Dated: November 15, 2022
The following is ORDERED:

Jennie D. Latta
Jennie D. Latta
UNITED STATES BANKRUPTCY JUDGE

UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF TENNESSEE
WESTERN DIVISION

In re
ISLAND INDUSTRIES, INC. — Case No. 22-20380-L
Debtor. — Chapter 11, Subchapter V

ORDER GRANTING MOTION TO DISMISS

BEFORE THE COURT are *Sigma Corporation's Motion for an Order Dismissing the Debtor's Chapter 11 Case*, filed July 20, 2022 [ECF No. 161]; *Joinder to Sigma Corporation's Motion for an Order Dismissing the Debtor's Chapter 11 Case*, filed by ASC Engineered Solutions, LLC, on August 5, 2022 [ECF No. 172]; *Response in Opposition to Sigma Corporation's Motion for an Order Dismissing the Debtor's Chapter 11 Case*, filed by Island Industries, Inc., on October 7, 2022 [ECF No. 190]; and *Reply of Sigma Corporation to Debtor's Opposition to Motion to Dismiss the Debtor's Chapter 11 Case*, filed October 14, 2022 [ECF No. 194]. Sigma Corporation, LLC, and ASC Engineered Solutions, LLC, assert that the bankruptcy

petition of Island Industries, Inc., was not filed in good faith but rather as a litigation tactic and therefore should be dismissed.

The Court conducted an evidentiary hearing on October 27, 2022, and has carefully reviewed the pleadings, exhibits, testimony, and arguments presented by the parties.

JURISDICTION, AUHTORITY, AND VENUE

Jurisdiction over a contested matter arising under the Bankruptcy Code lies with the district court. 28 U.S.C. § 1334(b). Pursuant to authority granted to the district courts at 28 U.S.C. § 157(a), the district court for the Western District of Tennessee has referred to the bankruptcy judges of this district all cases arising under title 11 and all proceedings arising under title 11 or arising in or related to a case under title 11. *In re Jurisdiction and Proceedings Under the Bankruptcy Amendments Act of 1984*, Misc. No. 81-30 (W.D. Tenn. July 10, 1984). A motion to dismiss a Chapter 11 bankruptcy case arises under the Bankruptcy Code and in a bankruptcy case, and thus is a core proceeding. *See* 11 U.S.C. § 1112 and 28 U.S.C. § 157(b)(2)(A). Venue of this contested matter is proper to the Western District of Tennessee because this matter arises in a bankruptcy case pending in this district. *See* 28 U.S.C. § 1409(a).

FINDINGS OF FACT

In advance of the hearing, the parties submitted a *Stipulation of Undisputed Facts* [ECF No. 202]. Other facts were introduced through the exhibits agreed to by the parties and the testimony of the witnesses, R. Glenn Sanders and David Barnett.

1. R. Glenn Sanders is the approximately 90% owner, president, and chief executive officer of Island Industries, Inc. ("Island"). Mr. Sanders has the sole authority to direct Island.

2. David Barnett is the approximately 10% owner and serves as secretary, treasurer, and chief financial officer of Island. He has worked for Island for 35 years.

3. Mark Woehrel is an employee of Island who testified as a witness in the False Claims Action.[1]

4. On July 30, 2021, a jury awarded Anvil International, LLC (now merged with Smith Cooper International, Inc. and renamed ASC Engineered Solutions, LLC ("ASC")) a judgment in the Trade Secrets Action against Island in the amount of $1,500,000. Mr. Sanders testified that he did not understand at that time that the entry of the ASC judgment on July 30, 2021, meant that Island was indebted to ASC in that amount. He claimed that he did not ask Island's attorney what the entry of the judgment meant. He also claimed that he had devoted the majority of his time for the previous six years to the False Claims Litigation. In light of his devotion to litigation for this extensive period of time, the Court finds Mr. Sanders' testimony that he did not understand the result of the entry of the judgment against Island not credible.

5. On August 2, 2021, Island received a payment of $2,144,773.26 in connection with a settlement it had reached in respect of the False Claims Action. Mr. Sanders was asked what his thoughts were when three days after the entry of the judgment against it, Island received $2,144,773.26 in settlement proceeds in connection with the False Claims Litigation. Mr. Sanders claimed that he did not consult with his counsel before he began distributing approximately $1 million of the proceeds to or for the benefit of insiders in the form of bonuses, loan payments, repairs, and the purchase of a luxury vehicle for his own use.

6. On August 6, 2021, Island paid Mr. Sanders a $200,000 bonus and Mr. Barnett a $100,000 bonus. Mr. Sanders testified that he couldn't recall why he picked August 6 as the date to provide these bonuses, but he acknowledged that it was related to receipt of the settlement proceeds. He thought it was reasonable to compensate himself for the work he had done in

[1] Capitalized terms not defined herein shall have the meanings assigned to them in Sigma's Motion to Dismiss.

connection with the litigation, and thought it was appropriate to compensate Mr. Barnett for the work he had done to keep Island's business running while Mr. Sanders was devoting his time to the litigation.

7. On August 15, 2021, Island paid Mr. Woehrel an after-tax bonus of $55,895.17. Mr. Woehrel had also devoted time to the False Claims Action and had provided testimony in connection with it.

8. On September 10, 2021, ASC filed its response to Island's motion to alter or amend the judgment. In addition to disputing the substantive basis of its opposition, ASC stated:

> Anvil also is concerned that Island's baseless Motion only serves to create delay in order to prevent Anvil from taking steps to increase the likelihood that Anvil is able to satisfy the Judgment. Currently, Anvil's ability to recover the Judgment is at risk because Anvil cannot move to execute the Judgment during the stay, while at the same time Anvil is not protected by an appellate bond that would be in place if Island had filed a notice of appeal. Accordingly, Anvil respectfully requests that the Court expeditiously deny the Motion in order to minimize the ongoing prejudice to Anvil.

Sigma Tr. Ex. 9, p. 3. Mr. Sanders acknowledged that he read this pleading about a week after it was filed and that he became aware of ASC's concern about not being paid even though it had been aware of Island's receipt of a portion of its share of the award in the False Claims Act.

9. On September 15, 2021, Island paid Mr. Barnett an additional $50,000 bonus.

10. On September 17, 2021, one week after ASC's response to Island's motion to alter or amend was filed, John Horne, attorney for Island, discussed obtaining bankruptcy advice with Mr. Sanders and Mr. Woehrel. Sigma Tr. Ex. 38.

11. On the same day, September 17, 2021, Island wrote a check to First Horizon Bank in the amount of $336,712.77. This payment was made to pay off a debt of Properties, LLC. Properties, LLC is 100% owned by Mr. Sanders. Mr. Sanders and Mr. Barnett both testified that

it was common for loans to be made back and forth between Island and Properties, but neither of them satisfactorily explained why this loan was paid on this date. Mr. Sanders suggested that by loaning funds to Properties to pay the note, Properties could avoid paying additional interest to First Horizon and Island could take advantage of receiving interest income from Properties. The record is clear, however, that no interest was accrued or paid to Island until after the bankruptcy petition was filed. The Court finds Mr. Sanders' explanation not credible.

12. On September 29, 2021, Sigma Corporation's ("Sigma") counsel sent a letter to Island's counsel, informing him that Sigma intended to file a lawsuit against Island for theft of trade secrets. Sigma Tr. Ex. 10. The body of the letter is some two and one-half pages of single-spaced type describing the conduct of Mr. Sanders that gave rise to Sigma's intention to file a claim. It described how Sigma had become aware of Mr. Sanders' conduct through a former Sigma employee, Tom Paquette. The letter stated Sigma's intention to file suit in federal court in the District of New Jersey for violation of the Federal Defend Trade Secrets Act, 18 U.S.C. § 1836, *et seq.*, and the New Jersey Trade Secrets Act, N.J. Stat. § 56:15-1, *et seq.* The letter makes demand for $11 million in lieu of litigation and asked for a response by 1:00 PM, PST on October 4, 2021, the eve of the trial in the False Claims Action.

13. From October 5 through 7, 2021, a three-day jury trial was held in the False Claims Action. On October 7, 2021, a jury found Sigma liable for violating the False Claims Act. Island Tr. Ex. 7.

14. Notwithstanding the $1,500,000 verdict obtained by ASC against Island on the basis of theft of trade secrets in connection with the False Claims Action, Mr. Sanders testified that he did not take Sigma's demand seriously. He said that he felt the letter was an "intimidation tactic." Mr. Sanders further testified that when he read the transcript of the trial of the False

Claims Action, nothing caused him to think that Sigma was going to pursue its claim for theft of trade secrets. After Island's bankruptcy petition was filed, Sigma filed a complaint against Island for violation of the Federal Defend Trade Secrets Act, the New Jersey Trade Secrets Act, and the Tennessee Uniform Trade Secrets Act, Tenn. Code Ann. § 47-25-1701, *et seq.*, seeking monetary damages, exemplary damages, attorneys' fees and costs, and injunctive relief. Adv. Proc. No. 22-00050. Reference of this adversary proceeding was withdrawn to the district court by order entered October 4, 2022. *Sigma Corporation v. Island Industries, Inc. and R. Glenn Sanders*, 22:2 cv-02436-JPM-cgc.

15. On October 14, 2021, Island paid Mr. Woehrel an additional after-tax bonus of $38,875.45.

16. On October 22, 2021, Island paid Mr. Barnett an additional $25,000 bonus.

17. On December 21, 2021, Mr. Horne had further discussions with Mr. Sanders and Mr. Woehrel about the judgment. Sigma Tr. Ex. 38.

18. On December 23, 2021, Island paid Mr. Barnett an additional $4,100 bonus.

19. On December 28, 2021, Island purchased a Genesis G90 vehicle for Mr. Sanders' personal use for $80,514. Mr. Sanders testified that he had previously had a company car that stopped working in July 2021. He said that when that car stopped running, he did not have a need for a company car. Nevertheless, he spoke with a dealer about a car he would like to purchase. He said that the dealer contacted him when the car he wanted became available, and he caused Island to purchase it for his use. Mr. Sanders did not explain why he needed a company car when he felt that he did not need one earlier that year, and he gave no explanation for his choice of the Genesis G90, a luxury automobile. The Debtor's Schedule A/B discloses three

vehicles owned by the company, a 1977 Camaro, valued at $2,000, a 2014 Ford Explorer, valued at $15,000, and the 2022 Genesis G90, valued at $75,000. Sigma, Tr. Ex. 17, p. 6.

20. In January 2022, at the suggestion of counsel, Mr. Sanders directed Mr. Barnett to prepare a note to memorialize the loan from Island to Properties. Mr. Barnett testified that he found a form on the internet in order to prepare the "Standard Promissory Note" that was backdated to September 17, 2021, and was signed by Mr. Barnett as "Lender" and Mr. Sanders as "Borrower." Sigma Tr. Ex. 16. The Note provides for payment of interest on the principal sum of $336,712.77 at the rate of 5.35% per annum in monthly installments of $3,618.46. The parties agree that no payments were made on this Note until after the bankruptcy petition was filed.

21. On January 20, 2022, Mr. Horne sent an email to Mr. Sanders with a copy to Mr. Michael Coury, who became bankruptcy counsel to Island, concerning "bankruptcy advice." Sigma Tr. Ex. 38.

22. Settlement discussions by and among Mr. Sanders and representatives of ASC occurred on January 21, 24, 25, 30, and 31, 2022. Bankruptcy was discussed between Mr. Horne and Mr. Sanders in the midst of these discussion on January 31, 2022. Sigma Tr. Ex. 38.

23. On January 31, 2022, the same day that Mr. Sanders was discussing bankruptcy with Mr. Horne, Island paid $99,734 for repairs on Island's headquarters located at 1083 North Hollywood Street, Memphis, Tennessee, property that is owned by Mr. Sanders. Mr. Sanders and Mr. Barnett testified that part of the parking lot at the Hollywood property had become impassable. Mr. Sanders testified that Island had put off making repairs because it did not have the money to make them. He testified that Progressive Construction was hired to make repairs in August 2021, presumably after Island received $2,144,773.26 as a result of the False Claims Action. Mr. Sanders

testified that Progressive completed the work in December and was paid when it finished the work. The accounts payable journal for Island reflects that $60,000 was invoiced by Progressive on September 1, 2021, with payment due October 1, 2021. Island Tr. Ex. 1. Other invoices from Progressive were not included in the trial exhibits. Nevertheless, on January 31, 2022, as Mr. Sanders was discussing bankruptcy with Island's attorney and just two days prior to the bankruptcy filing, the Debtor paid Progressive $99,734.

24. Also in January 2022, Mr. Sanders increased the rent Island paid him to lease its headquarters from $4,050 to $8,400 per month. There is no written lease between Mr. Sanders and Island with respect to Island's headquarters. Mr. Sanders testified that he became aware that he had not ever increased the rent as a result of the information requested by ASC and/or First Horizon Bank in connection with discussions regarding securing an appellate letter of credit. He said that he felt that it was appropriate to increase the rent as he had for other commercial properties that he owns.

25. Mr. Sanders was asked a number of questions about efforts to obtain an appellate bond in connection with the ASC judgment. He generally indicated that he left that to his attorneys. He did testify that he understood that there was some discussion about obtaining a letter of credit in lieu of a bond. He testified that First Horizon wanted substantial collateral to secure the letter of credit and that it asked for his personal financial information, too. Mr. Sanders indicated that negotiations with ASC continued through January but that he did not feel that Island could meet the payment terms requested in those discussions. The Court was left with the impression that notwithstanding Mr. Sanders' strong statements that he did not want to file a bankruptcy petition because he felt it was "immoral," he never seriously undertook steps to ensure that ASC would be paid its judgment in the event that Island's appeal failed. The Court also felt that Mr. Sanders did

not understand that it was his obligation to show to the Court that he was acting in good faith when he decided to file the bankruptcy petition for Island.

26. On February 2, 2022 (the "Petition Date"), Island filed a voluntary petition for relief under Subchapter V of Chapter 11 of the Bankruptcy Code.

27. Notwithstanding Sigma's letter of September 29, 2021, advising Island of Sigma's potential claim, Sigma was not listed as a creditor in Island's bankruptcy schedules.

28. On February 8, 2022, a judgment in favor of Island was entered against Sigma in the amount of $24,256,638.09.

29. On February 25, 2022, at the direction of Mr. Sanders, Mr. Barnett sent an email to Hal Hawkins of Ferrell Gas, a vendor of Island, which states:

> Paid --- invoice xxx today 74.18
> Check # xxxx
> If anything else is open, please end [sic] to me and we will pay immediately.
> Going forward, we have no problem paying any invoice, but if you need to get a check at delivery or have a credit card on file, I will be happy to supply.
> The Chapter 11 reorganization was at the instruction of our lawyers regarding a lawsuit in appeals. We expect to be in and out within 6 months.

Sigma Tr. Ex. 14. Mr. Barnett testified that Ferrell Gas is a critical vendor that refused to make deliveries unless it was paid. He acknowledged that the "lawsuit in appeals" refers to the ASC judgment. In order to reassure Ferrell Gas, he paid their prepetition account and offered cash terms for future deliveries.

30. On February 28, 2022, after the bankruptcy case was filed, the first payments were made by Properties under the Promissory Note.

31. On May 3, 2022, Island filed its proposed plan of reorganization a true and correct copy of which was admitted as Trial Ex. 18. It categorizes the claim of ASC as a Class 1 Claim

and all other unsecured claims as Class 2 claims. It proposes to pay all Class 1 and Class 2 claims a pro rata share of $500,000 on the effective date and a pro rata share of any Sigma recovery upon receipt up to the full amount of the claims. It further proposes to pay a pro rata share of $120,000 of the Vandewater Settlement if those funds are received before any Sigma recovery. No provision is made for the claim of Sigma. Counsel for the Debtor acknowledged at the hearing on the Motion to Dismiss that the plan will have to be amended.

32. Sigma did not enter an appearance in this case until May 6, 2022. It filed its proof of claim in an unliquidated amount on May 9, 2022 [Claim 5-3], and filed its complaint in the related adversary proceeding the same day [Adv. Proc. No. 22-00050].

33. On September 27, 2022, Sigma filed a Proportionality Statement in the Trade Secrets Action, a true and correct copy of which was admitted as Island, Tr. Ex.6.

DISCUSSION

Sigma and ASC ask that the bankruptcy case be dismissed pursuant to 11 U.S.C. § 1112(b)(1), which permits the Court to convert or dismiss a Chapter 11 bankruptcy case for cause. Although not specifically listed among the examples of "cause" for converting or dismissing a Chapter 11 case, the courts of appeal who have considered the question agree that lack of good faith in filing the bankruptcy petition may provide cause for dismissing a case. *See Trident Assocs Ltd. P'ship v. Metropolitan Life Ins. Co. (In re Trident Associates Ltd. P'ship)*, 52 F.3d 127,130 (6th Cir. 1995); *Laguna Assocs. Ltd. P'ship v. Aetna Cas. & Surety Co., (In re Laguna Assocs. Ltd. P'ship)*, 30 F.3d 734,737-38 (6th Cir. 1992); *see also In re Integrated Telecom Express, Inc.*, 384 F.3d 108, 118 (3d Cir. 2004); *In re SGL Carbon Corp.*, 200 F.3d 154, 162 (3rd Cir. 1999); *Humble Place Jt. Venture v. Fory (In re Humble Place Jt. Venture)*, 936 F.2d 814, 816–17 (5th Cir.1991); *Marsch v. Marsch (In re Marsch)*, 36 F.3d 825, 828 (9th Cir 1994); *Phoenix Piccadilly,*

Ltd. v. Life Ins. Co. (In re Phoenix Piccadilly, Ltd.), 849 F.2d 1393, 1394 (11th Cir. 1988). The Sixth Circuit has similarly determined that lack of good faith in filing may constitute "cause" for dismissing a petition filed under Chapter 7 of the Bankruptcy Code. *See Industrial Ins. Servs., Inc. v Zick (In re Zick)*, 931 F.2d 1124, 1126-1127 (6th Cir. 1991). In the context of its discussion, the court quoted with approval decisions indicating that good faith is an implied jurisdictional requirement underlying every filing. *Id.*, citing *In re Brown*, 88 B.R. 280 (Bankr. D. Hawaii 1988) (good faith is an implicit jurisdictional requirement and requires inquiry into any abuse of the provisions, the purpose, [or] the spirit of the bankruptcy law and into whether the debtor requires the liberal protection of the Code); *In re Kragness*, 63 B.R. 459, 465 (Bankr.D.Or.1986) ("That concept [good faith] is not open to serious debate."); *In re Khan*, 35 B.R. 718, 719 (W.D.Ky.) (Chapter 7 does not in express words require good faith, but good faith is an implicit jurisdictional requirement), remanded for clarification, 751 F.2d 162 (6th Cir.1984). Once the bankruptcy petitioner's good faith in filing the bankruptcy petition is called into question, the petitioner bears the burden of proving its good faith by a preponderance of the evidence. *See In re Integrated Telecom*, 384 F.3d at 118; *In re Bingham*, 68 B.R. 933, 935 (Bankr.M.D.Pa.1987), cited with approval by *In re Zick*, 931 F.2d at 1127.

Whether a petition has been filed in good faith is determined based upon a totality of the circumstances. The Sixth Circuit Court of Appeals has found the following factors meaningful to this inquiry:

> (1) the debtor has one asset;
>
> (2) the pre-petition conduct of the debtor has been improper;
>
> (3) there are only a few unsecured creditors;
>
> (4) the debtor's property has been posted for foreclosure, and the debtor has been unsuccessful in defending against the foreclosure in state court;

> (5) the debtor and one creditor have proceeded to a standstill in state court litigation, and the debtor has lost or has been required to post a bond which it cannot afford;
>
> (6) the filing of the petition effectively allows the debtor to evade court orders;
>
> (7) the debtor has no ongoing business or employees; and
>
> (8) the lack of possibility of reorganization.

In re Trident Assocs., 52 F.3d at 131, quoting *In re Laguna Assocs.*, 30 F.3d at 738. Essentially, the courts ask whether there was a valid reorganizational purpose or whether instead the debtor sought to gain some tactical advantage from the filing. *See, e.g., In re Integrated Telecom Express, Inc.*, 384 F.3d 108, 121 (3d Cir. 2004). "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 SGL Carbon Corp.*, 200 F.3d 154, 166 (3d Cir. 1999). The Third Circuit has focused on the underlying purpose of the Bankruptcy Code – to preserve value:

> To be filed in good faith, a petition must do more than merely invoke some distributional mechanism in the Bankruptcy Code. It must seek to create or preserve some value that would otherwise be lost–not merely distributed to a different stakeholder–outside of bankruptcy.

In re Integrated Telecom Express, Inc., 384 F.3d at 129.

To support its contention that the bankruptcy petition was filed in good faith, the Debtor relied heavily upon the testimony of its president and 90% shareholder, R. Glenn Sanders. Mr. Sanders indicated that the decision to file the bankruptcy petition was his. When asked why the decision to file was made, Mr. Sanders said, "Stuff was going on. We thought $7 million would be coming in. We never thought Anvil wouldn't be paid. In December we received a paper that said that Anvil could seize all the money in our accounts without notice. Then we would be out of business." Yet, at the time of filing, at least one month after receiving the "paper" in December, when the Debtor filed its bankruptcy petition on February 2, 2022, it had cash accounts in the

amount of $930,748.71; investments of $255,590.00, accounts receivable of $214,311.03; and had achieved a settlement of the Vandewater claim in the amount of $1,345,000. Sigma Tr. Ex. 17, pp. 3-4, 7. At that time, the Debtor's only significant unpaid debt was the judgment to ASC in the amount of $1,500,000.

Sigma argues that the totality of the circumstances demonstrates that Island filed its bankruptcy petition in bad faith and without a valid bankruptcy purpose. It focuses on five arguments: (1) Island engaged in improper prepetition conduct; (2) Island has few unsecured creditors; (3) Island is not in financial distress; (4) Island's petition was not filed with a valid reorganizational purpose; and (5) Island's petition was filed to avoid posting an appellate bond in its litigation with ASC. The Court will consider each of these arguments in turn.

A. Island Engaged in Improper Prepetition Conduct

Prior to the filing of its petition, Mr. Sanders caused Island to make numerous transfers to or for the benefit of insiders. All of these transfers were made after judgment in the amount of $1,500,000 was rendered against Island in favor of ASC, and after Island received more than enough to pay or bond the judgment in full. These transfers consisted in the payment of bonuses to the shareholders of the Debtor in the aggregate amount of $375,000.[2] It purchased a new vehicle for the use of Mr. Sanders at a cost of approximately $80,000. It used $336,712.77 to pay off a loan owed by Properties, a limited liability company solely owned by Mr. Sanders. It paid almost $100,000 to repair the Island facility, property owned by Mr. Sanders. These transfers total $891,712.77. In addition to these transfers, Mr. Sanders caused Island to make bonus payments to an employee who had aided him in the False Claims Action in the aggregate net amount of

[2] Mr. Barnett also received a Christmas bonus in the amount of $4,100, which appears to be in line with past practice.

$94,860.62.[3] It is not unreasonable to conclude that Mr. Sanders caused Island to use approximately $1 million in liquid assets that would otherwise have been available to pay or bond the ASC judgment for his own purposes.

This is significant because when he was asked why the settlement with ASC could not be concluded or why Island was unable to provide an appellate bond in connection with its appeal of the ASC judgment, Mr. Sanders could give no satisfactory explanation. At trial Mr. Sanders said that he resisted the suggestion to file the bankruptcy petition because he didn't think it was moral to do so. He acknowledged that Island didn't try to pay ASC or obtain a bond, nevertheless he insisted that the filing of the bankruptcy petition was in good faith because "without it we would go out of business."

After Mr. Sanders' testimony, the Court was left with the firm impression that he thought that he would be successful if he prevented the Court from getting a clear picture of his thought process in overcoming his moral repugnance to filing a bankruptcy petition. The opposite is true, of course. Faced with the Motion to Dismiss filed by Sigma and joined by ASC, undoubtedly the Debtor's largest creditors, it was Island's task to demonstrate to the Court that its petition was filed in good faith. It was incumbent upon Island to *show* the Court, not *tell* the Court that the petition was filed in good faith. Instead, Mr. Sanders often referred to advice given by counsel as justification for his decisions without testifying about the content of that advice. Island is within its rights to protect confidential communications, but the result in this civil action can be the drawing of the inference that Mr. Sanders' intention in filing the bankruptcy petition was in fact to hinder or delay Island's creditors. In other words, if the Court cannot easily determine the reasons for the decision to file the bankruptcy petition, especially in light of the substantial

[3] The gross amount does not appear in the record but the assets of the Debtor devoted to these bonuses obviously exceed this net amount.

transfers made to and for the benefit of insiders in the six months leading up to the filing of the petition and Mr. Sanders' apparent resistance to voluntarily returning those funds to the estate, it may reasonably conclude that the filing was not motivated by good faith.

B. Island Has Few Unsecured Creditors

In support of the Motion to Dismiss, Sigma points out that Island has no secured debt and few unsecured creditors holding small claims. Even though Island had been discussing a potential bankruptcy filing with its attorney at least five months prior to filing, it did not include its statements and schedules with its petition, and asked for, and received, additional time to file them. *See Order Granting Debtor's Motion for Extension of Time to Complete Filing*, February 22, 2022, ECF No. 18. When filed, the Debtor's Summary of Assets and Liabilities showed assets consisting of personal property valued at $3,939,328.51, and unsecured liabilities consisting of nonpriority unsecured claims in the amount of $1,680,515.31. These unsecured obligations consist of the disputed ASC judgment in the amount of $1,500,000, a debt to Mayer Brown, LLP, a law firm, in the amount of $157,500, which is covered by a retainer, and a debt to FM Approvals, LLC in the amount of $7,900, which has been paid. This leaves approximately $11,000 in nonpriority unsecured claims owed to eight creditors. ECF No. 19. Had the bankruptcy petition not been filed, these debts would have been paid in the ordinary course of business.

The Debtor responds by directing the Court to the claims register, which shows a claim filed by the Internal Revenue Service in the amount of $75,852.42 for estimated employment taxes for the first quarter of 2022; the claim of ASC for $1,508,648.99; the claim of Baker & Hostetler, LLP, a law firm for $15,309.39, secured by a retainer in the amount of $10,000; the claim of Dinsmore Shohl, another law firm, in the amount of $60,160.50; the claim of Sigma in an unliquidated amount; the claim of Mayer Brown in the fixed amount of $388,186.22, and an

unliquidated contingent amount related to representation of Island in the False Claims Action; and the claim of the Shelby County Trustee in the amount of $2,450.97 for personal property taxes due February 28, 2022. Island argues that Sigma should have included its own “massive, disputed claim” in its analysis but the question before the Court is whether Island filed its petition in good faith. Mr. Sanders insists that he had no idea that Sigma intended to file a claim against Island when he decided to cause Island to file its bankruptcy petition. The claim of Sigma could not have entered into his consideration. The other debts, including the attorney fees, but excluding the ASC judgment, would have been paid in the ordinary course and from anticipated litigation recoveries. They could not have entered into Mr. Sanders’ consideration when he decided to cause Island to file its bankruptcy petition. Therefore, the only claim that led to the filing of the petition was the ASC judgment, which was on appeal, but for which Island had failed or refused to provide an appellate bond or other security. This fact is indicative of Island’s lack of good faith. *See, e.g., Bricklayers and Trowel Trades Int’l Pension Fund v. Wasco*, 551 B.R. 319, 328-29 (M.D. Tenn. 2015) (“[A] Debtors’ only having a few unsecured creditors is a factor that can support a finding of bad faith,” quoting *In re Laguna Assocs*, 30 F.3d at 738).

C. Island Is Not in Financial Distress

Sigma and ASC argue that Island was not in financial distress when its petition was filed. Mr. Sanders testified that Island never experienced any difficulty in paying its vendors or employees. Its initial operating report shows an opening cash balance of $930,748.71. ECF No. 48. During the first month of its operation in bankruptcy, it enjoyed net cash flow of $94,237.01. *Id.* Its most recent operating report shows cash on hand at the end of September of $1,402,790.45. ECF No. 196. The Court concludes from this that the Debtor is operationally sound.

When asked the reason for the bankruptcy filing, Mr. Sanders pointed to the potential execution by ASC. Mr. Barnett also named the litigation with ASC as the reason for the filing. Neither of them satisfactorily explained, however, the inability of Island to obtain an appellate bond. There is no question that Island would have been able to post a cash bond in the amount of the ASC judgment from the settlement proceeds it received three days after the judgment was rendered. Mr. Sanders' reliance upon the advice of counsel cannot substitute for a clear explanation to the Court of the reasons for the bankruptcy filing. If Mr. Sanders did not fully understand what led to the filing, it was incumbent upon Island to produce a witness who did.

Island asks the Court to consider the potential impact on the Debtor should Sigma prevail in its adversary proceeding. ECF No. 190, p. 20. Mr. Sanders testified, however, that the potential for a Sigma claim did not enter into his thinking with respect to the need for filing the bankruptcy petition. As a result, the Court has focused solely on the facts known to the Debtor at the time of filing. These do not demonstrate financial distress but rather the desire to avoid the provision of an appellate bond.

D. Island Did Not File with A Valid Reorganizational Purpose

Sigma asserts that Island did not have a valid reorganizational purpose in filing its petition. In support of its position, it relies upon *In re Integrated Telecom Express* in which the Third Circuit stated: A good faith petition "must seek to create or preserve some value that would otherwise be lost—*not merely distributed to a different stakeholder*—outside of bankruptcy." *Id.*, 384 F.3d at 128-29 (emphasis added). Sigma argues that in the five months since the bankruptcy petition was filed, Island has taken no steps to maximize the value of its assets for creditors. Instead, Sigma suggests that Island has used the bankruptcy filing as a litigation tactic in the trade secrets litigation with Sigma. For example, as the result of the bankruptcy filing, Sigma has been compelled to file

a proof of claim and to file its complaint in Memphis rather than in New Jersey, which was its original intent.

In this instance, however, the Court credits Mr. Sanders' testimony that he did not have a potential claim by Sigma in mind when he decided to authorize a bankruptcy petition for Island. Notwithstanding Sigma's demand in September 2021, there is nothing in the record that suggests that concern about Sigma's demand entered into the discussion about filing a bankruptcy petition. To the contrary, it seems clear, and the Court finds, that the sole reason for the bankruptcy filing was the ASC judgment and Island's inability or refusal to provide for it without returning funds transferred to insiders. This, by itself, demonstrates the lack of good faith in filing the Island petition.

E. Island Petition Was Filed to Avoid Posting an Appellate Bond in Its Litigation with ASC

As Sigma states in its Motion to Dismiss, Mr. Sanders was very clear that the reason for filing the bankruptcy petition was to avoid ASC executing on its judgment. What he was less clear about was how and why this came about given the significant passage of time between the rendering of the judgment and the filing of the petition, and the fact that ASC was willing to enter into substantial negotiations with Island that spread over two to three months. Mr. Sanders indicated that negotiations broke down, but he acted rather detached from the process. He said, "All Anvil [i.e., ASC] wanted us to do was to say that we'd pay them if it [the judgment] wasn't overturned," but then "Anvil changed the terms and conditions at the end of the negotiation period" to require payoff of the Judgment within one-and-one-half years and "the Anvil people were as frustrated as we were that we couldn't reach an agreement." Island is within its rights to omit details of settlement discussions from its presentation, but the result is that the Court can only conclude that settlement discussions broke down when Island refused to provide the assurances

that ASC required. If ASC's demands were unreasonable, it was up to Island to show to the Court why this was so in light of its financial resources. Instead, Mr. Sanders' testimony gave no clear reason for Island's inability to provide a bond or otherwise reassure ASC that its judgment would be paid. The Court was left with the firm impression that Mr. Sanders decided to cause Island to file its petition in order to avoid posting the appellate bond. When given multiple opportunities to do so, he offered no other reason for the filing. As the *Integrated Telecom* court put it, "courts universally demand more of Chapter 11 petitions than a naked desire to stay pending litigation." *Id.*, 384 F.3d at 128. "Indeed," it said, "if there is a 'classic' bad faith petition, it may be one in which the petitioner's only goal is to use the automatic stay provision to avoid posting an appeal bond in another court." *Id.*, citing *Marsch*, 36 F.3d at 828.

CONCLUSION

Mr. Sanders' decision to cause Island to file a bankruptcy petition to deal with "a lawsuit in appeals" seems a particularly unfortunate one given the insider transfers made in the months leading up to the bankruptcy filing. Nevertheless, it is the only reason given by him for the filing, bringing this case within the category of classic bad faith petitions. In the face of the Motion to Dismiss, Island was required to show that its petition was filed in good faith, that is, that it was filed for a valid reorganizational purpose. It has failed to do so. The Motion to Dismiss is **GRANTED.**

cc: Debtor
Attorney for Debtor
Movant Sigma Corporation
Attorney for Sigma Corporation
Movant ASC Engineered Solutions, LLC
Attorney for ASC Engineered Solutions, LLC
Subchapter V Trustee
United States Trustee
Matrix