, negotiation, offer, acceptance, signing of documents, and delivery and receipt of funds, occur entirely outside North Carolina.
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> If any lender or agent of a lender who makes loan contracts outside this State in the

> amount or of the value of fifteen thousand dollars ($15,000) or less, comes into this State to solicit or otherwise conduct activities in regard to such loan contracts, then such lender shall be subject to the requirements of this Article.

The remedy for a violation of the Act is set forth in N.C.G.S. § 53-166(d), which states loans that violate the Act "shall be void and the licensee or any other party in violation shall have no right to collect, receive or retain any principal or charges whatsoever with respect to such loan." The North Carolina legislature has declared at N.C.G.S. § 24-2.1(a) "[i]t is the paramount public policy of North Carolina to protect North Carolina resident borrowers through the application of North Carolina interest laws."

Shortly after Debtor was organized in May 2019, it entered into an Asset Purchase Agreement ("APA") with AMI. The November 18, 2019, APA between Debtor and AMI was signed by Linda Derbyshire on behalf of Debtor, and John Derbyshire on behalf of AMI. The documentation for the transaction includes the following relevant terms:

- Debtor would acquire all AMI's rights under store leases and related agreements for 18 stores in northern South Carolina, all associated loans and notes outstanding at those locations, all security agreements and instruments relating to such notes and loans, and other assets.

- Debtor would acquire such property for a purchase price of $6,744,000.00, with such price being seller-financed by AMI and subject to a security agreement in AMI's favor on substantially all the Debtor's personal property assets.

- Section 1(c) of the APA provides "that any liability associated with the assets being transferred to [Debtor] by [AMI] herein, shall be expressly assumed by [Debtor] in this transaction, which includes - but is not limited to - the contingent liabilities associated with making title loans to North Carolina customers".

- Section 8(b) of the APA provides Debtor "shall indemnify, defend at [Debtor's] expense (unless defense is being provided by an insurance carrier), and hold harmless [AMI] against, and in respect of, any and all claims, demands, losses, costs, expenses, obligations, liabilities, damages, recoveries, and deficiencies (including interest penalties and reasonable attorney's fees) that [AMI] shall incur or suffer, which arise, result from, or relate to any claim, demand, or liability (including any tax deficiency or assessment) and the reasonable cost of defense, asserted against [AMI] after the Closing which arises or accrues from acts,

omissions, or transactions occurring after the Closing."

- All notices and demands regarding the APA are to be directed to the attention of John Derbyshire on behalf of AMI and Linda Derbyshire on behalf of Debtor.

After the APA was executed, Debtor became entangled in the AMI litigation and was named or added as a defendant in many instances. Complaints include allegations of additional contacts of Debtor and AMI within North Carolina. Post-petition, the Debtor has continued its practice of making loans to North Carolina residents at rates of interest that exceed the cap in that state and recording liens on car titles in North Carolina.

Litigation history among various related parties includes an action filed by AMI in the United States District Court for the District of South Carolina in 2019. In an Order abstaining from hearing AMI's action under the Declaratory Judgment Act, 28 U.S.C. § 2201, and granting the defendant's motion to dismiss, Judge Richard Mark Gergel found:

> This matter arises out of a dispute over the applicability of the North Carolina Consumer Finance Act to loans made outside North Carolina in which lenders allegedly "solicit or otherwise conduct activities" within the State of North Carolina. N.C. GEN. STAT. § 53-190(b). This is a subject of considerable litigation within the North Carolina courts, including an action pending in the Superior Court of Guilford County in which the Defendant here, Deirdre Booker Pippins, is the Plaintiff and the Plaintiff here, Automoney, Inc [AMI], is the Defendant.
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> ….First, it is apparent that North Carolina has a strong interest in the enforcement of its consumer protection laws and in protecting the citizens from what under North Carolina law are usurious loan rates. Second, the pending [North Carolina] Superior Court litigation between the parties affords an ample forum in which the parties can efficiently and effectively litigate all of their claims. Third, the creation of a parallel action in the United States District Court in South Carolina would be a potential recipe for confusion and unnecessary entanglement with the North Carolina state courts. Fourth, the initiation of a new action in federal court in South Carolina raises the appearance of procedural fencing and forum shopping, since the North Carolina forum appears perfectly adequate for all parties to litigate their claims.

AutoMoney, Inc. v. Deirdre Booker Pippins, No. 2:19-2217-RMG (D.S.C. Dec. 30, 2019).

Debtor filed a similar action in the same court, *Auto Money North, LLC v. Fentress Brown*,

No. 0:21-cv-00393-JMC.[6] Brown had filed a complaint against Debtor and AMI in North Carolina state court arising out of Brown's title loan with AMI. In response, Debtor filed the above-referenced action in which it sought a judicial determination under the Declaratory Judgment Act, 28 U.S.C. § 2201, as to whether its title loan with Brown violated South Carolina consumer lending laws and whether application of North Carolina lending laws to the Debtor violated the Commerce Clause of the U.S. Constitution. Judge Michelle Childs considered issues of "federalism, efficiency, and comity" when deciding whether to exercise jurisdiction over the matter, and stated:

> In determining whether to exercise declaratory judgment jurisdiction, courts look to (1) the state's interest in having its own courts decide the issue; (2) the state courts' ability to resolve the issues more efficiently than the federal courts; (3) the potential for unnecessary entanglement between the state and federal courts based on overlapping issue of fact or law; and (4) whether the federal action is mere forum shopping. *Id.* [citing *Trustgard Ins. Co. v. Collins*, 942 F.3d 195, 201 (4th Cir. 2019)].

Judge Childs determined that the North Carolina state courts have "a strong interest in interpreting the scope and application of its own consumer protection laws" and decided to abstain, in part finding that "the initiation of this action raises, at the very least, the appearance of forum shopping." *Auto Money North, LLC v. Fentress Brown*, No. 0:21-cv-00393-JMC (D.S.C. Feb. 18, 2022).[7] Debtor's appeal of that decision is pending before the Fourth Circuit Court of Appeals.[8]

The pre-petition lawsuits in North Carolina for alleged violations of North Carolina consumer lending laws were asserted (1) against Debtor and AMI as co-defendants, and (2) against AMI only. Within the second set of civil actions are the claims of the "Remand Defendants"[9] whose cases AMI moved to dismiss for lack of personal jurisdiction, failure to state a claim based

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[6] Fentress Brown is named as a defendant in Adv. Pro. No. 22-80047-hb.
[7] *See also McDonald v. AutoMoney, Inc*., No. 1:21-cv-00114, ECF No. 25 (M.D.N.C. Nov. 30, 2021) (federal court remanded removed action back to state court).
[8] *Auto Money North, LLC v. Fentress Brown*, C/A No. 22-1296 (4th Cir. Mar. 18, 2022).
[9] The Debtor did not name these parties as defendants in the Debtor's second adversary proceeding discussed below, Adv. Pro. No. 22-80047-hb.

on a South Carolina choice-of-law provision in the underlying contract, and improper venue based upon a South Carolina forum selection clause in the underlying contract. The North Carolina trial courts denied AMI's motions to dismiss, and AMI appealed those rulings to the North Carolina Court of Appeals. On July 19, 2022, in unanimous opinions, the North Carolina Court of Appeals affirmed the trial court orders denying AMI's motions to dismiss. The Remand Defendants' cases are currently pending in the trial courts of North Carolina. After remand, AMI filed its answers and, among other defenses, asserted that, as applied to its transactions with the Remand Defendants, the North Carolina Consumer Finance Act, at N.C.G.S. § 53-190, violates the dormant Commerce Clause of the U.S. Constitution. AMI also filed a Petition for Discretionary Review with the Supreme Court of North Carolina.

On December 2, 2022 , Debtor filed this Chapter 11 bankruptcy. 406 individual plaintiffs had filed 36 actions in North Carolina state courts against Debtor and/or AMI as of that time.[10] Debtor contends the primary reason for the bankruptcy filing is to resolve the pre-petition litigation expeditiously and efficiently by asking this Court to determine whether the application of North Carolina's consumer protection laws to Debtor violates the U.S. Constitution. Three days after the bankruptcy was filed, Debtor filed complaints initiating Adv. Pro. Nos. 22-80046-hb and 22-80047-hb, asking this Court to determine that question and naming approximately 400 Defendants.[11] The same day, Debtor filed a Motion seeking entry of an order declaring that 11 U.S.C. § 362(a) prohibits the commencement or continuation of certain litigation in North Carolina against AMI while Debtor's Chapter 11 case remains pending, and/or entering a preliminary injunction under § 105(a) of the Bankruptcy Code to enjoin the commencement or continuation of any such actions against AMI ("Stay Motion").

[10] Twenty-one (21) state court actions named both Debtor and AMI as defendants, and fifteen (15) named only AMI.
[11] Adv. Pro. No. 22-80046-hb also named John and Jane Does.

The attorneys for Movants accepted service in the adversary proceedings, filed notices of appearance in this Chapter 11, and objected to the Stay Motion including in the objection details of prior litigation in the federal courts, referenced above, along with discussion of litigation history and decisions of the North Carolina Court of Appeals regarding issues related to the adversary proceedings initiated here.[12]

Debtor filed schedules and statements in the bankruptcy case, signed by Jeremy Blackburn, Debtor's manager and officer since its inception. Blackburn oversees Debtor's day-to-day operations and reports to the Derbyshires. Debtor has 47 employees. Debtor's initial schedules and statements indicated assets of $8,893,800.07, including bank accounts with Wells Fargo, accounts receivable, and leasehold improvements. Secured debts of $896,693.13 were scheduled along with nonpriority unsecured debts of $575,985.53. Of the total scheduled liabilities of $1,472,678.53: $893,010.33 was listed as owed to AMI as a secured debt (not contingent, unliquidated, disputed nor otherwise indicated as challenged in any way); and $3,682.80 owed to Wells Fargo Vendor Fin. Services, LLC.

No priority debts were scheduled. Movants and any similarly situated parties listed therein were scheduled as contingent, unliquidated, and disputed with an "unknown" balance. The unsecured debts listed also included: a handful of smaller debts of hundreds of dollars each; one debt to Henry Allen Cauthen, III (no explanation) for $8,250.00; $2,480.00 to NAI Earle Furman, LLC; $2,343.32 to SCF RC Funding I, LLC; $3,112.00 to Springland, Inc.; $3,012.00 to Tammy S. Reason dba Associates Asset Recovery; along with debts to related companies ($24,000.00 to Jolin Enterprises, Inc. and $65,677.50 to MoneyLine Properties, LLC). The bulk of the unsecured debt amount ($450,200.00 to the U.S. Small Business Administration for an April 9, 2020, Payroll

[12] Debtor's Statement of Financial Affairs filed December 8, 2022, listed the caption of the pending 4th Circuit appeal as "*Auto Money North, LLC v. Fentress Brown*, 22-1296."

Protection Loan) is listed as disputed.[13] Schedule H listed numerous affiliated co-debtors: AMI, Jolin Enterprises, Inc., and MoneyLine Properties, LLC.

Debtor was able to reduce the $6,744,000.00 balance on the 2019 twenty-year APA note owed to AMI to $893,010.33 in the three years before filing. Debtor's First Day Motions stated the debt to AMI is secured by a 2019 Security Agreement, which grants a blanket lien on substantially all Debtor's assets, including its accounts receivable, chattel paper, instruments, deposit accounts, and other payment rights. A UCC Financing Statement was recorded almost three years after the Security Agreement and two months before the bankruptcy in the office of the South Carolina Secretary of State.

Although other creditors are listed in Debtor's schedules, the evidence received at the hearing on the Stay Motion painted a picture of essentially a two-sided dispute between Debtor and Movants herein, with other claims disputed, of minimal amounts, or owed to affiliated companies.

While the Stay Motion was under advisement, Debtor filed amended schedules that significantly change the debt amount and structure in this case. The amendments changed Debtor's total scheduled debt amount from $1,472,678.53 to $6,122,673.69[13] primarily due to the addition of debts to Wells Fargo of approximately $4.6 million because of Debtor's guarantee of the debts of affiliates. The filing stated that the filer "recently discovered that Debtor had signed a Commercial Guaranty…" Related parties John Derbyshire, Linda Derbyshire, and MoneyLine Properties, LLC were added as co-debtors. Property of this estate of approximately $405,000.00 in cash in Debtor's bank account at Wells Fargo was disclosed as security. The amendments also

[13] Debtor is challenging this debt in the U.S. District Court, *Auto Money North, LLC v. Small Business Assoc.*, 22-CV-01455.

added AMI and Auto Money Title Pawn, LLC as co-debtors on a contract with Decision Dynamics, LLC, and changed the list of 20 largest unsecured creditors by adding four new creditors (including Wells Fargo). The Wells Fargo loans were signed by one or both Derbyshires, were made to an affiliate, and guaranteed by Debtor in 2021—two years after the APA was executed.

The Court denied the requests in the Stay Motion, finding:

> all pre-petition claims that are for actions prosecuted against Debtor, as a named defendant, are stayed by the plain language of § 362(a)(1) without the need for an order from this Court; Debtor's request for of an order declaring that § 362(a) prohibits the commencement or continuation of the North Carolina Litigation by the parties listed on Appendix A to the Complaint in this Action, and John and Jane Does 1-1000 against non-debtor affiliate, AMI while Debtor's Chapter 11 case remains pending; and/or entering a preliminary injunction under §105(a) of the Bankruptcy Code to enjoin the commencement or continuation of such actions against AMI is denied.

Debtor requested reconsideration, which was denied, and Debtor filed Notices of Appeal.[14] Movants filed Answers in both adversary proceedings.[15]

The claims bar date in this case has passed and Movants have filed proofs of claim. Debtor has objected to the claims. The claims allowance process is interwoven with the resolution of Adv. Pro. No. 22-80047-hb.[16]

Debtor filed a proposed plan dated March 2, 2023. Debtor summarizes its status and plan, in part, as follows:

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[14] Adv. Pro. No. 22-80046-hb, ECF Nos. 33, 40, 48, 49.

[15] Adv. Pro. No. 22-80046-hb, ECF No. 35; Adv. Pro. No. 22-80047-hb, ECF Nos. 16, 21. Movants also filed a motion pursuant to Federal Rule of Civil Procedure 12(b)(6) for an order dismissing all claims in Adv. Pro. No. 22-80047-hb or, in the alternative, for an order of abstention pursuant to 28 U.S.C. § 1334(b)(1) or, in the further alternative, for an order staying the proceeding pursuant to 11 U.S.C. § 305(a). A separate order will be entered regarding those matters.

[16] *See, e.g.*, Objection to Claim at ECF No. 129, "The Debtor disputes any and all liability related to the allegations set forth in the NC Lawsuit or the Claim based on the arguments set forth in the Adversary Proceeding"; Response at ECF No. 697, "The Debtor has incorporated by reference in its Objection [to claim] allegations in Adversary Proceeding No. 22-80047…Claimant does likewise and incorporates herein by reference the arguments and authorities Claimant sets out in Defendant's Brief in Support of Motion to Dismiss Adversary Proceeding No. 22-80047."

> The primary reason for the Debtor's bankruptcy filing is to resolve the North Carolina Litigation expeditiously and efficiently by asking the Court to determine the fundamental question of whether the application of North Carolina's consumer protection laws to the Debtor violates the United States Constitution. The Debtor has filed an adversary proceeding complaint (Auto Money North LLC v. Abernathy, et al., AP No. 22-80047-hb (the "Constitutional Case")) to bring this important constitutional issue before the Court….
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> If the Debtor prevails in the Constitutional Case and the Claim Objections, the claims asserted by the North Carolina Claimants [essentially the Movants] will be disallowed, and the Debtor will have no liability on those claims. However, the magnitude of the claims filed by the North Carolina Claimants evidences the Debtor's concerns for its ability to continue operating if the North Carolina Claimants prevail in the Constitutional Case and the Claim Objections. In fact, as set forth in this Plan, if the Debtor does not succeed in the Constitutional Case and the Claim Objections, the Debtor will undertake an orderly liquidation of its assets to pay its creditors on a pro rata basis pursuant to the Bankruptcy Code's priority rules. If the Debtor succeeds in the Constitutional Case and the Claim Objections, then the Debtor will pay all of its creditors in full, with interest.
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> … the defendants in the Constitutional Case filed an Answer containing Motions to Abstain and Dismiss in that action… This Plan proceeds along two parallel paths. The first path sets forth what will transpire in the event that the Debtor is largely successful in the Constitutional Case and the Claim Objections, meaning that the application of North Carolina's consumer protection laws to the Debtor is held to violate the United States Constitution after all appeals have been exhausted. The second path sets forth what will transpire in the event that the opposite is found after all appeals have been exhausted. However, this Plan's viability does not depend on the Court denying the defendants' Motion to Abstain and Dismiss the Constitutional Case. Even if the Court chooses to abstain from the Constitutional Case, the legal issue at its center will still have to be decided, and it is that decision that will determine which path the Debtor will follow.

ECF No. 692, pp. 5-7.

There is no evidence that Debtor lacks sufficient resources and motivation to litigate the disputes with Movants in any court, whether offensive or defensive. Debtor's counsel previously stated "…we are simply saying it's expensive [litigating in numerous proceedings in North Carolina] and it's far more efficient to do it in one case, in one Court, and the only way we can do that and the only jurisdiction we could file in was this one [the South Carolina Bankruptcy

Court]."[17] "As this Court knows, you don't have to be in financial distress to file a bankruptcy, but it will be in financial distress if there is an adverse ruling with regard to that commerce clause."[18]

At the hearing on this Motion, Movants called the Court's attention to the transcript of the hearing on the Stay Motion,[19] Debtor's schedules and statements, the proofs of claim and responses, as well as the events and proceedings in this case and the adversary proceedings. Blackburn testified, and Debtor submitted the following which were admitted into evidence: letters from the South Carolina Board of Financial Institutions Consumer Affairs Division regarding 8 of the 9 biannual compliance examinations in 2022 and 2023, none of which reported any deficiencies; lending licenses for 8 locations; an amended Summary of Assets and Liabilities filed January 4, 2023 (ECF No. 96), which reflects assets of $8,893,800.07 and liabilities of $6,122,673.69 ($5,540,959.83 are secured and $581,713.86 are non-priority unsecured); the proposed plan filed March 2, 2023 (ECF No. 692); Monthly Operating Report for December 2022 (ECF No. 107), showing $105,225.56 in net cash flow; Monthly Operating Report for January 2023 (ECF No. 460), showing $962,921.06 in net cash flow; and Monthly Operating Report for February 2023 (ECF No. 1065), showing $1,062,230.17 in net cash flow.

Movants assert grounds for dismissal exist because Debtor has previously violated and is presently violating North Carolina consumer lending laws by making loans to North Carolina residents at illegal rates of interest; placing liens on North Carolina motor vehicle titles through the North Carolina Department of Motor Vehicles; receiving payments from within North Carolina by debit card and MoneyGram; engaging in collection activities in North Carolina; repossessing

[17] Adv. Pro. No. 22-80046-hb, Order at ECF No. 33; Transcript of hearing held December 28, 2022, at ECF No. 28, p. 61, lns. 10-13.
[18] *Id.*, at p. 131, lns. 22-25.
[19] Adv. Pro. No. 22-80046-hb, ECF No. 28.

motor vehicles in North Carolina; making solicitation telephone calls into North Carolina; and paying referral fees to North Carolinians in an effort to obtain North Carolina borrowers. Movants assert this constitutes "gross mismanagement of the estate", "the absence of a reasonable likelihood of rehabilitation", and bad faith for purposes of 11 U.S.C. § 1112(b), requiring dismissal of the case.

DISCUSSION AND CONCLUSIONS OF LAW

This Court has jurisdiction over this matter pursuant to 28 U.S.C. §§ 1334 and 157. This matter is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(A), and this Court may enter a final order.

11 U.S.C. § 1112(b)(1) provides:

> Except as provided in paragraph (2) and subsection (c), on request of a party in interest, and after notice and a hearing, the court shall convert a case under this chapter to a case under chapter 7 or dismiss a case under this chapter, whichever is in the best interests of creditors and the estate, for cause unless the court determines that the appointment under section 1104(a) of a trustee or an examiner is in the best interests of creditors and the estate.

For purposes of § 1112(b), the term "cause" includes "substantial or continuing loss to or diminution of the estate and the absence of a reasonable likelihood of rehabilitation" and "gross mismanagement of the estate." 11 U.S.C. § 1112(b)(4)(A)-(B).

Movants' arguments that the case should be dismissed for statutory cause on these grounds are predicated on a finding that the Debtor has violated and continues to violate North Carolina's consumer protection laws. There is nothing in the record at this point to suggest that North Carolina courts have found such a violation and the evidence before this Court at this time for this Motion is not sufficient for the Court to make such a finding, as the Debtor has asserted a defense in the pending adversary proceedings that the application of those laws to it would violate the U.S. Constitution.

However, though not explicitly listed in the statute, bad faith in filing the petition may constitute "cause" for purposes of § 1112(b). *Carolin Corp. v. Miller*, 886 F.2d 693, 699 (4th Cir. 1989).

"The right to file a Chapter 11 bankruptcy petition is conditioned upon the debtor's good faith—the absence of which is cause for summary dismissal." *In re Premier Automotive Servs., Inc.*, 492 F.3d 274, 279 (4th Cir. 2007) (citing *Carolin*, 886 F.2d at 698). "[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." *Id.* (internal quotations omitted) (quoting *Carolin*, 886 F.2d at 698). "The good faith standard also '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.* (quoting *Carolin*, 886 F.2d at 698).

In the Fourth Circuit, "a lack of good faith in filing a Chapter 11 petition traditionally requires a showing of 'objective futility' and 'subjective bad faith.'" *Id.* at 279-80 (citing *Carolin*, 886 F.2d at 700-01). "The objective test focuses on whether there exists the realistic possibility of an effective reorganization." *Id.* at 280 (internal quotation marks and citations omitted). Put another way, the objective test "concentrate[s] on assessing whether 'there is no going concern to preserve…and…no hope of rehabilitation, except according to the debtor's terminal euphoria.'" *Carolin*, 886 F.2d at 701-02 (internal quotation marks omitted) (quoting *Little Creek Dev. Co. v. Commonwealth Mortg. Corp. (In the Matter of Little Creek Dev. Co.)*, 779 F.2d 1068, 1073 (5th Cir. 1986)). "The objective futility requirement is designed to further the statutory objective of reviving the debtor[.]" *Minority Equity S'holders of Yachting Connections, Inc. v. Resol. Tr. Corp. (In re Yachting Connections, Inc.)*, No. 92-1493, 1992 WL 372947, at *1 (4th Cir. Dec. 18, 1992)

(citation omitted). On the other hand, "[t]he subjective test asks whether a Chapter 11 petition is motivated by an honest intent to effectuate reorganization or is instead motivated by some improper purpose." *Premier*, 492 F.3d at 280 (citation omitted). "Subjective bad faith is shown where a petition is filed to abuse the reorganization process, or to cause hardship or to delay creditors by resort to the Chapter 11 device merely for the purpose of invoking the automatic stay." *Id.* (internal quotation marks and citations omitted).

There is some dissonance in Fourth Circuit case law as to whether both objective futility and subjective bad faith must be demonstrated by the party seeking dismissal. Most cases seem to indicate that both prongs must be met. *See Carolin*, 886 F.2d at 700-01 (explicitly considering whether either or both prongs must be met, and deciding on the latter); *In re Coleman*, 426 F.3d 719, 727-28 (4th Cir. 2005); *In re Aronowitz Del. 2 Fam. Ltd. P'ship*, Case No. 21-50464, 2021 WL 4823520, at *4 (Bankr. M.D.N.C. Oct. 15, 2021) (citations omitted); *In re Paolini*, 312 B.R. 295, 311 (Bankr. E.D. Va. 2004); *In re Dunes Hotel Assocs.*, 188 B.R. 162, 168 (Bankr. D.S.C. 1995). "[I]t is better to risk proceeding with a wrongly motivated invocation of Chapter 11 protections whose futility is not immediately manifest than to risk cutting off even a remote chance that a reorganization effort so motivated might nevertheless yield a successful rehabilitation." *Carolin*, 886 F.2d at 701. However, "though separate inquiries into each are required, proof inevitably will overlap. Evidence of subjective bad faith in filing may tend to prove objective futility, and vice versa." *Id.* Additionally, other cases indicate that, at least in certain circumstances, a Chapter 11 case may be dismissed for bad faith upon a showing of only one prong. *See Premier*, 492 F.3d at 280 (stating that the fact that the Debtor was solvent and had no unsecured creditors and few, if any, secured creditors revealed subjective bad faith and would, on its own, justify dismissal because, as the Court of Appeals for the Third Circuit noted in *In re SGL*

Carbon Corp., 200 F.3d 154, 166 (3d Cir. 1999), "courts 'have consistently dismissed Chapter 11 petitions filed by financially healthy companies with no need to reorganize under the protection of Chapter 11.'"); *In re Carter*, 500 B.R. 739, 746 (Bankr. D. Md. 2013) (citation omitted) ("The court concludes that, if faced with a bad faith serial filing case—especially one with gross malfeasance by the debtor in the preceding case—the Fourth Circuit would determine that a bankruptcy court has discretion to dismiss the case upon a showing of subjective bad faith without the need to determine objective futility."); *In re Dunes Hotel Assocs*., C/A No. 94–75715, 1997 WL 33344253, at *8 (Bankr. D.S.C. Sept. 26, 1997) (citations omitted) ("While threshold dismissal requires both subjective bad faith in filing and objective futility, once the case has moved past that threshold stage, dismissal may be based solely on a failure to meet the objective criteria set out in Section 1112…Likewise, a debtor's subjective bad faith in the conduct of its case is a sufficient basis for dismissal by itself, and does not require a concurrent showing of one of the objective criteria under Section 1112(b)."), *aff'd sub nom. Dunes Hotel Assocs. v. Hyatt Corp.*, 245 B.R. 492 (D.S.C. 2000).

No single factor is determinative of the good faith inquiry, and the Court must examine the totality of the circumstances. *Carolin*, 886 F.2d at 701. "The overall aim of the twin-pronged inquiry must of course be to determine whether the purposes of the Code would be furthered by permitting the Chapter 11 petitioner to proceed past filing." *Id.* "The *Carolin* court made clear that the burden of establishing this two-prong requirement is very high." *Dunes Hotel Assocs.*, 188 B.R. at 168. "The power to dismiss a bankruptcy petition at the outset of a case 'is obviously one to be exercised with great care and caution. Decisions denying access at the very portals of bankruptcy, before an ongoing proceeding has even begun to develop the total shape of the debtor's

situation, are inherently drastic and not lightly to be made.'" *In re Bestwall LLC*, 605 B.R. 43, 48 (Bankr. W.D.N.C. 2019) (quoting *Carolin*, 886 F.2d at 700).

Although the totality of unique circumstances of each case must be examined in making the good faith inquiry, there is a typical pattern to Chapter 11 petitions that have been found to be filed in bad faith: (1) the debtor owns only one asset, such as a tract of real property; (2) the asset is encumbered by secured creditors' liens; (3) the debtor has few, if any, unsecured creditors; and (4) the debtor has few employees, little cash flow, and no available sources of income with which to reorganize. *RCO Inv. Co. v. Belair 301-50 S.W. Quadrant Com. Props., Inc. (In re Belair 301-50 S.W. Quadrant Com. Props., Inc.*), No. 92-1233, 1992 WL 200849, at *3 (4th Cir. Aug. 17, 1992) (citing *Little Creek Dev. Co.*, 779 F.2d at 1073). In these circumstances, "[r]esort to the protection of the bankruptcy laws is not proper…because there is no going concern to preserve, there are no employees to protect, and there is no hope of rehabilitation." *Id.* (quoting *Little Creek Dev. Co.*, 779 F.2d at 1073). This is the fact pattern in which *Carolin*'s two-prong test was created. *See Carolin*, 886 F.2d at 704.

In *Carolin*, the debtor was a real estate holding company that owned a parcel of land with an industrial building thereon. *Id.* at 695. The debtor had only one secured creditor with a lien on the property through a purchase money promissory note and purchase money deed of trust. *Id.* The debtor defaulted on the note and, fifty minutes before a scheduled foreclosure sale, filed a Chapter 11 petition. *Id.* The evidence suggested that the debtor did not have a current or prospective source of income through renting the property (which had been damaged by fire and had no prospect of being repaired); the debtor's owners were unwilling to provide the debtor with funds to operate; and the debtor, which had one employee who was not involved in the business, no other significant assets than the property, and no unsecured creditors with substantial claims (to

suggest ongoing business relationships), was more akin to a shell corporation than a viable business. *Id.* at 702-03. Accordingly, the Court held that the debtor's bankruptcy was objectively futile. *Id.* at 703. Further, the Court held that the debtor filed the petition in a subjective bad faith attempt to make a riskless investment rather than rehabilitate the debtor through ongoing investment, as indicated by the debtor's owners' acquisition of the debtor and the debtor's filing for bankruptcy just before the foreclosure sale; the debtor's failure to provide adequate protection to its only secured creditor; and the debtor's failure to repair its property and find a new tenant. *Id.* at 703-05. *See also In re Yachting Connections, Inc.*, No. 92-1493, 1992 WL 372947 (holding that dismissal for bad faith filing pursuant to § 1112(b) was proper where a receiver was in possession and control of the debtor's property, the debtor filed a Chapter 11 petition one hour prior to a scheduled foreclosure sale, and at no point during the case did the debtor attempt to remove the receiver, regain possession of its property, or reorganize).

However, in the years after *Carolin*, a new fact pattern has emerged in which an attempt to reorganize is futile, and the Chapter 11 petition filed in bad faith, not because the debtor has no assets to effectuate a reorganization, but because the debtor *is not* financially distressed and thus is not in need of reorganization. In these cases, the debtor's bad faith is found in its seeking the protections of Chapter 11 without being the kind of financially vulnerable entity those protections were intended by Congress to shield. For example, in *Premier*, the Court found objective futility where the Debtor never filed a proposed plan of reorganization, relied on its adversary litigation against its former lessor to reobtain possession of the leased premises as its plan, and, even if it obtained the relief it sought in the litigation, could not possibly have achieved a reorganization. *Premier*, 492 F.3d at 280. Further, the Court found subjective bad faith because the Debtor, at the time the petition was filed, was not experiencing financial difficulties, was solvent, had no

unsecured creditors and few, if any, secured creditors. *Id.* Additionally, the Debtor's failure to avail itself of state law remedies for its state law claim against the lessor before filing bankruptcy and filing of its petition the day before it was obligated to vacate the premises constituted a bad faith attempt to avoid eviction and coerce the lessor into executing a new lease on more favorable terms. *Id.* at 280-81.

A more recent example is embodied in the decision by the Court of Appeals for the Third Circuit in *In re LTL Management, LLC*, 58 F.4th 738 (3d Cir. 2023), which is similar to many of the circumstances presented here. The Third Circuit held that LTL did not file its Chapter 11 petition in good faith because it was not in financial distress. That Court found Chapter 11 petitions may be dismissed under § 1112(b) if filed in bad faith, which is determined more by an "objective analysis of whether the debtor has sought to step outside the equitable limitations of Chapter 11" rather than on a debtor's subjective intent, though that is relevant as well. *Id.* at 753 (internal quotation marks and citations omitted). In conducting this analysis, two factors are particularly relevant: (1) whether the petition serves a valid bankruptcy purpose, which assumes a debtor in financial distress; and (2) whether it is filed merely to obtain a tactical litigation advantage. *Id.* at 754 (internal quotation marks and citations omitted).

The requirement that a debtor must be in financial distress does not mean that it must necessarily be insolvent; rather, "the good-faith gateway asks whether the debtor faces the kinds of problems that justify Chapter 11 relief." *Id.* at 755. For example, "uncertain and unliquidated future liabilities could pose an obstacle to a debtor efficiently obtaining financing and investment" and "[a] financially troubled debtor facing mass tort liability…may require bankruptcy to enable a continuation of [its] business and to maintain access to the capital markets even before it is insolvent." *Id.* (internal quotation marks and citation omitted). "Congress designed Chapter 11

to give those businesses teetering on the verge of a fatal financial plummet an opportunity to reorganize on solid ground and try again, not to give profitable enterprises an opportunity to evade contractual or other liability." *Id.* (quoting *Cedar Shore Resort, Inc. v. Mueller (In re Cedar Shore Resort, Inc.)*, 235 F.3d 375, 381 (8th Cir. 2000)). The Court determined that the debtor in the *LTL* case was not in financial distress and therefore could not show its petition served a valid bankruptcy purpose and was filed in good faith under § 1112(b). *Id.* at 763.

With respect to the Movants' assertion that the case should be dismissed as a bad faith filing, the Fourth Circuit in *Carolin* expressly considered whether to require a showing of objective futility and subjective bad faith and concluded "it is better to risk proceeding with a wrongly motivated invocation of Chapter 11 protections whose futility is not immediately manifest than to risk cutting off even a remote chance that a reorganization effort so motivated might nevertheless yield a successful rehabilitation." *Carolin*, 886 F.2d at 700-01. This logic has been applied consistently by courts in the Fourth Circuit in the 34 intervening years, with most requiring both objective futility and subjective bad faith. The circumstances before the Court at this point in the case are not sufficiently similar to cases in which courts in this circuit have deviated and concluded that only one prong must be met. Debtor is not a repeat filer, the case has only been pending approximately four months, and the case has not yet progressed beyond the threshold stage. Further, while *Premier* suggested that the subjective bad faith prong alone may justify dismissal, that statement is dicta because the Court found the presence of both prongs in that case. *See* 492 F.3d 274.

As stated above, at this point, the Court has no reason to find objective futility as a result of Debtor's business model, and Movants have not demonstrated any other cause for the Court to find that this reorganization is objectively futile. Debtor has an ongoing business, employees,

significant equity, and ample cash flow, and has proposed a plan with two paths to deal with any challenges it faces. At this stage in the case, Movants have failed to show objective futility under applicable legal standards.

On the issue of the Debtor's subjective bad faith, as a solvent company with almost 50 employees, numerous assets with significant equity, no cash flow issues, and reliable sources of income, Debtor does not resemble a typical bad faith debtor as in a *Carolin*-type case. However, Debtor does resemble the debtors in *Premier* and *LTL* that were so financially healthy that there was essentially nothing to reorganize and filed for bankruptcy merely as a litigation tactic. While the Debtor does have debt,[20] the vast majority is either owed to AMI or is the result of guaranteeing the debt of the Debtor's affiliates. At filing, it appeared that Debtor could have easily repaid all liquidated, non-contingent, non-disputed debt. The fact that the Derbyshires own both Debtor and AMI and that Debtor was able to decrease its debt on the twenty-year APA note to AMI by over 86% in just three years evidences a Debtor that did not need bankruptcy relief at the time of filing, and a filing motivated by something other than financial need.

The Third Circuit in *LTL* commented, "uncertain and unliquidated future liabilities could pose an obstacle to a debtor efficiently obtaining financing and investment." *LTL Management, LLC*, 58 F.4th at 755. This Debtor may face uncertain and unliquidated future liabilities through litigation, but there is no indication from the facts that Debtor seeks or needs any financing from third parties in this case that would be impacted at the time by the pending litigation or aided by the bankruptcy filing. The lack of current financial distress for Debtor, the evidence regarding the

[20] Note that at the time of filing, total debt listed in Debtor's schedules was $1,472,678.53. After the hearing on the Stay Motion, Debtor amended the schedules to add a debt to Wells Fargo of $4,644,266.70, bringing the total to $6,122,673.69 (total debt, before the addition of any liability that could result from the litigation). The amendment that added the Wells Fargo debt states the filer "recently discovered that Debtor had signed a Commercial Guaranty…". Therefore, Debtor cannot credibly argue that this liability motivated the bankruptcy filing decision.

progression of the pre-petition litigation in the state courts, the unsuccessful pre-bankruptcy attempts by Debtor and AMI to bring the litigation into federal courts for decision, the fact that the disputes are now before this Court only as a result of the bankruptcy filing and the associated adversary proceeding, coupled with Debtor's statements that the only way to bring this controversy before a federal court was to file a bankruptcy proceeding, provide hefty evidence of forum shopping and use of a bankruptcy filing as a litigation tactic. All indicators point to a finding that this case was filed as the result of Debtor's subjective bad faith.

A careful review of the *LTL* case provided persuasive authority, but this Court must apply Fourth Circuit precedent. Movants have failed to convince the Court that the facts here present a case of objective futility under applicable law, or that both prongs of the *Carolin* test should not be applied to these facts.

IT IS, THEREFORE, ORDERED THAT the Motion to Dismiss pursuant to 11 U.S.C. § 1112 is denied.

FILED BY THE COURT
03/28/2023

Entered: 03/28/2023

Chief US Bankruptcy Judge
District of South Carolina