

SO ORDERED.

SIGNED this 29th day of December, 2022.




LENA MANSORI JAMES
UNITED STATES BANKRUPTCY JUDGE

**UNITED STATES BANKRUPTCY COURT
FOR THE MIDDLE DISTRICT OF NORTH CAROLINA
DURHAM DIVISION**

In re:)	
)	
East Coast Diesel, LLC,)	Case No. 22-80197
)	
Debtor.)	Chapter 11
_____)	

ORDER
GRANTING BA'S MOTION TO DISMISS

THIS MATTER came before the Court on the Motion to Dismiss Case or, in the Alternative, Motion to Convert Case to Chapter 7 (Docket No. 112, the "Motion") filed by the Bankruptcy Administrator on December 15, 2022. The BA seeks dismissal of this case for cause under 11 U.S.C. § 1112(b)(1) on several grounds, including gross mismanagement of the estate and substantial and continuing loss to and diminution of the estate without likelihood of rehabilitation. Alternatively, the BA requests that the case be converted to chapter 7 for cause. Creditor North State

Bank filed a Joinder in the BA's Motion on December 19, 2022 (Docket No. 129). The Debtor did not timely file a written objection to the Motion.

The Court held a hearing on the matter on December 21, 2022, at which Robert E. Price, Jr., appeared on behalf of the United States Bankruptcy Administrator, James White appeared in his capacity as Subchapter V Trustee, Philip Sasser appeared for the Debtor, and Lisa Sumner appeared for North State Bank. Robert Michael was present and testified as the designated representative for the Debtor. For the reasons set forth below, the Court finds that cause exists under § 1112(b) to dismiss or convert this case, and dismissal is in the best interests of creditors and the estate.

The BA seeks dismissal of this case or conversion to chapter 7 for “cause” under 11 U.S.C. § 1112(b)(1). Subject to limited exceptions, § 1112(b)(1) provides that “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 appointment of a chapter 11 trustee is in the best interests of creditors and the estate. Section 1112(b)(4) provides a non-exclusive list of circumstances constituting cause, but the applicability of each factor depends on where the debtor is in the bankruptcy reorganization process. *In re Paterno*, 511 B.R. 62, 66 (Bankr. M.D.N.C. 2014). The Court has discretion when conducting the fact-specific inquiry of the debtor's post-petition circumstances to determine whether cause exists. *Id.* at 66; *see In re Creekside Senior Apartments, L.P.*, 489 B.R. 51, 60 (6th Cir. BAP 2013).

I. Cause Exists to Dismiss or Convert the Case

The BA asserts that cause exists to dismiss or convert the case on several of the grounds listed in § 1112(b)(4). The Debtor does not dispute that cause exists but did not specify at the hearing whether it concurred with the BA's grounds under (b)(4). Nevertheless, the Court finds that the record in this case and the BA's uncontested allegations show that cause exists under each of the asserted bases as follows:

1. Continuing and substantial loss to and diminution of the estate and absence of reasonable likelihood of rehabilitation.
 - a. Since the petition date, the Debtor has not operated at a break-even level as it has failed to pay all current and required expenses, accumulating post-petition debt.
 - b. The Debtor had \$2,487 cash on hand as of December 14, 2022, yet the payroll on December 16 was approximately \$16,000. This amount was authorized in the Debtor's Fourth Interim Order Authorizing Use of Cash Collateral (Docket No. 108). It is unclear whether the Debtor paid all employees their earned wages on December 16.
 - c. Since the petition date, the Debtor's actual revenue has consistently been less than its projected revenue. From November 17 to December 14, the Debtor spent more than it received. These sustained losses show there is no reasonable likelihood of rehabilitation.
2. Gross mismanagement of the estate.

- a. The Debtor has repeatedly and substantially overestimated its revenue, hampering proper budgeting. It does not appear that the Debtor's management is able to properly identify and categorize the Debtor's expenses, again, hampering proper budgeting.
 - b. The Debtor failed to timely make the adequate protection payments to NFS Leasing under the Consent Order entered November 22, 2022 (Docket No. 87) despite testimony that the two trucks under NFS Leasing's control are necessary to a successful reorganization.
 - c. The Debtor's management has identified many errors in reports but has failed to fix the problems, such as proper tracking of revenue, accounts receivable, and tax obligations.
 - d. The Debtor has experienced persistent pre- and post-petition personnel turnover in financial and accounting areas of the Debtor's business.
3. Failure to comply with Orders of the Court.
- a. The Debtor failed to comply with interim cash collateral orders by failing to segregate the vast majority of payroll withholding taxes.
 - b. The Debtor failed to comply with the Interim Utilities Order (Docket No. 34) by failing to make adequate assurance payments in the amounts required by that Order.
 - c. The Debtor failed to comply with the Order Extending Deadline to File Monthly Operating Report (Docket No. 94), by filing its Monthly Operating Report late. (Docket No. 106).

4. Unexcused failure to comply with reporting requirements.
 - a. The Debtor filed its first Monthly Operating Report late despite an extended deadline.
 - b. The Monthly Operating Report had 80 pages of pre-petition bank information which appears to be wholly irrelevant.
 - c. The Debtor failed to file the Related Entities Report required under Bankruptcy Rule 2015.3.
 - d. The Debtor did not offer any excuse for these reporting failures.
5. Failure to timely provide information requested by the BA and Trustee.
 - a. The Debtor failed to respond to many of the Trustee's requests for information as part of his investigation into the Debtor's finances and budgetary controls. *See* Order Expanding Subchapter V Trustee Duties (Docket No. 76). This failure prevented the Trustee from completing a meaningful investigation and report.
 - b. The Debtor also failed to fully respond to the BA's reasonable requests for information.

II. Dismissal is in the Best Interests of Creditors and the Estate

Having determined that cause exists, the Court must decide whether dismissal or conversion is in the best interest of creditors and the estate. 11 U.S.C. § 1112(b)(1); *In re Aronowitz Del. 2 Fam. Ltd. P'ship*, No. 21-50464, 2021 WL 4823520, at *7 (Bankr. M.D.N.C. Oct. 15, 2021). At the hearing, the BA announced that an agreement had been reached with the Debtor to dismiss the case on the

condition that the Debtor would pay the Trustee's fees and certain outstanding taxes accrued post-petition. North State Bank and the Trustee approved this agreement. While the Court should consider the expressed preferences of creditors as to whether to convert or dismiss, the Court must ultimately uphold its independent duty to select the option that is, in fact, in the best interests of creditors and the estate. *See id.* (citing *Lakefront Investors LLC v. Clarkson*, 484 B.R. 72, 82 (D. Md. 2012)). "The Court has broad discretion in making this determination." *Id.*

Courts have considered various factors to determine whether dismissal or conversion is in the best interests of creditors and the estate, such as:

- (1) whether some creditors received preferential payments, and whether equality of distribution would be better served by conversion rather than dismissal;
- (2) whether there would be a loss of rights granted in the case if it were dismissed rather than converted;
- (3) whether the debtor would simply file a further case upon dismissal;
- (4) the ability of the trustee in a chapter 7 case to reach assets for the benefit of the creditors;
- (5) in assessing the interests of the estate, whether conversion or dismissal would maximize the estate's value as an economic enterprise;
- (6) whether any remaining issues would be better resolved outside the bankruptcy forum;
- (7) whether the estate consists of a "single asset;"
- (8) whether the debtor had engaged in misconduct and whether creditors are in need of a chapter 7 case to protect their interests;
- (9) whether a plan had been confirmed and whether any property remains in the estate to be administered; and
- (10) whether the appointment of a trustee is desirable to supervise the estate and address possible environmental and safety concerns.

Lakefront Investors, 484 B.R. at 83; see also *Andover Covered Bridge, LLC v. Harrington*, 553 B.R. 162, 177 (B.A.P. 1st Cir. 2016). The Court should weigh each option with respect to its impact on creditors and the estate; dismissal is appropriate where conversion to chapter 7 and the resulting liquidation would produce little to no benefit to creditors and the estate. See *In re Aronowitz*, 2021 WL 4823520, at *7 (citing *In re Superior Siding & Window, Inc.*, 14 F.3d 240, 243 (4th Cir. 1994), and *In re Washington*, No. 09-08248-DD, 2010 WL 5128955, at *4 (Bankr. D.S.C. Sept. 27, 2010)).

Here, the BA presented evidence that a chapter 7 trustee would have little, if any, ability to reach assets for the benefit of creditors. The Debtor's assets are significantly over-encumbered, and the Trustee credibly testified that there would be little value in pursuing possible avoidable transfers due to the significant administrative cost of such actions relative to the amounts, as well as the overall difficulty in tracking transfers given the Debtor's poor recordkeeping. The Court further considers that a state court will be better equipped to handle the likely foreclosure actions, and no non-insider creditor appeared at the hearing to contest the BA's request for dismissal, and North State, the Trustee, and the Debtor support dismissal. This case is relatively new, and the Debtor has not even proposed a plan of reorganization. Lastly, while the Trustee revealed there are some environmental concerns with the real property, the property is inspected annually and does not present any immediate safety concerns. Commissioning a chapter 7

trustee to resolve these environmental issues will incur more administrative costs that will likely not be repaid. For these reasons, the case will be dismissed.

III. Dismissal is Ordered Without Additional Terms or Conditions

As previously referenced, the BA and the Debtor announced an agreement whereby the case would be dismissed with the condition that the Debtor pay (1) the Trustee's compensation of \$10,000 for services rendered and (2) outstanding income-based taxes accrued post-petition, such as payroll withholding taxes (employer and employee portions).

Dismissal of a chapter 11 case with additional terms and conditions constitutes a "structured dismissal," which may only be approved if, at a minimum, any required distributions are in accordance with the priority scheme set forth in §507 of the Bankruptcy Code. *See Czyzewski v. Jevic Holding Corp.*, 137 S. Ct. 973, 978 (2017) ("[A] distribution scheme ordered in connection with the dismissal of a Chapter 11 case cannot, without the consent of affected parties, deviate from the basic priority rules . . ."); *In re Bluefield Women's Ctr., P.C.*, No. 1:18-bk-10063, 2021 WL 1245949, *4–5 (Bankr. S.D. W. Va. Mar. 30, 2021) (disapproving a structured settlement where the Debtor proposed to pay a general unsecured creditor but not a priority tax claim whose validity was not disputed and the taxing authority had not consented to the proposal).

Here, the agreement between the Debtor and the BA cannot be approved. First, its terms were simply announced in Court without notice to parties in interest or an opportunity to respond. Second, the agreement does not require payment of

wage claims, yet it is not clear from the record that no outstanding wage claims exist. These wage claims would be higher in priority than the taxes proposed to be paid. *See* 11 U.S.C. § 507(a). When asked whether any post-petition wages remained unpaid, Mr. Michael responded “I resolved those.” But the record in this case reflects that Mr. Michael does not have a complete understanding of either the components or mechanics of the Debtor’s payroll. For example, at the December 14 hearing, he explained that employees’ withholding taxes were not placed in a segregated account because the amount of those taxes was unknown. The Court cannot rely upon Mr. Michael’s testimony to make a finding that all post-petition wage claims have been paid, and according to the Trustee, the Debtor’s QuickBooks account is in disarray, with seemingly random transactions recorded.

Even at the hearing the BA and the Debtor were not in agreement on the amount of taxes to be paid, casting doubt on whether the proposed tax payment would really cure post-petition priority taxes owed. While the BA estimated that taxes in the amount of \$20,350.19 would be paid under the agreement, the Debtor estimated that the amount was about \$14,687.00, over 25% less. Mr. Michael testified that the Debtor’s in-house accountant arrived at the lower figure by reconciling its books — presumably after reporting its estimated tax obligations to the BA — and he believed this number was more accurate. However, the BA and Trustee’s credible allegations that the Debtor’s books and recordkeeping do not meaningfully reflect its finances, including wages earned by employees, lead the Court to conclude it is likely neither party’s tax figure is correct. The Court shares

the BA's concerns about unpaid payroll taxes accrued during the short pendency of this case, but taxing authorities will retain the full range of remedies to recover these amounts outside of bankruptcy. Accordingly, the Court will not attach the proposed conditions on the Debtor's dismissal.

Lastly, the Court notes that dismissal of this case is dispositive of other pending motions and, therefore, the BA's Motion to Remove Debtor from Possession (Docket No. 115), the Debtor's Motion for Authority to Use Cash Collateral (Docket No. 9), and the Debtor's Motion to Extend Time to File Subchapter V Plan (Docket No. 103) are moot.

Therefore, IT IS HEREBY ORDERED that the Trustee's Motion is GRANTED and this case is DISMISSED.

IT IS FURTHER ORDERED that the BA's Motion to Remove Debtor from Possession, the Debtor's Motion for Authority to Use Cash Collateral, and the Debtor's Motion to Extend Time to File Subchapter V Plan are DENIED as moot.

END OF DOCUMENT

PARTIES TO BE SERVED

East Coast Diesel, LLC

Ch.11 - #22-80197

Philip Sasser
via cm/ecf

Lisa P. Sumner
via cm/ecf

James C. White, Trustee
via cm/ecf

William P. Miller, BA
via cm/ecf

East Coast Diesel, LLC
2209 Dominion Street
Durham, NC 2770

And any/all additional Creditors and Parties of Record as of the Date of the Order Shall be
Served by the Bankruptcy Noticing Center