ORIGINAL

CAROL A. STATKUS
Assistant United States Attorney
AUGUST A. IMHOLTZ III
Trial Attorney, Tax Division
Civil Trial Section, Western Region
U.S. Department of Justice
P.O. Box 683, Ben Franklin Station
Washington, DC 20044-0683
Phone: (202) 307-2550

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF WYOMING

IN RE:	)	
	)	
KENNETH RICHARD KEELER,	)	Case No. 02-21121
	)	Chapter 7
Debtor.	)	

UNITED STATES' TRIAL BRIEF IN SUPPORT OF
UNITED STATES' MOTION TO DISMISS

The United States of America, by its attorneys, Carol A. Statkus, Assistant United States Attorney for the District of Wyoming, and August A. Imholtz III, Trial Attorney, Tax Division, United States Department of Justice, submits this Trial Brief in support of its Motion to Dismiss this bankruptcy case pursuant to 11 U.S.C. §707(a).

ISSUE

Should this Chapter 7 bankruptcy be dismissed pursuant to 11 U.S.C. §707(a) because it was not filed in good faith?

BACKGROUND

MR. KEELER'S FEDERAL INCOME TAX LIABILITY

In 1981, 1982, and 1983, Mr. Keeler participated in an abusive tax shelter designed to shield income through recognition of trading losses incurred in a derivatives market created by Merit Securities, Inc. *See Keeler v. Commissioner*, 243 F.3d 1212 (10th Cir. 2001); *see also Leema Enterprises, Inc. v. Commissioner*, T.C. Memo 1999-18, 1999 WL 34819, 77 T.C.M. (CCH) 1261 (1999). The United States Tax Court found that once his Merit Securities trading losses were disallowed, Mr. Keeler owed $4,242,388.00 in unpaid federal income taxes for 1981, 1982, and 1983. *See Keeler*, supra at 1217. The Tax Court also ordered Keeler to pay penalties for negligence and for participating in a tax shelter. *See id.* at 1220-21. The United States Court of Appeals for the Tenth Circuit affirmed the Tax Court decision in its entirety. *See id.* As a result of his involvement in the Merit Securities tax shelter and his failure to pay the resulting income tax liabilities, penalties, and interest, Mr. Keeler currently owes the IRS more than $49 million in unpaid federal income taxes, penalties, and interest for 1981, 1982, and 1983. Mr. Keeler has not voluntarily paid any of these federal tax liabilities. Instead, he filed this Chapter 7 bankruptcy.

MR. KEELER'S CHAPTER 7 BANKRUPTCY

On August 30, 2002, Mr. Keeler filed a voluntary petition for Chapter 7 bankruptcy relief. Mr. Keeler's bankruptcy schedules report assets totaling $2,035,310.40, and they report a single liability of $4,242,388.00. *See* Summary of Schedules; *see also* Schedule F. The $4,242,388.00 liability is the federal income tax that Keeler owes for 1981, 1982, and 1983; the remainder of the $49 million federal tax liability consists of interest as well as the negligence and

tax shelter related penalties. The IRS is the only creditor listed on Mr. Keeler's bankruptcy schedules. *See* Schedules D, E, and F.

ARGUMENT

Numerous courts have dismissed Chapter 7 bankruptcy cases for "cause" pursuant to 11 U.S.C. § 707(a) after determining that they were not filed in good faith. Mr. Keeler's Chapter 7 bankruptcy was not filed in good faith and should be dismissed.

BAD FAITH DISMISSAL OF CHAPTER 7 BANKRUPTCY PROCEEDINGS

Section 707(a) of the United States Bankruptcy Code provides:

> (a) The court may dismiss a case under this chapter only after notice and a hearing and only for cause, including --
>
> (1) unreasonable delay by the debtor that is prejudicial to creditors;
>
> (2) nonpayment of any fees or charges required under chapter 123 of title 28; and
>
> (3) failure of the debtor in a voluntary case to file, within fifteen days or such additional time as the court may allow after the filing of the petition commencing such case, the information required by paragraph (1) of section 521, but only on a motion by the United States trustee.

11 U.S.C. § 707(a).

The United States Court of Appeals for the Sixth Circuit has held that the word "including" in Section 707(a) is not meant to limit "cause" to the reasons stated in subparagraphs (1), (2), and (3). *See In re Zick*, 931 F.2d 1124, 1126 (6th Cir. 1991); *see also* 11 U.S.C. § 102(3). Accordingly, the specific "causes" enumerated in subparagraphs (1), (2), and (3) of Section 707(a) are "merely illustrative and are not an exhaustive listing" of the grounds for

dismissal. *In re Davidoff*, 185 B.R. 631, 634 (Bankr. S.D. Fla. 1995); *see also In re Cappuccetti*, 172 B.R. 37, 39 (Bankr. E.D. Ark. 1994); *In re Burns*, 169 B.R. 563, 567 (Bankr. W.D. Pa. 1994); *In re Studdard*, 159 B.R. 852, 855 (Bankr. E.D. Ark. 1993); *In re Hammonds*, 139 B.R. 535, 541 (Bankr. D. Colo. 1992); *In re Jones*, 114 B.R. 917, 926 (Bankr. N.D. Ohio 1990).

A lack of good faith in the filing of a bankruptcy petition constitutes grounds for dismissal under Section 707(a). *See Zick*, supra at 1126-27; *see also Tamecki v. Frank*, 229 F.3d 205, 207 (3d Cir. 2000); *Davidoff*, supra at 634; *In re Barnes*, 158 B.R. 105, 108 (Bankr. W.D. Tenn. 1993); *Cappuccetti*, supra at 39; *Burns*, supra at 563; *Studdard*, supra at 855; *Hammonds*, supra at 541; *In re Campbell*, 124 B.R. 462, 464 (Bankr. W.D. Pa. 1991); *Jones*, supra at 925-26. *But see In re Padilla*, 222 F.3d 1184, 1191 (9th Cir. 2000) ("Bad faith as a general proposition does not provide 'cause' to dismiss a Chapter 7 petition under § 707(a)"). "A debtor's good faith is an implicit jurisdictional prerequisite to the filing of a case under the Bankruptcy Code." *Hammonds*, supra at 541. "The good faith requirement also comports with the bankruptcy court's role as a court of equity, where those seeking relief must approach the court with clean hands and an honorable purpose." *Jones*, supra at 926. "It has also been suggested that the bankruptcy court may dismiss a petition for lack of good faith under its inherent authority to control its own docket." *Id.* Indeed, a Bankruptcy Court has broad discretion in this arena and a decision to dismiss for lack of good faith pursuant to Section 707(a) "will be reversed only for an abuse of discretion." *Zick*, supra at 1126 (citing *In re Atlas Supply Corp.*, 857 F.2d 1061, 1063 (5th Cir. 1988)).

Lack of good faith is determined on an ad hoc, case-by-case basis upon consideration of all the facts and circumstances of the particular case. *See Zick*, 931 F.2d at 1129; *Barnes*, supra at

108; *Burns*, supra at 567; *Hammonds*, supra at 541; *Campbell*, supra at 464; *In re Maide*, 103 B.R. 696, 697 (Bankr. W.D. Pa. 1989). "A determination of good faith requires an inquiry into any possible abuses of the provisions, purposes, or spirit of bankruptcy law and whether the debtor genuinely needs the liberal protections afforded by the Bankruptcy Code." *Davidoff*, supra at 634; *accord*, *Hammonds*, supra at 541-42; *Campbell*, supra at 464. The Sixth Circuit describes the ad hoc inquiry into good faith as the "'smell test.'" *Zick*, supra at 1127-28.

The debtor has the burden of proof in this action; "[o]nce the question of good faith/bad faith is put in issue, the party bringing the bankruptcy petition has the burden of proving that the petition was brought in good faith." *Hammonds*, supra at 541.

ELEMENTS INDICATING AN ABSENCE OF GOOD FAITH

Over the years, courts considering the issue of good faith have developed a set of factors that should be considered in deciding whether a Section 707(a) dismissal for lack of good faith is warranted:

> 1. The debtor reduced his creditors to a single creditor in the months prior to filing the petition.
> 2. The debtor failed to make lifestyle adjustments or continued living an expansive or lavish lifestyle.
> 3. The debtor filed the case in response to a judgment, pending litigation, or collection action; there is an intent to avoid a large single debt.
> 4. The debtor made no effort to repay his debts.
> 5. The unfairness of the use of Chapter 7.
> 6. The debtor has sufficient resources to pay his debts.
> 7. The debtor is paying debts to insiders.
> 8. The schedules inflate expenses to disguise financial well-being.
> 9. The debtor transferred assets.
> 10. The debtor is over-utilizing the protection of the Code to the unconscionable detriment of creditors.
> 11. The debtor employed a deliberate and persistent pattern of evading a single major creditor.

12. The debtor failed to make candid and full disclosure.
13. The debts are modest in relation to assets and income.
14. There are multiple bankruptcy filings or other procedural "gymnastics."

In re Spagnolia, 199 B.R. 362, 364-65 (Bankr. W. D. Ky. 1995) (collecting cases and adopting 14 factor analysis to consider in determining good faith); *In re Stump*, 280 B.R. 208, 214 (Bankr. S. D. Ohio 2002) (endorsing *Spagnolia* 14 point analysis); *see also Davidoff*, supra at 634 (court considered 11 factors in good faith analysis) *Zick*, supra at 1124 (four-prong analysis). Generally, the presence of a single factor is not sufficient to support a Section 707(a) dismissal. *See Cappuccetti*, supra at 39. Where a combination of these factors are present, however, the courts have held that a Section 707(a) dismissal is warranted. *See Zick*, supra at 1124; *Cappuccetti*, supra at 39.

THE COURT SHOULD DISMISS KEELER'S CHAPTER 7 BANKRUPTCY FOR CAUSE PURSUANT TO 11 U.S.C. § 707(a) BECAUSE IT WAS NOT FILED IN GOOD FAITH

Here, analysis of the relevant factors mandates the conclusion that Mr. Keeler's Chapter 7 bankruptcy was filed in bad faith and therefore should be dismissed.

The Debtor's Pre-petition Conduct.

The **first factor** is present because "**the debtor reduced his creditors to a single creditor in the months prior to filing the petition.**" It is undisputed that the IRS is Keeler's only creditor and that he owes the IRS more than $49 million in unpaid federal taxes, penalties, and interest. *See* Bankruptcy Schedules D, E, and F. "Courts have held that seeking to discharge primarily one creditor is an element of bad faith under Code § 707(a)." *In re Griffieth*, 209 B.R. 823, 829 (Bankr. N. D. NY. 1996) (Chapter 7 case filed in bad faith where almost solely designed to discharge obligation to the IRS). On or about April 11, 2002, several months before

filing his Chapter 7 bankruptcy petition, Mr. Keeler disposed of his only other large creditor; he paid the California Franchise Tax Board $1,500,000.00. *See* Statement of Financial Affairs, p. 2, ¶ 3.

The $1.5 million payment to the California taxing authority also implicates the **ninth factor** as a **pre-petition transfer of assets**. *See Cappuccetti*, supra at 39-40 (granting motion to dismiss for bad faith where IRS was primary creditor and debtors had paid nearly all of their state tax liability). The $1.5 million payment to the California Franchise Tax Board pales in comparison to the fact that Mr. Keeler donated $6,127,218.00 to the Urantia Foundation between December 31, 1993 and December 31, 2002. Mr. Keeler has been a member of the Urantia Foundation's Board of Trustees since 1989 and has been President of the Urantia Foundation since 1997. Of particular interest is the fact that Mr. Keeler filed a Petition in the U.S. Tax Court in 1993 with respect to his involvement in the Merit Securities tax shelter and then, while his tax liability was being litigated, he gave more than $6 million to a charitable organization that he was - and remains - closely involved with. Finally, in or around February of 2002, Mr. Keeler gave his late-model minivan to friends as a gift.

The extraordinary generosity that Mr. Keeler displays toward the Urantia Foundation implicates the **second factor**; Mr. Keeler has **failed to make lifestyle adjustments** in order to attempt to satisfy his federal tax liabilities. While not improper *per se*, it may be considered inappropriate for a debtor to give substantial amounts to charity while ignoring his obligations to creditors. *See Griffieth*, supra at 827-28 (noting excessive charitable contributions as possibly indicative of bad faith and dismissing bankruptcy for cause under Section 707(a)).

Mr. Keeler's failure to modify his lifestyle is also apparent from his postpetition conduct; he has transferred $150,000.00 to the Urantia Foundation since he filed the bankruptcy petition on August 30, 2002. He made a $100,000.00 donation by check on October 20, 2002 as well as a $50,000.00 wire-transfer on November 26, 2002. It is worth noting that Mr. Keeler's postpetition transfers to the Urantia Foundation of $150,000.00 are equal in value to nearly one-half of his bankruptcy estate. While Mr. Keeler's generosity is commendable, it is inappropriate for him to donate massive amounts to the Urantia Foundation while ignoring his federal tax liabilities for 1981, 1982, and 1983.

The Debtor and his Obligations.

The **third factor** is also present in this case - **"the debtor filed the case in response to a judgment, or collection action intending to avoid a large single debt**." Because Mr. Keeler has only one creditor, there can be only one reason why he filed this Chapter 7 bankruptcy: to defeat his federal tax liabilities for 1981, 1982, and 1983 as adjudicated by the U.S. Tax Court and affirmed by the Tenth Circuit. Accordingly, it is clear that Keeler filed this case "with the intent to avoid a large single debt." The **fourth factor** is present - **"the debtor made no effort to repay his debts**." Mr. Keeler has not made any payments of his 1981, 1982, and 1983 federal tax liability, he has not submitted an offer in compromise, and he has not proposed a payment plan or otherwise attempted to resolve these tax liabilities with any finality. *See Griffieth*, supra at 829-30 (fact that debtors did not make a good faith effort to pay the federal tax debt indicates a lack of good faith); *see also Zick*, supra at 1127 n. 3 ("When a debtor capable of at least partial payment has made every effort to avoid payment of an obligation ... lack of good faith sufficient to justify dismissal may be found.").

Equitable and Financial Considerations.

The **fifth** and **tenth factors** should be considered together and both are present here - "**the unfairness of the debtor's use of Chapter 7**" and "**the debtor's over-utilization of the protection of the Code to the unconscionable detriment of creditors.**" Mr. Keeler's unpaid tax liabilities result directly from his own misconduct; he attempted to shield large amounts of income from taxation - $7.5 million in 1981 alone - by participating in an abusive tax shelter. *See Keeler*, supra at 1220-21 (upholding Tax Court imposition of negligence penalty against Keeler); *see also Leema Enterprises, Inc. v. Commissioner*, T.C. Memo 1999-18, 1999 WL 34819, 77 T.C.M. (CCH) 1261 (1999). Mr. Keeler should not be allowed to escape his federal tax liability resulting directly from his participation in a sophisticated abusive tax shelter by exploiting the bankruptcy system to resolve what is essentially a two-party dispute between him and the IRS. "Even if a debtor is in **technical compliance** with the Bankruptcy Code, if he is attempting to over-utilize the protections afforded by the bankruptcy process to the unconscionable detriment of creditors, the case may be dismissed for cause." *Davidoff*, supra at 636 (emphasis added). As the Sixth Circuit has stated with respect to the bad faith filing of bankruptcy petitions:

> The Bankruptcy Code is intended to serve those persons who, **despite their best efforts**, find themselves hopelessly adrift in a sea of debt. Bankruptcy protection was not intended to assist those who, despite their own misconduct, are attempting to preserve a comfortable standard of living at the expense of their creditors. Good faith and candor are necessary prerequisites to obtaining a fresh start. The bankruptcy laws are grounded on the fresh start concept. There is no right, however, to a head start.

Zick, supra at 1129-30 (emphasis added); *see also Campbell*, supra at 465 (dismissal despite technical compliance with Bankruptcy Code: "by no stretch of the imagination is the debtor 'unfortunate'" and deserving of bankruptcy protection). Mr. Keeler is not the poor and unfortunate debtor who found himself "hopelessly adrift in a sea of debt" despite his best efforts. Instead, Mr. Keeler is a sophisticated and financially savvy professional investor who voluntarily dove headfirst into debt by participating in an abusive tax shelter.

The **sixth factor** is present here - **"the debtor has sufficient resources to pay his debts."** While it is unlikely that Mr. Keeler could fully satisfy his $49 million tax liability in the immediate future, he certainly posses the assets and earning power to attempt to at least partially pay his 1981 - 1983 tax liabilities. Mr. Keeler lists over $2 million of assets on his bankruptcy schedules. *See* Summary of Schedules. In the two calender years preceding the bankruptcy petition, he earned approximately $2.2 million dollars. *See* Statement of Financial Affairs, p. 2, ¶¶ 1-2. While the ability to repay debts is not, by itself, cause for dismissal under Section 707(a), it is, without question, one circumstance which may be considered in determining lack of good faith. *See Cappuccetti*, supra at 39, n.1; *Hammonds*, supra at 542-43; *Maide*, supra at 697; *Davidoff*, supra at 636. "The notion that the Bankruptcy Court may never examine debtor's ability to repay his debts as an element of cause for dismissal or substantial abuse undermines the essential purpose of Section 707." *Jones*, supra at 925; *see also Zick*, supra at 1128 (noting that the debtor earned $7,000.00 per month). Mr. Keeler reported that he earned approximately $10,000.00 per month in 2002. *See* Schedule I, Current Income of Individual Debtor. In 2001, if his capital gains are taken into account, Mr. Keeler earned an average of more than **$100,000.00 per month**. Accordingly, given Mr. Keeler's assets and unique earning power, there is no reason

why he cannot begin to pay down his federal tax debt. *See Spagnolia*, supra at 366 ("Courts have repeatedly held that a debtor's resort to bankruptcy when he or she has the ability to pay his or her creditors is unfair and is an indication that good faith is lacking."); *see also Stump*, supra at 216 ("While there may not be income or assets to satisfy the [creditors' claims] fully and immediately, there are significant and available resources to make some payment over time.").

Debtor's Bankruptcy Court Filings.

The **eighth factor** is present here; Mr. Keeler appears to have **inflated his expense schedules in order to disguise his financial well-being**. *See Davidoff*, supra at 634-35; *Cappuccetti*, supra at 39; *Hammonds*, supra at 542-43; *Jones*, supra at 924; *see also Calder v. Job*, 907 F.2d 953, 954-55 (10th Cir. 1990) (Bankruptcy Court may take judicial notice of contents of a debtor's bankruptcy schedules pursuant to Fed. R. Evid. 201(b)(2)). Mr. Keeler's expense schedules are suspect. First, he lists monthly charitable contributions of $2,500.00 as an "expense." *See* Schedule J, Current Expenditures of Individual Debtor. He also lists a $3,100.00 monthly payment of self-employment tax. *See id.* In 2002, the self-employment tax rate was 15.3%. *See* 26 U.S.C. § 1401 (a) and (b). Accordingly, a monthly employment tax payment of $3,100.00 is approximately double the self-employment tax that would be owed on the monthly income of $10,000.00 that Mr. Keeler reports on his Schedule I. Finally, Mr. Keeler reports that he spends $50.00 per month on clothing, but also claims that his entire wardrobe is worth only $248.00. *Compare* Schedule B "Wearing apparel" *with* Schedule J.

Mr. Keeler has failed to make **"candid and full disclosure"** of his assets on his bankruptcy schedules and statement of financial affairs thus implicating the **twelfth factor**. "By seeking discharge, ... [the debtor places] the rectitude of his prior dealings squarely in issue, for

... the Act limits that opportunity to the honest but unfortunate debtor." *Brown v. Felsen*, 442 U.S. 127 (1979). Mr. Keeler has been less than forthright about the nature of his indebtedness. Mr. Keeler reports on his Statement of Financial Affairs that his "federal tax appeal" is "pending" when, in fact, the United States Court of Appeals for the Tenth Circuit issued it's opinion in favor of the government more than a year before the bankruptcy petition was filed. *Compare* Statement of Financial Affairs, ¶ 4 *with Keeler v. Commissioner*, 243 F.3d 1212 (10th Cir. 2001).

Additionally and more importantly, Mr. Keeler has not been entirely candid about his assets. His bankruptcy schedules and Statement of Financial Affairs filed on September 16, 2002 did not mention his interest in a partnership that owns an office park, North Coast Business Park Associated, Ltd. *See* Schedules B and C, and Statement of Financial Affairs. After the government noted that Mr. Keeler had a previously undisclosed ownership interest in North Coast Business Park, Mr. Keeler tardily disclosed that interest to the Court. *See United States' Brief in Support of United States' Motion to Dismiss*, pp. 11-12 (Doc. No. 18 filed December 23, 2002); *see also Amendment to Schedules*, (Doc. No. 36, filed February 5, 2003) (disclosing North Coast Business Park with a value of $0.00). A debtor must disclose all of his assets, even those he believes to be worthless. *See Calder*, supra at 955 (affirming denial of discharge under 11 U.S.C. § 727(a)(4) for debtor's failure to disclose assets that he claimed were worthless).

Mr. Keeler did not report the fair market value of his interest in the Hamilton Family Limited Partnership (hereafter "Hamilton") on his bankruptcy schedules; he listed the market value of his interest in the Hamilton as $0.00. *See* Schedule B. Mr. Keeler previously reported on financial statements submitted to the IRS that his interest in Hamilton had a fair market value

of $309,894.00. *See* Form 433-A, Collection Information Statement for Individuals, p. 3. Mr. Keeler asserted that his interest in Hamilton was worth $0.00 because he "cannot withdraw funds." *See* Schedule B. While Mr. Keeler may not be able to withdraw funds from Hamilton, he could sell his interest in the partnership. Article 10.2 of the Agreement of Limited Partnership for the Hamilton Family Limited Partnership specifically provides that "any limited partner may transfer his Units to a third party provided such transfer is done in accordance with the provisions of this Article 10 and does not violate the provisions of any applicable federal or state securities law." *See* Agreement of Limited Partnership, dated December 23, 1992, p. 13. Additionally, Article 10.5 provides that, in the event of the bankruptcy of a limited partner, the bankruptcy estate "shall have the rights of an Assignee only unless and until the other requirements set forth in this Article are satisfied." *Id.* at p. 14. Accordingly, if Mr. Keeler's interest in Hamilton can be sold, his representations that it is worthless are untrue.

CONCLUSION

In addition to the simple unfairness of permitting Mr. Keeler to employ the protections of Chapter 7 in this case in order to walk away from his outstanding federal tax liabilities for 1981, 1982, and 1983, the majority of the elements of bad faith, as demonstrated above, are present in this case. "Use of the Bankruptcy Code by persons of extraordinarily high income and persons attended by all of the accouterments of wealth are an abuse to the privileges and opportunities afforded under the Bankruptcy Code." *In re Tanenbaum*, 210 B.R. 182, 186 (Bankr. D. Colo. 1997). Mr. Keeler is attempting to overutilize the protections of Chapter 7 in an unconscionable manner. Thus Mr. Keeler's Chapter 7 petition was filed in bad faith and "cause" exists for dismissal of the petition pursuant to 11 U.S.C. § 707(a).

For the reasons stated above, Mr. Keeler's Chapter 7 bankruptcy case should be dismissed pursuant to 11 U.S.C. § 707(a) because it was not filed in good faith.

Respectfully submitted this 11th day of April, 2003.

ROBERT S. WATKINS
Chief, Civil Trial Section
Western Region, Tax Division
United States Department of Justice

MATTHEW H. MEAD
United States Attorney

CAROL A. STATKUS
Assistant United States Attorney
District of Wyoming
P.O. Box 668
Cheyenne, WY 82003-0668
Phone: (307) 772-2124

for AUGUST A. IMHOLTZ III
Trial Attorney, Tax Division
Civil Trial Section, Western Region
U.S. Department of Justice
P.O. Box 683, Ben Franklin Station
Washington, DC 20044-0683
Phone: (202) 307-2550

CERTIFICATE OF SERVICE

IT IS HEREBY CERTIFIED that service of the foregoing UNITED STATES' TRIAL BRIEF IN SUPPORT OF UNITED STATES' MOTION TO DISMISS has been made this 11th day of April, 2003, by placing copies thereof in the United States Mail, first class postage prepaid, addressed to the following:

Georg Jensen, Esq.
1613 Evans Avenue
Cheyenne, WY 82001

Gary A. Barney, Esq.
Chapter 7 Trustee
267 Main Street
Lander, WY 82520

Frank B. Watkins, Esq.
Roberts & Watkins, P.C.
P.O. Box 1811
Riverton, WY 82501

United States Attorney's Office