

1 WRITTEN DECISION - NOT FOR PUBLICATION

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8 UNITED STATES BANKRUPTCY COURT  
9 SOUTHERN DISTRICT OF CALIFORNIA

10 In re: ) Bankruptcy Case No. 04-05619-H7  
11 DONALD YATES, ) MEMORANDUM DECISION  
12 Debtor. )  
13 \_\_\_\_\_ )

14 Chapter 7 trustee, Gregory A. Akers, (the "Chapter 7  
15 Trustee"), moved for sanctions against Donald A. Yates ("debtor")  
16 to compensate the estate for expenses caused by debtor's alleged  
17 "bad faith" conversion of his chapter 7 to chapter 13 and  
18 reconversion to chapter 7.

19 After a two-day evidentiary hearing, the Court took the matter  
20 under submission. Subsequently, the Chapter 7 Trustee submitted  
21 offers of proof and debtor filed a response and opposition. The  
22 Chapter 7 Trustee moved ex parte to file a reply, which this Court  
23 granted on January 10, 2007. The matter has been fully briefed and  
24 is now ripe for decision.

25 This Court has jurisdiction to determine this matter pursuant  
26 to 28 U.S.C. §§ 1334 and 157(b)(1) and General Order No. 312-D of  
27 the United States District Court for the Southern District of  
28 California. This is a core proceeding pursuant to 28 U.S.C.

1 § 157(b)(2)(A).

2 I.

3 FACTS

4 Debtor filed his voluntary chapter 7 petition on June 24,  
5 2004.

6 A. THE DEBTOR'S REAL PROPERTY

7 On December 14, 2004, the Chapter 7 Trustee filed an adversary  
8 complaint against debtor and others to avoid fraudulent transfers  
9 with respect to his real property. The debtor had arranged to sell  
10 his real property while it was still property of this estate and  
11 without court authority.

12 The Chapter 7 Trustee moved for partial summary judgment and  
13 for an order to surrender possession and control of the property to  
14 the Chapter 7 Trustee. On August 16, 2005, the Court granted the  
15 Chapter 7 Trustee's motion and ordered debtor's real property sold.  
16 In addition, the order provided that the United States Marshals  
17 Service or the San Diego County Sheriff were authorized and  
18 directed to evict debtor.

19 B. DEBTOR'S MOTION TO CONVERT TO CHAPTER 13

20 Shortly thereafter, on August 31, 2005, debtor moved to  
21 convert his case from chapter 7 to chapter 13. Debtor also filed  
22 an emergency motion for an order allowing him to remain in  
23 possession of his residence due to medical reasons.

24 The Chapter 7 Trustee opposed both motions, contending that  
25 debtor's motion to convert his chapter 7 to chapter 13 was in bad  
26 faith. On September 19, 2005, the Chapter 7 Trustee filed a  
27 request and notice for hearing opposing debtor's motion to convert  
28 and moved to reconvert his case to chapter 7. On September 22,

1 2005, the Court granted debtor's motion to convert his case to a  
2 chapter 13 and authorized him to regain possession of his real  
3 property. The Chapter 7 Trustee's motion to reconvert was vacated  
4 without prejudice to be reset on the Chapter 13 Law and Motion  
5 calendar.

6 C. THE SHORT-LIVED CHAPTER 13

7 On October 20, 2005, debtor filed his chapter 13 plan which  
8 provided for a \$1500 monthly payment, resulting in a 40% payment to  
9 unsecured creditors. Debtor began making his plan payments.

10 On November 1, 2005, the Chapter 7 Trustee renewed his motion  
11 to reconvert debtor's case to chapter 7 on various grounds  
12 including, inter alia, debtor's bad faith. The Chapter 7 Trustee  
13 alleged that the "bad faith of this debtor is extreme." The  
14 debtor's alleged bad faith included, inter alia, concealment of  
15 estate assets from this Court and the Chapter 7 Trustee, lying  
16 under oath, misrepresentations, inaccuracies and omissions in the  
17 debtor's schedules, filing of the original chapter 7 petition to  
18 avoid a state court judgment against him, pre-bankruptcy transfer  
19 of his property interests, unauthorized transfer of his real  
20 property post-petition, noncooperation with the Chapter 7 Trustee,  
21 lying under oath in his pleadings, illegal conduct involving  
22 wholesale automobile purchasing and selling of vehicles without a  
23 license, apparent tax evasion, and a history of dishonest and  
24 contentious litigation conduct.

25 The chapter 13 trustee, Thomas Billingslea (the "Chapter 13  
26 Trustee") objected to confirmation of debtor's plan on various  
27 grounds and also moved to reconvert debtor's chapter 13 case to  
28 chapter 7.

1 Debtor opposed the Chapter 7 Trustee's motion for  
2 reconversion, but debtor's attorney evidently continued to meet and  
3 confer with the Chapter 13 Trustee in an effort to resolve the  
4 objections to debtor's plan. The hearing on the Chapter 7  
5 Trustee's motion to reconvert and the Chapter 13 Trustee's  
6 objection to debtor's plan and motion to reconvert was initially  
7 scheduled for November 29, 2005, and continued to December 14,  
8 2005, so this Court could hear the matters.

9 Shortly before the hearing, or at the hearing, debtor withdrew  
10 his opposition to the reconversion of his case. Accordingly, the  
11 Court sustained the Chapter 13 Trustee's objections to debtor's  
12 plan and granted the motions to reconvert the case to one under  
13 chapter 7.

14 D. THE CHAPTER 7 TRUSTEE'S MOTION FOR SANCTIONS

15 On January 26, 2006, the Chapter 7 Trustee filed his motion  
16 for sanctions in the amount of \$46,708 to compensate the estate for  
17 the expense and injury resulting from debtor's alleged bad faith  
18 conversion of his case from chapter 7 to chapter 13, his related  
19 bad faith emergency applications, and his frivolous opposition to  
20 the Chapter 7 Trustee's motion to reconvert the proceedings to  
21 chapter 7, which debtor withdrew at the last minute.

22 II.

23 DISCUSSION

24 A. SUMMARY OF THE ARGUMENTS

25 The Chapter 7 Trustee argues that sanctions are warranted  
26 under Federal Rule Bankruptcy Procedure ("FRBP") 9011(a) and  
27 11 U.S.C. § 105(a). The Chapter 7 Trustee contends that the  
28 "facts and evidence" show debtor converted his case in bad faith.

1 Specifically, debtor allegedly had no real ability or intention to  
2 perform under chapter 13; the debtor brought various, related  
3 emergency applications for the purposes of regaining possession and  
4 use of the estate's real property based on lies and misrepresenta-  
5 tions to the Court; the debtor opposed the Chapter 7 Trustee's  
6 motion to reconvert to chapter 7 in bad faith and without any good  
7 faith basis in fact or law; and, finally, the debtor concealed  
8 estate assets, lied under oath regarding his schedules, failed to  
9 cooperate with the Chapter 7 trustee (in numerous respects), and  
10 allegedly has engaged in tax evasion and other illegal conduct.  
11 [Chapter 7 Trustee's Motion, 5:17-28; 6; 7:1-3, docket #97].

12 In opposition, debtor refutes the Chapter 7 Trustee's  
13 allegations one by one, with back-up declarations by various  
14 witnesses. Debtor also notes that the Chapter 7 Trustee failed to  
15 comply with the safe harbor provisions of FRBP 9011(c)(1)(A).  
16 Debtor argues that the actions taken by the Chapter 7 Trustee's  
17 counsel, for which he seeks reimbursement of close to \$47,000 from  
18 debtor, were totally unnecessary as a "simple challenge to the  
19 confirmation of debtor's chapter 13 plan . . . would have been all  
20 that was required to bring the issue of the viability of the  
21 conversion before the court."

22 In reply, the Chapter 7 Trustee argues that the safe harbor  
23 provision under FRBP 9011(c)(1)(A) is inapplicable if the conduct  
24 alleged is the filing of a petition. The Chapter 7 Trustee also  
25 cites In re Porras, 188 B.R. 375, 379 (Bankr. W.D. Tex. 1995)<sup>1</sup> in  
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27 <sup>1</sup> In Porras, the debtor sought to convert his chapter 7 case to chapter 11  
28 after the trustee moved to take his 2004 exam. The United States objected to the  
debtor's motion to convert. The court overruled the objection, finding that the  
plain language of 11 U.S.C. § 706(a) confers on the debtor the absolute right to  
convert his or her case to chapter 11 or chapter 13. The court found that the

1 support of his position that sanctions under FRBP 9011(a) are  
2 appropriate to recover damage caused by conversion and he  
3 reiterates examples of debtor's bad faith.

4 B. SANCTIONS PURSUANT TO FRBP 9011

5 1. THE SAFE-HARBOR PROVISION

6 Federal Rule Bankruptcy Procedure was amended in 1997 to  
7 conform to the 1993 changes in Federal Rule Civil Procedure 11.  
8 Rule 9011 requires that precise procedures be followed before  
9 sanctions may be imposed. The "safe harbor" provision contained in  
10 subdivision (c)(1)(A) prohibits the filing of a motion for  
11 sanctions unless the challenged paper is not withdrawn or corrected  
12 within a prescribed time after service of the motion, and is  
13 inapplicable if the challenged paper is a petition. The Advisory  
14 Committee Notes states:

15 The filing of a petition has immediate serious  
16 consequences, including the imposition of the  
17 automatic stay under § 362 of the Code, which  
18 may not be avoided by the subsequent withdrawal  
19 of the petition. In addition, a petition for  
20 relief under chapter 7 or chapter 11 may not be  
21 withdrawn unless the court orders dismissal of  
22 the case for cause after notice and a hearing.  
23 See Advisory Committee Notes (1997) to FRBP  
24 9011.

21 The safe harbor provision is therefore inapplicable if the  
22 challenged paper is a petition. However, debtor's motion to  
23 convert his case from chapter 7 to chapter 13 under 11 U.S.C.  
24 § 706(a) is done by way of motion and not by the filing of a new  
25 petition. See FRBP 1017(f)(2) (stating that the procedure for  
26 \_\_\_\_\_

27 United States had ample remedies regarding any abuse caused by the debtor's  
28 conversion. The United States could move to reconvert the case or could seek  
sanctions under FRBP 9011. Notably, FRBP 9011 was amended after the Porras decision  
to include the safe harbor provision. The Porras court did not therefore discuss  
the safe harbor provision in its decision.

1 conversion under § 706(a) shall be by motion). Moreover, the safe  
2 harbor provision would also apply to the other pleadings the  
3 Chapter 7 Trustee complains about, i.e., debtor's emergency  
4 application and opposition to the Chapter 7 Trustee's motion for  
5 reconversion of his case. The Chapter 7 Trustee failed to comply  
6 with the requirements of FRBP 9011(c).

7 The Chapter 7 Trustee's motion for sanctions was filed well  
8 after debtor had any opportunity to withdraw the allegedly  
9 offending pleadings. Therefore, the Chapter 7 Trustee's motion for  
10 sanctions to the extent it is based on FRBP 9011 must be denied.  
11 See Polo Bldg. Grp., Inc. v. Rakita (In re Shubov), 253 B.R. 450,  
12 545 (B.A.P. 9th Cir. 2000) ("Parties who ask for sanctions under  
13 this rule are not permitted to circumvent the safe harbor by  
14 waiting until it is too late to withdraw or correct the offending  
15 matter.") (citations omitted).

16 2. THE COURT'S INHERENT POWERS

17 To the extent the Chapter 7 Trustee implies the Court may  
18 act on its own initiative to impose sanctions under FRBP 9011,  
19 there is a mandatory procedure that was not followed in this case.  
20 See FRBP 9011(c)(1)(B). This Court did not issue an order to show  
21 cause why debtor may have violated the rule with respect to any of  
22 the pleadings that the Chapter 7 Trustee refers to in his motion.

23 3. APPLICABILITY TO DEBTOR'S MOTION TO CONVERT

24 It is unlikely that FRBP 9011(b) is applicable to  
25 debtor's motion to convert his case from chapter 7 to chapter 13  
26 since the Ninth Circuit holds that debtor has an absolute right to  
27 convert when certain statutory requirements are met. Croston v.  
28 Davis (In re Croston ), 313 B.R. 447, 451 (B.A.P. 9th Cir. 2004)

1 (neither conduct nor motive vitiates the absolute nature of the §  
2 706(a) right to convert).

3           The Bankruptcy Appellate Panel explained that if the  
4 debtor was engaged in bad faith, there were multiple remedies  
5 available:

6           One remedy for addressing bad faith  
7 manipulation lies in the fact that there is no  
8 absolute right to remain in the chapter to  
9 which the case is converted. Thus, a case that  
10 is converted to chapter 11, 12, or 13 under  
11 § 706(a) is nonetheless vulnerable to  
12 conversion back to chapter 7 for 'cause.' Facts  
13 that are sufficiently egregious to support an  
14 argument that the § 706(a) conversion right  
15 should be overridden ought to make it easy to  
16 demonstrate 'cause' for reconverting the case  
17 to chapter 7. Nor does the reconversion  
18 process necessarily introduce inordinate delay.  
19 Parties in interest can make a reconversion  
20 motion as soon as they learn of conversion.  
21 Likewise, the court is even entitled to raise  
22 the § 1307(c) conversion issue on its own  
23 motion and has substantial control over matters  
24 of timing.

25           Given the precedent in this Circuit, it is unclear to the  
26 Court why the Chapter 7 Trustee would bother filing an opposition  
27 to debtor's motion for an order converting his case when he was  
28 eligible to file a chapter 13. See docket #30. Clearly, the  
Chapter 7 Trustee's opposition to debtor's motion was contrary to  
the law.

          In sum, the Court denies the Chapter 7 Trustee's motion for  
sanctions to the extent it is based on FRBP 9011.

C. SANCTIONS UNDER 11 U.S.C. SECTION 105(a)

          The Chapter 7 Trustee also relies on this Court's inherent  
power under § 105(a) as a basis to sanction debtor for moving to  
convert his case and presumably for his emergency application and  
opposition to the Chapter 7 Trustee's motion for reconversion of

1 his case.

2 Section 105(a) provides:

3 The court may issue any order, process, or  
4 judgment that is necessary or appropriate to  
5 carry out the provisions of this title. No  
6 provision of this title providing for the  
7 raising of an issue by a party in interest  
8 shall be construed to preclude the court from,  
9 sua sponte, taking any action or making any  
10 determination necessary or appropriate to  
11 enforce or implement court orders or rules, or  
12 to prevent an abuse of process.

13 The United States Supreme Court has cautioned that this Court  
14 must exercise restraint and discretion in using its powers under  
15 § 105(a). Chambers v. NASCO, 501 U.S. 32, 44, 111 S.Ct. 2123, 115  
16 L.Ed.2d 27 (1991). Chambers held that a federal court is not

17 forbidden to sanction bad-faith conduct by  
18 means of the inherent power simply because that  
19 conduct could also be sanctioned under the  
20 statute or the Rules. A court must, of course,  
21 exercise caution invoking its inherent power,  
22 and it must comply with the mandates of due  
23 process, both in determining that the requisite  
24 bad faith exists and in assessing fees.  
25 Furthermore, when there is bad-faith conduct in  
26 the course of litigation that could be  
27 adequately sanctioned under the Rules, the  
28 court ordinarily should rely on the Rules  
rather than the inherent power. But if in the  
informed discretion of the court, neither the  
statute nor the Rules are up to the task, the  
court may safely rely on its inherent power.

501 U.S. at 50 (citation omitted).

23 1. APPLICABILITY TO DEBTOR'S MOTION TO CONVERT

24 As previously mentioned, the debtor's alleged bad faith  
25 does not provide grounds to grant sanctions in connection with  
26 debtor's motion to convert his case to Chapter 13 when the debtor  
27 has the absolute right to convert under Croston.

28 ///

1           2.     FRBP 9011 PROVIDES ADEQUATE REMEDY FOR OTHER PLEADINGS

2           The United States Supreme Court noted in Chambers that  
3 this Court's inherent power must be exercised with caution  
4 especially when there is bad-faith conduct that could be adequately  
5 sanctioned under the Rules. To the extent the Chapter 7 Trustee  
6 seeks sanctions with respect to debtor's emergency application or  
7 his opposition to the Chapter 7 Trustee's motion to reconvert, the  
8 Court finds that FRBP 9011 is "up to the task" and the Court  
9 declines to use its general authority under § 105(a). The Chapter  
10 7 Trustee cannot use this Court's inherent powers to circumvent the  
11 requirements of FRBP 9011.

12           Even if this Court were to use its inherent powers under  
13 § 105(a), as further explained below, an award of sanctions would  
14 be inappropriate in this case.

15 D.     THE COURT CANNOT FIND ANY BAD FAITH BASED ON THE EVIDENCE AND  
16     THE CHAPTER 7 TRUSTEE'S OFFERS OF PROOF

17           This Court held a two-day evidentiary hearing on May 31 and  
18 June 1, 2006, and made numerous rulings with respect to the  
19 admissibility of the Chapter 7 Trustee's evidence. The Chapter 7  
20 Trustee later filed offers of proof on November 3, 2006, which this  
21 Court has examined.<sup>2</sup>

22           Based on the admissible evidence, the Court cannot find debtor  
23 acted in bad faith in converting his case under the totality of  
24 circumstances. See In re Ho, 274 B.R. 867, 876 (B.A.P. 9th Cir.  
25 2002) (citation omitted) (in determining whether a chapter 13  
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27           <sup>2</sup> Debtor complains that he has never seen any of the new exhibits attached to  
28 the Chapter 7 Trustee's offers of proof. Moreover, the debtor alleges that the  
Chapter 7 Trustee's counsel fabricates some statements regarding her "evidence."  
The Court gave the Chapter 7 Trustee the opportunity to respond to debtor's  
arguments and has considered the Chapter 7 Trustee's response.

1 petition has been filed in bad faith, a bankruptcy court must  
2 review the totality of circumstances). The debtor testified at  
3 length and was thoroughly questioned by the Chapter 7 Trustee's  
4 counsel and this Court.

5 The Court finds that debtor adequately explained the  
6 discrepancies on his tax returns. He also adequately explained why  
7 he filed his Chapter 7 petition, which was not to avoid a state  
8 court judgment. Rather, debtor explained that he had been unable  
9 to work for almost two years, he had lost his law practice and was  
10 ill. As a consequence, he had mounting bills and was "borrowing  
11 significant amounts of money from friends." [Transcript dated  
12 June 1, 2006, at 14:12-25; 15:1]. Thus, it appears to the Court  
13 that events other than the state court judgment prompted debtor to  
14 file his initial chapter 7 petition. The Court further finds that  
15 the judgment had little relevance to debtor's desire to convert his  
16 chapter 7 case to one under chapter 13. See Ho, 274 B.R. at 876  
17 (one factor for the court to consider in determining whether debtor  
18 filed his chapter 13 petition in bad faith is whether the debtor's  
19 only purpose in filing is to defeat state court litigation).

20 Debtor adequately explained why he mistakenly thought he had  
21 the right to sell to his real property after his discharge.  
22 Further, he had even contacted his bankruptcy attorney and advised  
23 him of what he intended to do with his real property. [Id. at  
24 19:1-25; 20:1-19]. Lastly, debtor testified that his motive for  
25 the conversion of his case was not to hinder or delay. He  
26 testified that he had a good faith belief his Chapter 13 plan would  
27 be confirmable and he hired competent counsel to assist him with  
28 his plan. [Id. at 26:21-25; 27:1-7].

1           Moreover, the record demonstrates that debtor immediately  
2 filed his chapter 13 plan and began making his plan payments. The  
3 plan proposed a 40% payout to unsecured creditors. It was only  
4 after the Chapter 13 Trustee objected to his plan, that debtor and  
5 his counsel learned that the Chapter 13 Trustee would not be  
6 recommending his plan. [Id. at 28:24-25]. Therefore, the debtor  
7 did not oppose the Chapter 7 Trustee's reconversion motion. See  
8 Croston, 313 B.R. at 453 (inability to propose a confirmable plan  
9 is a reconversion issue).

10           The Court finds debtor's testimony credible. The Court cannot  
11 find any evidence that the debtor intended to hinder or delay  
12 creditors from receiving some sort of payment on their claim.  
13 [Transcript dated June 1, 2006, at 51:22-24; 52:1-5]. Nor can the  
14 Court find prejudice to the Chapter 7 estate. "A 'court must make  
15 its good-faith determination in light of *all* militating factors.'" Ho,  
16 274 B.R. at 877. Under these circumstances, the Court cannot  
17 find debtor converted his chapter 7 to chapter 13 in bad faith.

18 E. THE AMOUNT OF THE SANCTIONS REQUEST

19           Although the Court denies the Chapter 7 Trustee's request for  
20 sanctions, the Court is troubled by the amount of sanctions sought.  
21 Not only was the Chapter 7 Trustee's opposition to debtor's motion  
22 to convert unwarranted, but the Chapter 7 Trustee's request for  
23 reconversion of the case was both premature and unnecessary. The  
24 debtor had commenced making his plan payments, attended the 341a  
25 hearings, and was producing documents to Mr. Billingslea, an  
26 experienced chapter 13 trustee. In addition, debtor was  
27 represented by an experienced consumer attorney, Harold Thompson.  
28 This Court expressed its views at the evidentiary hearing:

1 In this Court's experience, when you get these  
2 conversions, usually what the chapter 7 trustee  
3 does is he or she sits back and they coordinate  
4 with the Chapter 13 trustee. And the Chapter  
5 13 trustee takes the lead, which he has to  
6 because the plan is coming under their  
7 supervision and administration....Rarely do  
8 they file a motion to reconvert and charge full  
9 bore into the Chapter 13 arena when there's an  
10 experienced trustee such as Mr. Billingslea  
11 handling the case, dialoguing with experienced  
12 Chapter 13 counsel, as Mr. Thompson was -- I'll  
13 take judicial notice of that -- and attempt to  
14 negotiate a plan. See Transcript dated June 1,  
15 2006, at 43:7-24.

16 This Court further noted that it was Mr. Billingslea's duty as the  
17 chapter 13 trustee to address plan confirmation issues and it  
18 wasn't necessary for the Chapter 7 trustee to get aggressively  
19 involved. Id. at 45:3-10. The Court further pointed out that if  
20 the Chapter 7 Trustee felt his interests were not being represented  
21 adequately by the Chapter 13 Trustee, since he is a creditor, he  
22 could have simply filed an objection to the plan. Id. 61:21-25.

23 The Court is concerned with the amount of the requested  
24 sanctions, since Mr. Akers is an experienced chapter 7 trustee, and  
25 the services rendered by his attorney appear to have been  
26 unnecessary in light of the Chapter 13 Trustee's active  
27 participation in the Chapter 13 case.

28 Ironically, the Chapter 7 Trustee's counsel's over-aggressive  
and unnecessary services may reduce any distribution to unsecured  
creditors in this case. This issue, however, will be addressed at  
a later date, when the Chapter 7 Trustee and his attorney submit  
their fee applications.

III.

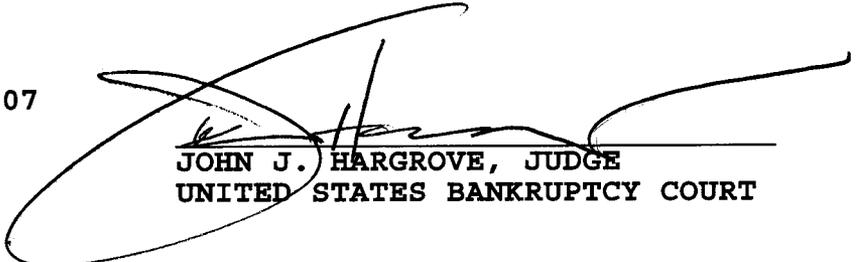
CONCLUSION

The Court denies the Chapter 7 Trustee's motion for sanctions.

1           This Memorandum Decision constitutes findings of fact and  
2 conclusions of law pursuant to Federal Rule of Bankruptcy Procedure  
3 7052. The debtor is directed to file with this Court an order in  
4 conformance with this Memorandum Decision within ten (10) days from  
5 the date of entry thereof.

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Dated: January 26, 2007



JOHN J. HARGROVE, JUDGE  
UNITED STATES BANKRUPTCY COURT