UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF NEW YORK

In Re:

Robert N. & Karen E. Kornfield, **CASE NO. 96-22165**

Debtors.

DECISION & ORDER

BACKGROUND

On July 30, 1996, Robert N. Kornfield and Karen E. Kornfield (the "Kornfields") filed a petition initiating a Chapter 7 case. On October 28, 1996, the Court entered an Order (the "Extension Order") granting the *ex parte* motion of the United States Trustee (the "U.S. Trustee") to extend her time to bring a substantial abuse motion under Section 707(b). On December 27, 1996, the Kornfields filed a motion to resettle the Extension Order (the "Resettlement Motion") which was denied by the Court by an Order (the "Denial Order") entered on January 10, 1997.

On June 23, 1997, this Court filed its Decision & Order (the "Decision & Order") granting the January 7, 1997 substantial abuse motion of the U.S. Trustee (the "Substantial Abuse Motion").

On July 30, 1997, the Kornfields filed a motion (the "Stay Motion"), pursuant to Bankruptcy Rule 8005, requesting a stay pending their appeal of the Decision & Order to the United States District Court for the Western District of New York (the "District Court").

The Stay Motion advised the Court that: (1) in their appeal the Kornfields were not only challenging the Decision & Order on a number of grounds, but were also challenging the Extension Order and the Denial Order; (2) on July 24, 1997, the Kornfields' attorneys, Lacy, Katzen, Ryen &

Mittleman ("Lacy, Katzen"), had taken a judgment (the "Lacy, Katzen Judgment") against the Kornfields for the amount of $10,154.78, which was authorized by a July 23, 1997 Affidavit of Confession of Judgment executed by the Kornfields in favor of Lacy, Katzen, for unpaid post-petition legal fees and disbursements due Lacy, Katzen from the Kornfields in connection with the Substantial Abuse Motion; (3) Lacy, Katzen had filed an income execution (the "Income Execution"), pursuant to Section 5231 of the New York Civil Practice Law & Rules (the "CPLR"), with an enforcement officer, which directed that it be served upon Dr. Kornfield's professional corporation in order to collect 10% of his gross salary which would then be paid over to and applied by Lacy, Katzen to its Judgment; (4) since the Kornfields had numerous grounds for appealing the Decision & Order and the Extension and Denial Orders, which they believed presented serious and important legal issues, they had demonstrated the level of likelihood of success on the merits required by the United States Court of Appeals for the Second Circuit (the "Second Circuit") and the Bankruptcy Appellate Panel for the Second Circuit (the "BAP") to warrant the Court granting a stay pending appeal; (5) the Kornfields would be prejudiced and face irreparable harm by a failure to grant such a stay because: (a) they would incur substantial additional legal fees in defending the efforts of creditors such as First Federal Savings & Loan Association ("First Federal") and First Union Home Equity Bank, N.A. ("First Union"), which had pending state court proceedings to determine the final amounts owed them by the Kornfields on their respective mortgages on the Kornfields' former residence; (b) such collection efforts would result in irreparable harm to the Kornfields' reputation; and (c) the possible media attention such collection efforts would receive would negatively affect the states of mind of the Kornfields as well as the business of Dr. Kornfield;

and (6) there would be no prejudice to the Kornfields' pre-petition creditors from not granting such a stay because: (a) the Kornfields had no non-exempt assets of any kind which those creditors could enforce their debts against; and (b) since Dr. Kornfield's future income had already been executed against and tied up by Lacy, Katzen, and it was unlikely that the Lacy, Katzen Judgment would be paid in full before the appeal was decided by the District Court, no additional income executions by those creditors would result in any payment to them.[1]

On August 5, 1997, the U.S. Trustee filed opposition (the "U.S. Trustee Opposition") to the Stay Motion which alleged that: (1) the Lacy, Katzen Judgment and Income Execution served upon Dr. Kornfield's professional corporation removed any threat of irreparable harm to the Kornfields that might result from the Court not granting a stay; (2) the continuation of the efforts of First Federal and First Union to determine the exact amount which the Kornfields owed them would not affect the business of Dr. Kornfield; and (3) the Kornfields' references to media attention appeared to be irrelevant and any effect on their state of mind from routine collection efforts would not constitute irreparable harm.

On August 5, 1997, First Union filed opposition to the Stay Motion (the "First Union Opposition") which alleged that: (1) the Kornfields were indebted to First Union by reason of a promissory note dated February 15, 1995 in the original principal amount of $225,000.00, which had been secured by a mortgage on the Kornfields' former residence at 12 Merrycreek Crossing, Pittsford, New York; (2) First Union had commenced an action against the Kornfields in New York

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[1] Under New York law, only one income execution at a time can be honored by an employer.

State Supreme Court on August 22, 1995, and prior to a hearing on First Union's motion for summary judgment in that action, the Kornfields had filed their bankruptcy petition on July 30, 1996; (3) in the Stay Motion, the Kornfields have merely stated the numerous issues they intend to raise on their appeal to the District Court, but have failed to present a substantial case on the merits, which is required in order to warrant granting a stay pending appeal; (4) harm to the Kornfields' financial condition and reputation does not constitute the kind of irreparable harm which warrants the granting of a stay pending appeal; (5) the Kornfields' failure to pay their debts and voluntarily filing a Chapter 7 petition alone "harmed" their financial reputation; (6) the Kornfields' pre-petition creditors would be substantially harmed by the granting of a stay since they already had been delayed for over a year in their collection efforts by the Kornfields' filing of their voluntary Chapter 7 case and the imposition of the automatic stay.

On the August 6, 1997 return date of the Stay Motion, the Court heard oral argument from attorneys representing the Kornfields, the U.S. Trustee and an attorney representing First Union, and the following additional facts and circumstances were presented: (1) First Federal was seeking to obtain a deficiency judgment in its pending state court mortgage foreclosure action involving the Kornfields' former residence, in which a referee was about to be appointed and in connection with which there appeared to be a substantial dispute as to the fair market value of the residence at the time of First Federal's mortgage foreclosure sale, which would require the Kornfields to incur substantial legal fees and disbursements in that action if it were not stayed; (2) since the Kornfields had no non-exempt equity in any of their assets, if the District Court determined that their Chapter 7 case should not have been dismissed for substantial abuse, the reinstated Chapter 7 case would be

either a no asset case or, if a potential preferential payment to the New York State Department of Taxation and Finance were pursued by the Chapter 7 Trustee, the recovery would not inure to the benefit of unsecured pre-petition creditors, so that it would not be necessary for the debts due to the Kornfields' creditors, such as First Federal and First Union, to be finally liquidated and determined, since they would be discharged in full no matter what was due; (3) the Kornfields believed that the principal important legal issues they were raising on their appeal to the District Court were: (a) whether the Court had abused its discretion in granting the Extension Order on an *ex parte* basis; (b) that one of the factors the Court took into consideration in evaluating the totality of circumstances was the Kornfields' significant exempt pension fund which the Kornfields otherwise could, in whole or in part, voluntarily make available for the payment of creditors; (c) whether the Court was correct in utilizing a "per se income test"; and (d) whether the Court erred in allowing the parties other than the Kornfields and the U.S. Trustee to intervene in connection with the Substantial Abuse Motion.

DISCUSSION

A request for a stay pending appeal is addressed to the sound discretion of the Court, and requires that the Court take into consideration the following four factors:

1. The likelihood that the party seeking the stay will prevail on appeal;

2. The prospect of irreparable injury to the moving party which might result without the stay;

3. The relative certainty that no substantial harm will come to other parties if the stay were issued; and

4. The relative absence of harm to the public interest if the stay were granted. *See Hirschfield v. Board of Elections,* 984 F.2d 35, 39 (2d Cir. 1993) and *In re Bijan-Sara Corporation*, 203 B.R. 358 (2d Cir. BAP 1996).

When each of these four required factors are carefully considered and balanced, the relief requested by the Kornfields must be granted.

I. LIKELIHOOD OF SUCCESS ON THE MERITS

The test in the Second Circuit is that the movant demonstrate "a substantial possibility, although less than a likelihood of success" on the merits. *See Hirschfield*, 984 F.2d at 39.

Although I agree that the Kornfields' appeal to the District Court of the Decision & Order may not be a frivolous appeal, and that important legal issues will be presented and argued on the appeal since neither the Kornfields, the U.S. Trustee or this Court are aware of any published decision of the Second Circuit, the BAP or any District Court within the Circuit deciding an appeal of a substantial abuse motion, I do not believe that, given the facts and circumstances presented in their case, the Kornfields will be successful on their appeal of the Decision & Order. As I stated in the Decision & Order, "to allow the Kornfields a Chapter 7 discharge would be a substantial abuse of Chapter 7, no matter what legal standard the Court utilizes."

In its Stay Motion and at oral argument, the Kornfields highlighted what they felt were the four principal grounds which they believed would warrant the District Court reversing the Decision & Order, the Extension Order or the Denial Order. I will briefly address these issues in connection with my evaluation of likelihood of success on the merits, as follows:

A. USE OF EXEMPT PROPERTY

In their Stay Motion, the Kornfields have asserted that they "intend to demonstrate on appeal, among other things, that the Court improperly conditioned relief under Chapter 7 of the Bankruptcy Code upon the surrender of all or part of a lawfully claimed exemption in Dr. Kornfield's qualified profit-sharing plan."

In the Decision & Order, the Court set forth as one of the factors it would consider which might mitigate against a debtor's Ability to Pay[2], or constitute an aggregating factor to show that a debtor is truly not needy[3], is whether a debtor has significant retirement funds which could be voluntarily devoted, in whole or in part, to the payment of creditors. Clearly the Decision & Order did not state that a debtor could be required to utilize otherwise legally exempt assets for the payment of creditors. However, the reality in Bankruptcy Court is that very often the Court sees debtors who prior to the filing of their petition have utilized otherwise exempt funds (the proceeds of loans against pension plan funds) to pay creditors. Furthermore, often in Chapter 13 proceedings debtors utilize otherwise exempt assets to fund their plans in whole or in part. For example, many older debtors fund their Chapter 13 plans with exempt Social Security and pension payments, and

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[2] Ability to Pay was defined as the ability to pay: (1) all priority and unsecured debt in a Chapter 13 case under a plan of from one to five years in duration, or over a reasonable period of time in a Chapter 11 case, while properly providing for any secured debt; (2) all priority debt and a significant percentage of unsecured debt through such a Chapter 13 or 11 plan; or (3) a significant dollar amount, irrespective of percentage, to unsecured creditors through such a Chapter 13 or Chapter 11 plan.

[3] For example, a debtor may not actually need any kind of bankruptcy relief.

it is not unusual for debtors to contribute all or a portion of their homestead exemption on the sale of a residence to fund a Chapter 13 plan, in whole or in part. In addition, the Court often sees debtors obtain loans from retirement funds to fund Chapter 13 plans, in whole or in part. Therefore, I believe that since it is not uncommon for individuals to voluntarily use exempt funds to pay creditors, the unwillingness of a particular debtor to do so, especially when that debtor has substantial retirement funds, is a proper factor for the Court to consider, along with all of the many other factors it should consider, in determining whether a debtor has an Ability to Pay. However, that factor alone could not result in a finding of substantial abuse, and clearly the Court would never require a debtor to use exempt assets to pay creditors. In addition, the ability to voluntarily use exempt assets to pay creditors certainly is a relevant factor to determine whether a debtor is in fact a truly needy debtor.

B. THE GRANTING OF THE EXTENSION ORDER ON AN EX PARTE BASIS

Neither Section 707(b) nor Rule 1017(e)[4] requires notice and a hearing in connection with

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[4] Rule 1017(e) provides in pertinent part:

> Dismissal of Individual Debtor's Chapter 7 Case for Substantial Abuse. An individual debtor's case may be dismissed for substantial abuse pursuant to §707(b) only on motion by the United States trustee or on the court's own motion and after a hearing on notice to the debtor, the trustee, the United States trustee, and such other parties in interest as the court directs.
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> (1) A motion by the United States trustee shall be filed not later than 60 days following the first date set for the meeting of creditors held pursuant to §341(a), unless, before such time has expired, the court for cause extends the time for filing the motion. The motion shall advise the debtor of all matters to be submitted to the court for its consideration at the hearing.

the Court, for cause, granting an extension to the U.S. Trustee of the time within which it must bring a substantial abuse motion.

In this regard, it is important to note that Rule 4004(b)[5], which deals with a debtor's overall discharge under Section 727, and Rule 4007(c)[6], which deals with the determination of dischargeability of a particular debt under Section 523, each specifically require notice and a hearing in order for the Court to extend the same 60-day period.

Although this Court has now required that the U.S. Trustee bring applications to extend the time within which to bring a substantial abuse motion on notice, which in appropriate cases may be even telephonic, it is not because the Court believes that such notice is required by the Bankruptcy Code, the Rules of Bankruptcy Procedure or fundamental principles of due process. It is because,

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[5] Rule 4004(b) provides:

> Extension of Time. On motion of any party in interest, after hearing on notice, the court may extend for cause the time for filing a complaint objecting to discharge. The motion shall be made before such time has expired.

[6] Rule 4007(c) provides:

(c) Time for Filing Complaint Under Rule 523(c) in Chapter 7 Liquidation, Chapter 11 Reorganization, and Chapter 12 Family Farmer's Debt Adjustment Cases; Notice of Time Fixed.

A complaint to determine the dischargeability of any debt pursuant to § 523(c) of the Code shall be filed not later than 60 days following the first date set for the meeting of creditors held pursuant to § 341(a). The court shall give all creditors not less than 30 days notice of the time so fixed in the manner provided in Rule 2002. On motion of any party in interest, after hearing on notice, the court may for cause extend the time fixed under this subdivision. The motion shall be made before the time has expired.

as is often the case, Bankruptcy Courts establish rules of practice and procedure which they believe will enhance the credibility of that particular court and the Bankruptcy System within their specific community, based upon local practices and procedures in that legal community, which may, nevertheless, not be specifically required by any statute, rule or principle of fundamental due process.

Notwithstanding the foregoing, I cannot find with reasonable certainty that on this issue the Kornfields have not demonstrated the required substantial possibility, although less than a likelihood, of success on appeal.

C. PER SE INCOME TEST

The Kornfields have asserted that the Court utilized a "per se income test" in making its decision on the Substantial Abuse Motion. It is difficult for the Court to understand how the approach which it set forth and utilized in the Decision & Order can properly be considered to be a "per se income test".

D. THE INTERVENTION OF OTHER PARTIES

It is clear from the language of Section 707(b), its history and its legislative history, that Congress intended that a motion for substantial abuse be brought only by the Court or the U.S. Trustee, and that it not be initiated by creditors. Once a substantial abuse motion is properly brought, this Court believes that it is not only proper, but it is necessary, for the Court, in the exercise of its very important responsibility to determine such a motion, to consider any and all relevant and appropriate facts and arguments from any available and credible source.

II. PREJUDICE OR HARM TO THE KORNFIELDS

I simply cannot give any credence to the argument of the Kornfields that their state of mind, the business of Dr. Kornfield or their reputation would somehow be more irreparably harmed by the continuation of routine collection efforts by their creditors to finally liquidate what is owed to them, and, if appropriate, to obtain judgments and serve income executions on Dr. Kornfield's professional corporation, than the harm which has already been sustained by them by their admission (these Bankruptcy Court proceedings are public record) that they have failed to pay Lacy, Katzen for their legal services, which resulted in Lacy, Katzen, taking a Judgment against them and serving an Income Execution on Dr. Kornfield's professional corporation.

Nevertheless, it does appear that at least with respect to the pending First Federal mortgage foreclosure proceeding, that the Kornfield's, who may have legitimate defenses to the amount claimed by First Federal as a deficiency, may have to incur significant expenses which would not otherwise be required should the District Court on appeal reverse the Decision & Order and find that the Kornfields were proper candidates for a Chapter 7 proceeding and a discharge under Section 727. As stated above, if the Kornfields are successful on appeal and are permitted to continue in Chapter 7, their case will be a no asset case, or at least a case which will not see a distribution to unsecured pre-petition creditors, so that the Kornfields would not be concerned as to whether the claims of their creditors, which would be discharged in full, are filed in the correct amount.

III. IRREPARABLE HARM TO THE CREDITORS

Although this Court has determined in its Decision & Order that the Kornfields are ineligible for Chapter 7 relief because granting them such relief would be a substantial abuse of Chapter 7 and the Bankruptcy System, it does not appear from the evidence presented in connection with the Stay

Motion that the Kornfields' creditors would be substantially or irreparably harmed by the granting of a stay pending appeal. If the Decision & Order is affirmed, the creditors will be able to finally have their debts determined in state court and proceed to collect those debts from the Kornfields' future income in accordance with New York State law.

Since it appears from the evidence before the Court that the Kornfields have no non-exempt assets which are of value or which may be disposed of, and Dr. Kornfield's income stream is already subject to the Income Execution[7], which it does not appear will result in the full payment of the Lacy, Katzen Judgment before the District Court makes its determination on the appeal, it does not appear that there will be any substantial or irreparable harm to the creditors from the short delay in the enforcement of their rights pending the determination of the appeal.[8]

IV. PUBLIC POLICY INTERESTS

The Kornfields have suggested that their appeal raises important public policy interests such as the Bankruptcy Code's "fresh start policy", the Kornfields' rights to exempt property and fundamental due process. Although the Court acknowledges that those are important public policies of the Bankruptcy Code and the Bankruptcy System, it believes that those policies were

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[7] The U.S. Trustee, in her Opposition, termed it a "maneuver by the debtors and their counsel".

[8] Should the District Court affirm the Decision & Order and it is thereafter discovered that the Kornfields have done some pre-appeal decision planning which results in further charges against Dr. Kornfield's future income to the detriment of his valid pre-petition creditors, such as the current charge against his income resulting from the Lacy, Katzen Income Execution, it may not be that the New York State courts will or can do anything about such "otherwise legal" charges against future income. However, it is something which would certainly be remembered by this Court in connection with any similar future stay motions.

acknowledged, taken into account, and properly balanced when it made its determinations in the Decision & Order, the Extension Order and the Denial Order that: (a) there was cause to extend the time for the U.S. Trustee to bring a substantial abuse motion and neither fundamental due process, the provisions of the Bankruptcy Code nor the Bankruptcy Rules required that the U.S. Trustee bring the motion on notice; and (b) allowing the Kornfields to proceed in a Chapter 7 case would be a substantial abuse of Chapter 7. Nevertheless, in connection with the Stay Motion, there is really not the kind of recognizable public interest directly implicated or which will be harmed whether or not the stay is granted.

CONCLUSION

It is ironic that many of the facts and circumstances presented by the Kornfields' case, in particular that they have an "Ability to Pay" and are truly not needy of a complete discharge from all of their debts, which in this Court's opinion made them so clearly ineligible for Chapter 7 relief, are the very factors which make them eligible for a stay pending appeal. Specifically, if the Kornfields are not successful on their appeal and are honorable with their pre-petition creditors and do not put further charges against Dr. Kornfield's income to delay or prevent their payment of those creditors, they will be able to ultimately pay the creditors. Therefore, those creditors will not be sufficiently harmed by a relatively short delay in enforcing their rights so that the appeal can be heard. In addition, the fact that the Kornfields could incur significant unnecessary legal expenses if a stay were not granted and they are successful on their appeal, swings the balance in favor of a stay, notwithstanding that I do not believe the Kornfields will be successful on their appeal of the

Decision & Order and that, in their case, the public policy of Section 707(b) to prevent abuse outweighs the public policy of fresh start.

Although there was no law in the Second Circuit which I was bound by in making the Decision & Order, the law in the Circuit regarding whether to grant a stay pending appeal does bind me and I believe that it requires me, in the proper exercise of my discretion, to grant a stay pending appeal.

A stay pending appeal, pursuant to Rule 8005, is hereby granted which shall terminate upon the earlier of: (1) the entry of a decision by the District Court on the appeal; or (2) the entry of any judgment against either or both of the Kornfields or the voluntary assignment of or the granting of any charge or lien against Dr. Kornfield's future income before the entry of the decision of the District Court on the appeal.

IT IS SO ORDERED.

_____/s/_____
HON. JOHN C. NINFO, II
U.S. BANKRUPTCY JUDGE

Dated: August 7, 1997