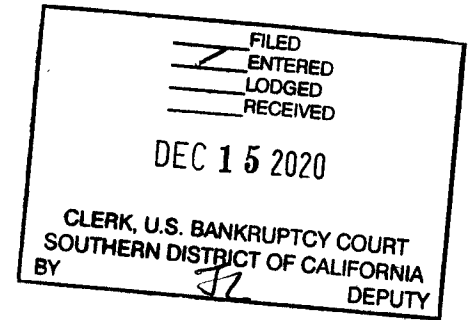


WRITTEN DECISION - NOT FOR PUBLICATION



UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF CALIFORNIA

In re: } BK. No. 19-07519-LT11
NSHE CA BULLS, LLC, }
Debtors. } MEMORANDUM DECISION¹

Debtor has made clear that it may object to the claim of Strategic Emerging Economics, Inc. ("Strategic"). In so doing, it will necessarily challenge the enforceability of Strategic's Note and Deed of Trust. And the consequence of such a challenge will be that the provisions of Cal. Civ. Code 1717 will be applicable. If Strategic wins, it can recover its fees under its contract; if Debtor prevails, it will be entitled to its fees under the fee shifting provisions of the statute. But in the motion at issue here, Debtor seeks to obtain statutory fee-shifting in the plan confirmation context where the terms and enforceability of the operative contracts were not at issue. Instead, the existence of the contracts and their terms were assumed facts relevant to confirmation decisions made under bankruptcy law. Thus, Civil Code § 1717 does not apply.

¹ This opinion is intended only to resolve the dispute between these parties and is not intended for publication.

Broad Factual Overview

The Debtor's sole asset is a beach front home in La Jolla (the "Property"). The Debtor encumbered the Property with two liens securing obligations totaling approximately \$9.0 million. On the petition date, both loans were in default, and the Debtor did not pay debt service during the course of the case. The Court acknowledges that the Debtor's principal/related entity/sole member advanced monthly costs to protect and insure the Property in the form of gifts or unsecured loans.

The Court approved Debtor's Disclosure Statement on June 29, 2020 and set the matter for a confirmation hearing on September 9 and 10, 2020.

Debtor's Plan.

Generally speaking, the Debtor proposed to liquidate the Property over a 180-day period, unless funds from another source materialized during this time period. It opined that the Property was worth far more than the secured obligations, so, from the proceeds of this sale or from other sources, the Debtor proposed to pay any debts not already paid at the end of the 180-day period.

The Debtor proposed to pay the holder of the first trust deed, Wells Fargo, at the contractual interest, non-default rate (it is unclear that there is a default rate). The Debtor achieved a stipulated agreement with Wells Fargo as to its Plan treatment. Wells Fargo voted in favor of the Plan.

The Plan proposed to pay the second priority trust deed lender, Strategic, at a rate of 8.25% (Prime plus 5%). This rate was less than either the regular contractual interest rate of 11.75% or the default rate of 23.5% under Strategic's Note. Strategic made its opposition to the Debtor's bankruptcy, and virtually any plan of action short of immediate payment in full per its Note's terms, clear throughout the case. It voted against the Plan.

Consistent with its vote, Strategic objected to the Debtor's Plan. The grounds were good faith, feasibility, best interest of creditors, and the Debtor's alleged failure to meet the cramdown requirements of 11 U.S.C. § 1129(b)(2)(A). Counsel for the Debtor and

1 Strategic prepared a Joint Pre-Trial Statement and List of Exhibits and Witnesses for the
2 Court (the "Joint Pre-Trial Statement").

3 Section 6 of the Joint Pre-Trial Statement provided:

4 The following issues of fact, and no others, remain to be litigated during the trial:

- 5 a. The Debtor bears the burden of establishing all of the elements for
6 confirmation.
- 7 b. The Debtor intends to present sufficient facts to establish good faith under
8 § 1129(a)(3).
- 9 c. The Debtor intends to present sufficient facts to establish feasibility.
- 10 d. The Debtor intends to present sufficient facts to establish best interest of
11 creditors under § 1129(a)(7).
- 12 e. The Debtor intends to present sufficient facts to support a cram-down over
13 Strategic's objection via § 1129(b)(1).
- 14 f. The Debtor intends to establish a basis for cram-down over Strategic's
15 objection via the application of a proposed interest rate under
16 § 1129(b)(2)(A)(i).
- 17 g. Strategic refutes the applicability of the proposed rate and refutes that facts
18 are sufficient to support a cram-down under § 1129(b)(1).

19 Dkt. No. 115.

20 The Court conducted a trial and made an oral ruling after trial confirming Debtor's
21 Plan over the objections of Strategic.

22 **The § 1717 Motion**

23 After the Court ruled in its favor on the confirmation motion, Debtor brought a
24 motion to recover fees and costs incurred in connection with Strategic's objections to Plan
25 confirmation under Cal. Civ. Code § 1717.

26 The Court considered the briefs and the arguments made at the hearing and
27 tentatively ruled that the grounds Strategic raised in its objection to confirmation were not
28 "actions on the contract" as required for an award under § 1717. After a hearing, the Court

1 confirmed its Tentative in the main but also afforded Debtor an opportunity to file additional
2 briefing addressing whether two specific elements of Strategic's objection to confirmation
3 were actions on the contract: (1) Strategic's challenge to the interest rate proposed under
4 Debtor's Plan; and (2) Strategic's argument that accrual of post-petition mortgage interest
5 payments owing on account of Strategic's secured claim constituted an administrative
6 expense claim that needed to be satisfied on the effective date of the Plan. Strategic was not
7 required to file additional opposition.

8 Debtor filed the supplemental brief, and the Court took the matter under submission.
9 For the reasons set forth below, Debtor's motion is hereby denied in its entirety.

10 Analysis

11 The purpose of Cal. Civ. Code § 1717 is to make reciprocal a unilateral contractual
12 obligation to pay attorney's fees such as is found in Strategic's Note and Deed of Trust. *See*
13 *Santisas v. Goodin*, 17 Cal.4th 599, 610-11 (1998). The Strategic documents broadly allow
14 Strategic to recover its attorneys' fees and costs related to protection of its rights under the
15 documents. But the documents do not provide Debtor or the "prevailing party" with any
16 rights to collect such fees and costs; the provision is in no way contractually reciprocal.
17 Debtor, thus, relies exclusively on section 1717 to fill the void and allow fee recovery.

18 The parties both recognize that "[t]hree conditions must be met before [section 1717]
19 applies." *Penrod v. AmeriCredit Financial Services, Inc.*, (In re Penrod), 802 F.3d 1084,
20 1087 (9th Cir.2015). First, the action generating the fees must have been an action "on a
21 contract." *Id.* Second, the contract must provide that attorney's fees incurred to enforce it
22 shall be awarded either to one of the parties or to the prevailing party. *Id.* And third, the
23 party seeking fees must have prevailed in the underlying action. *Id.* at 1087-88. *See also*
24 *Bos v. Bd. of Trs.*, 818 F.3d 486, 489 (9th Cir. 2016). The conditions are in the conjunctive;
25 Debtor must establish them all to collect.

26 Here, the second and third conditions are not in question. Strategic challenges only
27 the first condition and argues that its objections did not give rise to "an action on the
28 contract." As noted, the Court has already sustained this objection in part. For example, the

Debtor's good faith in proposing a plan or filing its bankruptcy involve the contracts only in the historical context that they exist, are in default, and, thus, bankruptcy is required to avoid foreclosure. Litigation of this issue is not "on the contract." Similarly, valuation issues are relevant to feasibility concerns and interest rate risk factors. But they do not require contractual analysis. The Court here rules that those items addressed in the additional briefing are also not on the contract.

Action "on a contract."

Debtor cites to *Turner v. Schultz*, 175 Cal. App. 4th 974, 979-980 (2009) for the proposition that California courts construe the term "on a contract" liberally, and that "as long as the action 'involves' a contract it is 'on the contract' within the meaning of section 1717. *Id.*" Dkt. No. 138-1. However, the entire discussion in *Turner* establishes that the mere existence of a contract between the litigants is not enough, rather enforcement of the contract must be involved to bring section 1717 into issue:

As long as the action "involve[s]" a contract it is " "on [the] contract" " within the meaning of section 1717. Where an attorney fee clause provides for an award of fees incurred in enforcing the contract, the prevailing party is entitled to fees for any action "on the contract," whether incurred offensively or defensively. Such fees are properly awarded under section 1717 "to the extent that the action in fact is an action to enforce or avoid enforcement of the specific contract." An action for declaratory relief can be an action "on a contract." In this action, Turner sought declaratory and injunctive relief to avoid enforcement of the agreement's arbitration provision absent an order compelling arbitration. Under these circumstances, we conclude that this action was on the contract for purposes of an award of attorney fees.

175 Cal. App. 4th at 979-80. (internal citations omitted).

The most recent input on the "on the contract" requirement by the Ninth Circuit is found in *Bos v. Bd. of Trustees*:

The California Supreme Court has explained that "section 1717 applies only to actions that contain at least one contract claim," and that "[i]f an action asserts both

1 contract and tort or other noncontract claims, section 1717 applies only to attorney
2 fees incurred to litigate the contract claims." *Santisas*, 17 Cal.4th at 615,
3 71 Cal.Rptr.2d 830, 951 P.2d 399. Consistent with *Santisas*, we have previously held
4 that a nondischargeability action is "on a contract" within section 1717 if "the
5 bankruptcy court needed to determine the enforceability of the ... agreement to
6 determine dischargeability." *In re Baroff*, 105 F.3d 439, 442 (9th Cir.1997).

7 The Bankruptcy Appellate Panel of the Ninth Circuit has held that *Santisas*
8 and relevant Ninth Circuit cases establish not just a rule of inclusion, but also a rule
9 of exclusion: that "if the bankruptcy court did not need to determine whether the
10 contract was enforceable, then the dischargeability claim is not an action on the
11 contract within the meaning of [California Civil Code] § 1717." *In re Davison*,
12 289 B.R. 716, 723 (9th Cir. BAP 2003) (emphasis added)....

13 We adopt the BAP's construction of section 1717. It accords with the
14 common sense meaning of the phrase "on a contract" and finds ample support in our
15 precedents.

16 818 F.3d 489-90.

17 At trial, the enforceability of Strategic's Note or Deed of Trust was not raised and did
18 not need to be determined. Again, Strategic objected to the Debtor's Plan on the basis of
19 good faith, feasibility, best interest of creditors, and on the Debtor's basis for meeting the
20 burden of cramdown under 11 U.S.C. § 1129(b)(2)(A). The Joint Pre-Trial Statement,
21 which details the issues to be decided, is devoid of any suggestion that any contract
22 enforcement issues were extant in the litigation. Dkt. No. 115.

23 Instead, as the Court explained in its oral ruling after trial, the issues it considered
24 were:

- 25 1. What is the appropriate value of the Property;
- 26 2. Is the Plan feasible;
- 27 3. What is the correct interest rate to be paid to Strategic; and
- 28 4. Is the Plan proposed in good faith.

Whether or not the Note and Deed of Trust were enforceable was not included as an issue, and such issues were never raised at trial. Debtor never even argued that the underlying Note and Deed of Trust were unenforceable. In fact, at this stage of the litigation it was agreed that Strategic held an enforceable claim under its Note and Deed of Trust. The only issues was whether the Plan treated the claim as required or allowed by the Bankruptcy Code. For the purposes of the objection to confirmation, it would have been no different had Strategic's claim been based on a tort judgment or a claim based on statute.

The Court certainly did not make a ruling on enforceability. The Court did not need to read the Note and Deed of Trust to render its decisions on the issues of value, interest rate, and good faith. Based on the clear statement of the law in *Bos*, the Court finds that Strategic's objections to confirmation including the trial did not involve a determination of whether the Note or Deed of Trust were enforceable and therefor did not amount to an action on the contract for the purposes of § 1717.

Debtor argues that the holding in *Bos* should be limited to nondischargeability actions. However, the Court sees no reason for this and no support for it in the language of the decision. Furthermore, the first precedent the Court in *Bos* considered, *Johnson v. Righetti, (In re Johnson)*, 756 F.2d 738 (9th Cir. 1985), was not a nondischargeability case.

In fact, *Bos*, in terms of context, is very similar to our situation here. *Bos* involved nondischargeability true. But at bottom the challenge to dischargeability there was a question about bankruptcy treatment of a claim. In *Bos*, the Court considered whether an undisputed claim would be discharged under the Code. In our case, the Court considered how a plan could alter or treat an undisputed claim under the Code. Thus, in both *Bos* and here neither the claim at issue nor its supporting documents nor their terms were at issue. Instead, all the Court evaluated was what treatment the bankruptcy court allowed for an undisputed claim. *Bos* directly supports that section 1717 does not apply here.

Debtor, however, asks the Court to ignore the clear language of the decision in *Bos* and rather follow the earlier *Penrod* case, but *Penrod* does not require a different result. In *Penrod*, the court was required to delve into the relevant contract. The claimant argued that

1 its entire contract was a "purchase money" contract and, thus, entitled to the protection of
2 the hanging paragraph of Bankruptcy Code § 1325. As the Court explained:

3 AmeriCredit sought to enforce the provisions of its contract with Penrod when
4 it objected to confirmation of her proposed Chapter 13 plan. The plan treated
5 AmeriCredit's claim as only partially secured, but AmeriCredit insisted that it was
6 entitled to have its claim treated as fully secured. The only possible source of that
7 asserted right was the contract—in particular, the provision in which Penrod granted
8 a security interest in her Taurus to secure "payment of all you owe on this contract."
9 (Had the contract not granted AmeriCredit a security interest in the car, AmeriCredit
10 could not have asserted a secured claim for any amount. See 11 U.S.C. § 506(a).)
11 The security interest conveyed by the contract covered not just the funds Penrod
12 borrowed to pay for the Taurus, but also the funds she borrowed to refinance the
13 negative equity in the Explorer. The sole issue in the hanging-paragraph litigation
14 was whether this provision of the contract should be enforced according to its terms,
15 or whether its enforceability was limited by bankruptcy law to exclude the negative-
16 equity portion of the loan. See *In re Penrod*, 611 F.3d at 1159-61 & n. 2. By
17 prevailing in that litigation, Penrod obtained a ruling that precluded AmeriCredit
18 from fully enforcing the terms of the contract. For that reason, § 1717's first
19 condition was satisfied as well.

20 *Penrod*, 802 F.3d at 1088. In *Penrod*, the court quoted language from the contract and,
21 necessarily evaluated its terms in deciding that the entire contract was not a purchase money
22 contract. Put another way, the Court could not answer the bankruptcy code related question
23 until it resolved a question under the relevant contract. As noted above, in this case and in
24 *Bos*, the Court was not asked to and was not required to make any ruling on the
25 enforceability or interpretation of the relevant contracts. Here it was able to decide the
26 matter without reference to the terms of either contract to determine feasibility, the interest
27 rate required to pay Strategic the present value of its claim, good faith, or any of the issues
28 identified by the parties.

1 On the issue of present value, the Court acknowledges that Strategic argued that the
2 default rate under the Note should be used under the plan. However, the issue was not the
3 enforceability of the contract rate in the Note or whether the default rate was enforceable.
4 Rather the issue was whether the default rate was the rate required to provide present value
5 for the purposes of Bankruptcy Code § 1129. Strategic did not argue that it was entitled to
6 the default rate regardless of the requirements of the Bankruptcy Code. Rather, Strategic
7 argued, unsuccessfully, that the contract default rate would provide the equivalent value
8 required under the Code. Its expert opined that this rate continued to reflect the default rate
9 for a loan such as the coerced loan under the plan. And, as the parties are aware, the Court
10 rejected Strategic's contract argument and employed the "formula approach" outlined in
11 *Till v. SCS Credit Corp.*, 541 U.S. 465, 469 (2004). The formula approach begins with the
12 prime rate and adds an adjustment based upon risks of non-payment under the plan under
13 advisement. It does not depend on the terms of the underlying contract. Simply put, while
14 Strategic argued that the default rate was the proper rate to be used because it was a market
15 rate, the Court resolved the issue without recourse to the Note or any of the terms thereof.
16 Whether the default rate was enforceable under the contract was never at issue.

17 Strategic also raised as an objection to confirmation the argument that the interest
18 that had accrued postpetition was an administrative claim. Debtor argues that this issue was
19 an action on the contract. The Court disagrees. As with the interest rate argument, while
20 Strategic's underlying and undisputed claim is based on its contract, whether or not a portion
21 of that claim was entitled to administrative claim status has nothing to do with the terms of
22 the contract. Rather the issue is solely how that undisputed claim must be treated under the
23 Code. As with the interest rate issue, the Court resolved the matter without reference to the
24 Note.

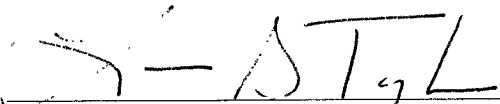
25 Having considered all of the briefs and argument, the Court rules that resolution of
26 Strategic's objection to confirmation did not equate to an action on the relevant contracts
27 because the Court was not required to determine whether they were enforceable or to
28

1 otherwise evaluate their terms and, in fact, was able to rule independently of any terms of
2 the contract between Debtor and Strategic.

3 The Court's ruling is not inconsistent with the Supreme Court's ruling in *Travelers*
4 *Cas. & Sur. Co. of Am. v. Pac. Gas & Elec. Co.*, 549 U.S. 443, 444 (2007), nor with that
5 Court's abrogation of *Fobian v. Western Farm Credit Bank (In re Fobian)*, 951 F.2d 1149
6 (9th Cir. 1991). In *Traveler's* the Court rejected the "*Fobian rule*" that a decision based
7 solely on bankruptcy law could not result in fees otherwise allowable under a contract. This
8 Court does not deny the Motion because the objection to confirmation was resolved under
9 federal bankruptcy law. Rather, as discussed above, the fees are denied because the Court
10 made no ruling on the enforceability of the contract and did not have to consider any terms
11 of the contract to rule on confirmation, so the matter was not an action on the contract as
12 required under § 1717. And, in any event, *Travelers* was not a section 1717 case. It would
13 be analogous only to the extent the issue is Strategic's ability to recover its own fees as a
14 result of its documents' language expressly allowing such recovery. The Court, thus, denies
15 the fees because a California law, Cal. Civ. Code § 1717, does not support fee shifting in
16 this context.²

17 For the reasons set forth above the Court denies Debtor's Motion.

18
19 DATED: December 15, 2020

20 
21 LAURA S. TAYLOR, JUDGE
22 United States Bankruptcy Court
23
24

25 ² In its additional documentation, the Debtor also requests recovery of certain fees not specifically
26 relevant to interest rate and administrative claim treatment on the theory that it is impossible to
27 determine what portion of trial time and trial prep related to these topics as opposed to other issues
28 such as good faith or valuation. The Court strongly disagrees. The administrative claim issues
were only slightly touched on in briefing and largely ignored at trial. And while interest rate was a
critical issue and discussed at trial, it took much less time than valuation testimony. The Court
would not exercise its discretion to award the vast majority of such fees even if it was otherwise
appropriate.

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF CALIFORNIA
325 West "F" Street, San Diego, California 92101-6991

In re NSHE CA BULLS, LLC, Bk. No. 19-07519-LT11

CERTIFICATE OF MAILING

The undersigned, a regularly appointed and qualified employee in the office of the United States Bankruptcy Court for the Southern District of California, at San Diego, hereby certifies that a true copy of the attached document, to wit:

MEMORANDUM DECISION

was enclosed in a sealed envelope bearing the lawful frank of the bankruptcy judges and mailed via first class mail to the party at their respective address listed below:

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Said envelope(s) containing such document was deposited by me in the City of San Diego, in said District on December 15, 2020.

/s/ Regina Fabre

Regina Fabre, Judicial Assistant