

IN THE UNITED STATES DISTRICT COURT  
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

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IN RE:	:	CIVIL ACTION NO. 98-2531
EAGLE TRUST,	:	BANKRUPTCY NO. 97-23298
Debtor.	:	

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**MEMORANDUM**

ROBERT F. KELLY, J.

SEPTEMBER 16, 1998

This is an appeal by the Debtor from the April 6, 1998 Order of the United States Bankruptcy Court dismissing this case. The dismissal was based upon findings that Eagle Trust is not eligible to be a debtor under the Bankruptcy Code, that this case was filed in bad faith, and that the Debtor was unable to effectuate a Chapter 11 plan and unable to reorganize. For the reasons that follow, the bankruptcy court's Order will be affirmed.

**I. Background**

On November 14, 1986, Leon M. Martin and Barry Newhart, d/b/a Masefield Associates ("Masefield"), a general partnership, obtained two loans totaling \$3,500,000 from Farmers First Bank ("the Bank"). The loans financed 100% of the purchase price and the first phase of renovation and new construction of a residential condominium project in Montour County, Pennsylvania.

Martin and Newhart, along with their respective wives, each signed a guaranty of the loans at closing. The guaranties are substantially identical, and obligated the Martins (and the

Newharts) to pay any and all amounts due from Masefield to the Bank in connection with the loans. The guaranties contained clauses authorizing the Bank to confess judgment against the Martins and the Newharts. In November of 1988, Masefield defaulted under the terms of the Loan Agreements. Since 1988, Masefield has failed to satisfy its loan obligations to the Bank and the Martins have also failed to satisfy the debt as provided in their guaranty. On December 20, 1991, the Bank entered judgment by confession against the Martins.

On October 27, 1992, Martin and Newhart filed a pro se complaint against the Bank, its officers, and its counsel in this Court, alleging various federal and state claims. The suit was dismissed and Rule 11 sanctions were awarded against Martin and Newhart. See Martin v. Farmers First Bank, 151 F.R.D. 44 (E.D. Pa. 1993).

In December of 1993 and January of 1994, Martin established a series of trusts, including the Debtor. Ownership of the Debtor, as well as Martin's other trusts, is evidenced by the issuance of Capital Units. At the time of the Debtor's inception, all of its Capital Units were issued to Jubilee Disbursement Trust ("Jubilee"), a trust established to hold the Capital Units and beneficial interest of most or all of Martin's other trusts. Jubilee continues to hold the beneficial interests in the Debtor, as well as the beneficial interests in all of

Martin's other trusts.<sup>1</sup> Jubilee does not hold any other assets.

Martin established each of his trusts with the assistance of Robert Singleton, principal of an entity known as the Worthington Group. Singleton manages some four hundred trusts through two entities, Echo Management Services ("Echo") and Teton Management Services ("Teton"). Echo serves as the trustee of the Debtor and most of Martin's other trusts, including Jubilee. Singleton is the Chairman and sole member of the Board of Trustees of Echo and Teton and, therefore, acts as the actual trustee for Martin's various trusts.

Singleton described the Debtor and Martin's other trusts as based upon the Contracts Clause of the United States Constitution. The trusts were established pursuant to a contract between Singleton, on behalf of the proposed trustee, and a settlor. The contract acts as the trust indenture, setting forth the specific terms of the trust agreement, as well as the obligations and responsibilities of the trustee. It provides in part:

The Purpose of this Contract and Agreement is to create an entity or organization, which may receive and shall then hold both legal and equitable title in real

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<sup>1</sup>Martin's other trusts include the Q.S.S.T. Trust (which now holds all of the shares of stock in L.M. Martin, Inc., his roofing and siding business), the L.M. Supply Trust (which purchases and sells the inventory used by L.M. Martin, Inc.), the Countryside Trust, the L.M.M. Trust (which provides management and marketing services to Martin's other trusts), the Wheels Trust, and the Human Resources Trust.

property, receive personal property and preserve assets, in its own name, and to engage in whatever business may be lawful and which will further the preservation and protection of the assets, in trust for certain named beneficiaries whose interests are represented by certificates of beneficial interest.

R.R., Tab 17, p.37.

At the time the Debtor was established, Martin and his wife transferred virtually all of their personal property to the Debtor, including all of their household belongings, bank accounts, and any other property of value. They also transferred their beneficial interests in certain revocable land trusts into which they had previously transferred all of their real property. Martin and his wife are the only individuals or entities that have ever transferred assets to the Debtor.

As of the Petition date, the Debtor held all of the beneficial interest in the land trust or trusts that owned four tracts of land. Two of these tracts are unimproved and generate little, if any income. The other two are improved and generate some income for the Debtor through lease agreements with various entities and/or individuals. The Debtor also owns the entire contents of at least one house situated on one of the tracts of land.

A warehouse is situated on one of the two income-producing tracts. The warehouse is leased to LM Supply Trust to store the inventory it sells to L.M. Martin, Inc. L.M. Martin, Inc. subleases office space in this building and operates its

roofing and contracting business out of this office. The lease between the Debtor and LM Supply generates approximately \$3,260 per month to the Debtor.

Two houses are located on the other income-producing tract. One of the houses is occupied by Wesley Graham and his family. Graham is one of Martin's sons-in-law. The Grahams pay \$365 per month to the Debtor pursuant to a lease. An additional \$200 in rent per month is waived in exchange for services Graham provides as a dispatcher for L.M. Martin, Inc.

The second house is leased by Jubilee and occupied by Martin and his wife. The lease provides for semi-annual payments of \$3,000. But these payments are waived in exchange for services Martin allegedly performs as Manager of the Debtor and his various other trusts. All of the Martins' utilities are paid by the Debtor pursuant to the lease. Martin is also provided with an automobile with all expenses paid in exchange for his services as Manager. The rents are set by the trustee of the Debtor, who has never made an independent determination whether the rents charged are the market rate for similar properties in the area where the Debtor's properties are located.

Although the Debtor collects some rents, it never generates any taxable income. Any net income after payment of expenses is passed through to Jubilee. Jubilee in turn passes all of the income it receives from the Debtor and Martin's other

trusts to two off-shore entities located in the Bahamas, Exodus Trust ("Exodus") and Covenant International Business Corporation ("Covenant").

Exodus holds the beneficial interest in Jubilee and Martin holds the beneficial interest in Exodus. Martin claims to have no knowledge of either the identity of the trustee of Exodus, or the identity of the directors or officers of Covenant. Martin also claims to lack any knowledge of the disposition of the money transferred to Exodus and Covenant, and claims to have received no money from either of these entities at any time. He also testified that he is not entitled to ever receive a distribution from Exodus or Covenant, nor is he aware of any individual or entity entitled to distributions.

After the establishment of the various trusts and the property conveyances, the Martins and Newharts continued their litigation. On March 2, 1994, they filed a Petition to Open or Strike the Confessed Judgment, which was denied on November 30, 1994, by the Lancaster County Court of Common Pleas. The Martins and Newharts appealed to the Superior Court of Pennsylvania, which affirmed the decision. The Supreme Court of Pennsylvania then denied the Petition for Review.

Subsequently, on January 4, 1995, Masefield filed a Voluntary Petition for relief in the United States Bankruptcy Court for the Middle District of Pennsylvania under 11 U.S.C. §

101 et seq. The Bank, Masefield, and Martin and Newhart eventually entered into an Escrow Agreement and corresponding Letter Agreement. Pursuant to these Agreements, the bank agreed to temporarily forbear in its collection efforts in exchange for the deposit into escrow arrangements of certain property of the Martins and Newharts pending an agreed-upon period during which Masefield was to either file a reorganization plan or liquidate its assets. Because Masefield failed to do either of these, the Bankruptcy Court granted the Bank's motion to terminate the agreements and take title to the properties in escrow.

On December 9, 1996, the Bank filed a Praecipe for Writ of Revival of the confessed judgments. In the Writ of Revival action against the Martins, the Bank named as terre tenants the various trust entities (including the Debtor) into which the Martins had transferred their property. The Lancaster County Court of Common Pleas then entered an Order granting judgment to the Bank in its revival action.

On April 29, 1997, the Bank filed a Praecipe for Writ of Execution against the Martins and the various trust entities (including the Debtor) as garnishees on the judgment. In addition, the Bank scheduled an execution sale on real property transferred by the Martins into Eagle Trust. The Martins and the trust entities then began another series of court filings prior

to the instant case.<sup>2</sup>

The Debtor commenced its bankruptcy case on July 28, 1997, by filing a voluntary petition under Chapter 11 of the Bankruptcy Code, claiming to be a business trust operating in Pennsylvania and, thus, eligible for relief. On August 12, 1997, the Bank, the Debtor's sole creditor, filed a motion to dismiss this case. The United States Trustee filed a response in support of the Bank's motion. The Bankruptcy Court held hearings on the Bank's Motion to Dismiss and its Motion for Relief from the Automatic Stay in Leon Martin's individual case over a period of five days. On April 6, 1998, the Bankruptcy Court entered its Order granting the Bank's motion to dismiss, finding that: (1) Eagle Trust is not eligible to be a debtor under the Bankruptcy Code, (2) cause existed to dismiss the case because Eagle Trust filed this petition in bad faith, and (3) cause existed to dismiss the case because Eagle Trust is unable to effectuate a

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<sup>2</sup>On June 30, 1997, they filed a "Complaint to Quiet Title" in the court of common pleas against the Bank and the Sheriff of Lancaster County, seeking among other things, declaratory judgment and injunctive relief with respect to the Sheriff's Sale and the Bank's state court proceedings against the Martins and the trust entities. This action is currently pending. On July 17, 1997, the Martins and the trust entities filed a Petition to Compel Valuation of Real Estate and Stay of Execution of Sheriff's Sale, which was denied by the court of common pleas on July 21, 1997. On July 23, 1997, the Martins again sought a stay of the Sheriff's Sale by filing (under the Masefield bankruptcy case) a Petition for Temporary Restraining Order and Complaint to Stay Sheriff's Sale and Compel Accounting of Money and Property Received by the Bank. The Middle District Bankruptcy Court denied the requested TRO.

Chapter 11 plan and unable to reorganize.

## II. Standard

A district court's review of questions of law in a bankruptcy appeal is plenary. Meridian Bank v. Alten, 958 F.2d 1226, 1229 (3d Cir. 1992); Sharon Steel Corp. v. National Fuel Gas Distribution Corp., 872 F.2d 36, 38-39 (3d Cir. 1989).

Findings of fact may not be set aside unless clearly erroneous. FED. R. BANKR. P. 8013. Mixed questions of law and fact "must be divided into their respective components and the appropriate test applied." In re Brown, 951 F.2d 564, 567 (3d Cir. 1991).

Further, a bankruptcy court's decision to convert or dismiss a Chapter 11 bankruptcy case is reviewed only for abuse of discretion. In re Abijoe Realty Corp., 943 F.2d 121, 128 (1st Cir. 1991); Hall v. Vance, 887 F.2d 1041, 1044 (10th Cir. 1989); In re Humble Place Joint Venture, 936 F.2d 814, 816 (5th Cir. 1991); In re Mazzocone, 180 B.R. 782, 785 (E.D. Pa. 1995).

## III. Discussion

### A. The Debtor's Eligibility Under Chapter 11

As a general matter, trusts are not eligible for relief in Bankruptcy. In re John M. Cahill, M.D. Assocs. Pension Plan, 15 B.R. 639, 639-40 (Bankr. E.D. Pa. 1981). The Bankruptcy Code provides that only a "person" or "municipality" may be a debtor under Chapter 11. 11 U.S.C. § 109(a). "Person" is defined to include an individual, partnership, or corporation. 11 U.S.C. §

101(41). But "corporation" is defined to include a "business trust." 11 U.S.C. § 101(9)(A)(v). Thus, in order to be eligible for relief, the Debtor must be a business trust.

Unfortunately, the Bankruptcy Code does not define business trust. The various courts that have addressed the issue have applied different factors to determine the existence of a business trust. Some courts have held that the basic distinction between a business trust and a non-business trust is that a business trust is created for the purpose of carrying on some kind of business or commercial activity, whereas the purpose of a non-business trust is to protect and preserve the trust res. See In re Secured Equip. Trust of Eastern Air Lines, 38 F.3d 86, 89 (2d Cir. 1994); In re Treasure Island Land Trust, 2 B.R. 332, 334 (Bankr. M.D. Fla. 1980). Another factor considered by many courts is whether the trust was initially funded by a group of investors pooling their resources. See In re Morgantown Trust No. 1, 155 B.R. 137, 143 (Bankr. N.D. W.Va. 1993); In re Armstead and Margaret Wayson Trust, 29 B.R. 58, 59 (Bankr. D. Md. 1982). Several courts have examined whether the trust at issue was created in compliance with state law. See In re Sung Soo Rim Irrevocable Intervivos Trust, 177 B.R. 673, 676-77 (Bankr. C.D. Cal. 1995); In re Mohan Kutty Trust, 134 B.R. 987, 989 (Bankr. M.D. Fla. 1991). Further, courts have considered whether the beneficial interests in the trust were freely transferable. See

In re Woodsville Realty Trust, 120 B.R. 2, 5 (Bankr. D. N.H. 1990). Finally, several courts have utilized the Supreme Court's test for whether a trust qualifies as a corporation for federal income tax purposes.<sup>3</sup> See Mosby v. Boatmen's Bank of St. Louis County, 61 B.R. 636, 638 (E.D. Mo. 1985), aff'd, 791 F.2d 628 (8th Cir. 1986); In re St. Augustine Trust, 109 B.R. 494, 495 (Bankr. M.D. Fla. 1990).

Based upon this case law, the bankruptcy court combined the factors used by other courts and held that the key attributes of a business trust are:

- (1) the trust was formed for the primary purpose of transacting business or commercial activity, as opposed to preserving assets;
- (2) the trust was formed by a group of investors who contribute capital to the enterprise with the expectation of receiving a return on their investment;
- (3) the trust was created in compliance with state law; and
- (4) the beneficial interests in the trust must be freely transferable.

R.R. Tab 4, at n.2 (citations omitted). The court then applied

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<sup>3</sup>Under this test, the characteristics of a business trust include:

1. a trust created and maintained for a business purpose;
2. title to property held by trustees;
3. centralized management;
4. continuity uninterrupted by death among beneficial owners;
5. transferability of interests; and
6. limited liability.

Mosby, 61 B.R. at 638 (citing Morrissey v. Commissioner, 296 U.S. 344, 359 (1935)).

these elements to the Debtor. In evaluating the primary purpose of the Debtor, the bankruptcy court found that the Debtor does not manufacture a product, provide any service, or undertake any other type of operations. It has no Board of Directors or employees. Eagle Trust has no accounts receivable, accounts payable, line of credit, or other business loans. Further, it has no machinery, inventory, or equipment. Eagle Trust simply holds real estate and personal property, receives some income from these properties, and pays the maintenance and expenses of holding the property for the benefit of Martin and his family. In addition to these facts, the Debtor's own indenture states that it may "engage in whatever business may be lawful and which will further the preservation and protection of the assets" (emphasis added), indicating that the primary purpose of the trust is the preservation of assets, and any business in which the trust engages is merely incidental to this purpose. The bankruptcy court was correct in its holding that the Debtor was not formed for the primary purpose of transacting business or commercial activity.

Applying the second element, the bankruptcy court found that the Debtor was essentially formed by one person (Martin) who transferred his assets to Eagle Trust for "estate planning purposes and asset protection." N.T. 10/23/97 at p. 53. It was not formed by a group of investors contributing capital with the

expectation of earning a profit. Thus, as the bankruptcy court held, the Debtor was not funded by a group of investors pooling their resources in order to receive a return on their investment. See Morgantown, 155 B.R. at 143; Woodsville, 120 B.R. at 5.

Under the third element, the Debtor must have been created in compliance with state law. Pennsylvania requires a business trust to be registered with the Department of State. 15 Pa.C.S. § 9503(a). Further, if the Debtor is a foreign business trust, it is required to obtain a certificate of authority to do business in Pennsylvania.<sup>4</sup> 15 Pa.C.S. § 9507; 15 Pa.C.S. § 4121. The Debtor failed to comply with either of these requirements. Therefore, it was not created in compliance with state law.

The final element requires that the beneficial interests in the trust be freely transferable. Paragraph 57 of the Debtor's indenture provides that beneficial interests can be transferred only if "approved by the Board of Trustees." R.R. Tab 17, p. 44. This provision places a restriction on the transferability of the interests in the trust, and thus, the Debtor also fails to possess this element of a business trust.

Based upon the case law, the Debtor clearly is not a business trust. It does not possess any of the common attributes of a business trust, and was not established for the purpose of

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<sup>4</sup>The Debtor contends in its brief that it was created under the laws of Nevada. Debtor's Br. on Appeal at p. 12.

carrying on commercial activity or business. The bankruptcy court was correct in finding that the Eagle Trust is ineligible to be a debtor under Chapter 11.

#### B. Bad Faith

The Debtor also challenges the bankruptcy court's finding that this petition was filed in bad faith for the sole purpose of delaying state court litigation with the Bank and to frustrate the Bank's efforts to enforce their rights. The Bankruptcy Code sets forth 10 factors that justify dismissal of a Chapter 11 petition for cause. See 11 U.S.C. § 1112(b). The Third Circuit has held that this list is not exhaustive, and that courts should consider other factors that may arise. Brown, 951 F.2d at 572. Bad faith is a factor that justifies dismissal under § 1112(b). Argus Group 1700, Inc. v. Steinman, 206 B.R. 757, 764-65 (E.D. Pa. 1997). The existence of bad faith is a question of fact that turns on the totality of the circumstances. In re SB Properties, Inc., 185 B.R. 198, 204 (E.D. Pa. 1995).

The Debtor's Chapter 11 petition was only the latest in a series of filings attempting to prevent the Bank from enforcing its rights. This is essentially a dispute between two parties, as the Bank was the Debtor's only creditor. The petition was filed soon after the Bank scheduled an execution sale. The pre-petition conduct of the Martins, including the numerous court filings, shows that this petition was an attempt to evade the

state court orders. Therefore, the bankruptcy court was correct in holding that cause existed to dismiss this case because the Debtor filed this petition in bad faith. See SB Properties, 185 B.R. at 205 (discussing factors courts have identified that indicate the existence of bad faith).

#### C. Inability To Reorganize

A Chapter 11 case may also be dismissed if the debtor is unable to effectuate a Chapter 11 plan. 11 U.S.C. § 1112(b)(2). The bankruptcy court found that the Debtor had no operations, employees, or business. The Debtor merely owns real and personal property, receives some income from these properties, and pays maintenance expenses of these properties all for the benefit of Martin and his family. The bankruptcy court was correct in ruling that the Debtor was unable to reorganize.

#### **IV. Conclusion**

In summary, the bankruptcy court was correct in holding that the Debtor is not a business trust, and therefore is not eligible for relief under Chapter 11 of the Bankruptcy Code. Further, the bankruptcy court ruled correctly that this case should be dismissed for cause because the petition was filed in bad faith, and that the Debtor was unable to effectuate a Chapter 11 plan and was unable to reorganize. Therefore, the decision of the bankruptcy court is affirmed.

An appropriate Order follows.



IN THE UNITED STATES DISTRICT COURT  
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

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Debtor.	:	
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**O R D E R**

AND NOW, this 16th day of September, 1998, the Order of the United States Bankruptcy Court dated April 6, 1998, is hereby AFFIRMED. The appeal is DENIED.

BY THE COURT:

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Robert F. Kelly, J.