NOT FOR PUBLICATION

UNITED STATES BANKRUPTCY APPELLATE PANEL

OF THE NINTH CIRCUIT

In re:	BAP No. MT-07-1348-DJuPa
JUDY BARTELT and LEE BARTELT,	Bk. No. 03-61599-RBK
Debtors.	
GARY S. DESCHENES, Chapter 7 Trustee,	
Appellant,	
v.	**M E M O R A N D U M**[1]
JUDY BARTELT; LEE BARTELT,	
Appellees.	

Argued and Submitted on March 18, 2008
at Helena, Montana

Filed - March 31, 2008

Appeal from the United States Bankruptcy Court
for the District of Montana

Hon. Ralph B. Kirscher, Chief Bankruptcy Judge, Presiding.

Before: DUNN, JURY and PAPPAS, Bankruptcy Judges.

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[1] This disposition is not appropriate for publication. Although it may be cited for whatever persuasive value it may have (see Fed. R. App. P. 32.1), it has no precedential value. See 9th Cir. BAP Rule 8013-1.

The chapter 7 trustee, Gary Deschenes ("Deschenes"), appeals the bankruptcy court's order granting the debtors' motion to convert their case from chapter 7 to chapter 13.[2] Deschenes argues that the debtors, Judy and Lee Bartelt, acted in bad faith by moving to convert their case in an attempt to circumvent distributions to creditors and to retain for themselves the proceeds from the settlement of a class action lawsuit.

While this appeal was pending, the debtors proceeded under chapter 13. The bankruptcy court confirmed the debtors' chapter 13 plan, which provided for 100% payment on all allowed claims. As no stay was imposed on the confirmation order, the chapter 13 trustee made distributions pursuant to the plan.

Because the funds at issue already have been distributed to creditors and the debtors, we are unable to grant any effective relief. Additionally, as Deschenes did not obtain a stay of the confirmation order, the rights of the creditors intervened, thereby making it inequitable for us to consider the merits. We therefore DISMISS the appeal as MOOT.

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[2] Unless otherwise indicated, all chapter, section and rule references are to the Bankruptcy Code, 11 U.S.C. §§ 101-1330, and to the Federal Rules of Bankruptcy Procedure, Rules 1001-9037, as enacted and promulgated prior to October 17, 2005, the effective date of most of the provisions of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. 109-8, 119 Stat. 23.

I. FACTS[3]

The debtors filed their chapter 7 petition on May 16, 2003. The debtors received their discharge on August 19, 2003. The case closed as a no asset case on November 14, 2003.

Approximately one year later, Deschenes moved to reopen the case to administer a tax refund, which the debtors had listed in their schedules but did not claim as exempt. On October 26, 2004, the bankruptcy court entered an order reopening the case. The case closed again on November 30, 2005.

On April 23, 2007, Deschenes again moved to reopen the case, this time to distribute $34,188.82 that the debtors were entitled to receive through settlement of a class action lawsuit. Although the class action claim arose prepetition,[4] the debtors neither scheduled nor claimed an exemption in the class action lawsuit.[5] The bankruptcy court entered an order reopening the

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[3] The parties did not include a number of relevant documents in the record on appeal. These documents were docketed and imaged by the bankruptcy court. We have reviewed these documents on the bankruptcy court's electronic docket and take judicial notice of them. See Atwood v. Chase Manhattan Mortgage Co. (In re Atwood), 293 B.R. 227, 233 n.9 (9th Cir. BAP 2003) (obtaining relevant documents not included in the record on appeal from the bankruptcy court clerk and taking judicial notice of them).

[4] According to Deschenes's motion for turnover, the class action lawsuit, Costello v. Beneficial Montana, Inc., No. DV-03-280 (Mont. 2d Jud. Dist. filed December 3, 2003), challenged the policies and practices that Beneficial Montana, Inc. employed in making consumer loans.

[5] The debtors filed amended schedules on November 20, 2007. The debtors listed the class action lawsuit in their amended Schedule B, but did not claim an exemption in it in their amended Schedule C. The debtors did not add any new creditors to their

(continued...)

case on the same day.

On June 8, 2007, the debtors filed a motion to convert their case from chapter 7 to chapter 13 ("Motion to Convert").[6]

Deschenes filed an objection, relying on Marrama v. Citizens Bank of Massachusetts, 127 S. Ct. 1105 (2007), and alleging that the debtors were acting in bad faith by moving to convert their case in an attempt to circumvent distribution of the settlement proceeds to creditors and to retain for themselves as much of the settlement proceeds as possible.

On August 28, 2007, the bankruptcy court held a hearing (the "Hearing") on the Motion to Convert. At the Hearing, Judy Bartelt ("Judy") testified that she intended to pay all creditors through the chapter 13 plan and, with any surplus funds remaining, pay as many of her current medical expenses as possible so that she and her husband, Lee Bartelt ("Lee"), "could have a little time without the pressure . . . ." Tr. of August 28, 2007 Hr'g, 8:21-22. Given all of her medical expenses from her cancer treatment, she feared that she would "leave [Lee] bankrupted," so she wanted to "leave him as good as [she could] under the circumstances." Tr. of August 28, 2007 Hr'g, 8:6-15.

Judy also believed that proceeding under chapter 13, instead of chapter 7, "would be done very fast" and that she "[did not] have to wait for the tax returns, which could take months or longer . . . ." Tr. of August 28, 2007 Hr'g, 9:23-24. She

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[5](...continued)
amended Schedule F.

[6] The debtors had not previously moved to convert their case from chapter 7 to chapter 13.

explained that her belief was based on a bad experience in the chapter 7 case; there had been a substantial delay in the distribution of the 2003 tax refund, which caused her to lose "some confidence with that situation . . . ." Tr. of August 28, 2007 Hr'g, 10:9.

She further testified that neither she nor Lee had any knowledge of the class action lawsuit when they filed their bankruptcy petition. Judy admitted receiving a letter regarding the class action lawsuit sometime in 2005, but she and Lee had thrown the letter away, believing that it did not affect them. She "didn't really realize until the settlement thing came, and then [she and Lee] became aware, you know, it said – some money available . . . [and] that was in 2006." Tr. of August 28, 2007 Hr'g, 11:12-15.

At the Hearing, Deschenes asserted that, as chapter 7 trustee, he had a duty to contact creditors upon discovery of any assets and to remind them to file their claims, even after the claims bar deadline. The bankruptcy court questioned whether the chapter 7 trustee had such a duty, given that the creditors seemingly "[slept] on their rights and never file[d] a claim." Tr. of August 28, 2007 Hr'g, 17:6-7. The bankruptcy court acknowledged, however, that creditors who file tardy claims were entitled to payment on their claims after payment to creditors with timely-filed claims.[7]

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[7] Section 726 provides:

> (a) Except as provided in section 510 of this title, property of the estate shall be distributed –

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The bankruptcy court asked counsel for the debtors whether the case would result in surplus funds for the debtors. Counsel informed the bankruptcy court that the claims so far amounted to approximately $17,000 to $18,000. After payment of these claims, the debtors stood to receive approximately $15,000 in surplus funds. The bankruptcy court suggested that, if the amount of general unsecured claims totaled less than the amount of the settlement proceeds, an interim partial distribution might be made to the debtors.

After listening to Judy's testimony, the bankruptcy court concluded that the debtors did not act in bad faith in moving to convert their case. Rather, the debtors merely were "look[ing] at some alternatives, trying to get some monies released that are in excess of what is required to pay the creditors that have

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[7](...continued)

> . . .
> (2) second, in payment of any allowed unsecured claim, other than a claim of a kind specified in paragraph (1), (3), or (4) of this subsection, proof of which is –
> . . .
> (C) tardily filed under section 501(a) of this title, if –
> (i) the creditor that holds such claim did not have notice or actual knowledge of the case in time for timely filing of a proof of such claim under section 501(a) of this title; and
> (ii) proof of such claim is filed in time to permit payment of such claim;
> (3) third, in payment of any allowed unsecured claim proof of which is tardily filed under section 501(a) of this title other than a claim of the kind specified in paragraph (2)(C) of this subsection . . . .

filed claims, legitimate claims." Tr. of August 28, 2007 Hr'g, 22:7-10.

The bankruptcy court noted, however, that it did not believe that proceeding under chapter 13, instead of under chapter 7, was necessarily better for the debtors. It further noted that proceeding under chapter 13 might not be a "speedier resolution of this case" and that the debtors would "be looking at some time here in any event." Tr. of August 28, 2007 Hr'g, 29:3-7.

The bankruptcy court ultimately took the matter under advisement to allow Deschenes and the debtors time to negotiate.

On September 4, 2007, the debtors filed a notice, stating that they still wished to convert their case, believing they would be better off proceeding under chapter 13.

On the same day, the bankruptcy court issued its Memorandum of Decision and entered an order granting the Motion to Convert ("Conversion Order") and requiring that the settlement proceeds be turned over to the chapter 13 trustee. The bankruptcy court found that Deschenes failed to demonstrate that the debtors acted in bad faith in moving to convert their case from chapter 7 to chapter 13. The bankruptcy court also found that, based on the record, the case would result in surplus funds to the debtors, regardless of whether the case proceeded under chapter 7 or chapter 13.

Upon entry of the Conversion Order, the chapter 13 claims bar deadline was set for January 13, 2008, and the confirmation hearing was set for November 28, 2007.

Deschenes timely appealed the Conversion Order. Approximately one month later, Deschenes moved for stay pending

the appeal, requesting a stay of the chapter 13 case until resolution of the appeal. The bankruptcy court denied the motion.

The debtors filed their initial chapter 13 plan on October 1, 2007, but filed two amended plans prior to the confirmation hearing.[8] The bankruptcy court held the confirmation hearing on November 28, 2007, but continued confirmation to December 17, 2007. At the December 17, 2007 hearing, the bankruptcy court denied confirmation, but allowed the debtors to file another amended plan.

On the same day, the debtors filed their third amended plan, which was a 100% repayment plan.[9]

No objections to the third amended plan were filed. The bankruptcy court entered an order confirming the third amended plan, with a provision for 100% payment, on December 21, 2007. Deschenes neither appealed the confirmation order nor moved for a stay of the confirmation order pending the appeal.

The amount of general unsecured claims filed as of the claims bar date in the debtors' chapter 13 case totaled $48,010.57. However, the debtors filed objections to a number of general unsecured claims, which the bankruptcy court sustained.

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[8] The debtors filed their first amended plan on November 20, 2007, and their second amended plan on November 27, 2007. The chapter 13 trustee objected to both the first amended and second amended plans.

[9] Prior to filing their third amended plan, the debtors filed a motion to waive the requirement that the debtors make monthly plan payments. The bankruptcy court granted their motion.

Taking the sustained objections into account, a total of $20,964.37 in allowed general unsecured claims remained. Notably, Deschenes did not file a proof of claim for his administrative expenses.

On February 27, 2008, Deschenes filed a motion for stay pending appeal, seeking to stay distribution by the chapter 13 trustee. We entered an order the following day, granting a temporary stay ("Stay Order") until March 19, 2008.

On March 4, 2008, the debtors filed a motion to dismiss the appeal as moot on the grounds that the chapter 13 trustee already had made distributions pursuant to the confirmed plan, paying 100% of all allowed claims. We entered an order the following day, requiring Deschenes to file a response to the debtors' motion to dismiss the appeal and advising the parties to address the issue of mootness at oral argument.

In his response to the debtors' motion to dismiss, Deschenes acknowledged that the chapter 13 trustee had paid all allowed claims in full on February 28, 2008, and remitted the surplus funds to the debtors on March 3, 2008. Deschenes asked counsel for the debtors to advise them against spending the surplus funds pending the outcome of the appeal.

However, Deschenes was too late. At oral argument, counsel for the debtors explained that, by the time he reached the debtors to advise them to hold on to the surplus funds, they already had spent most of the surplus funds on mortgage payments and other obligations.

II. ISSUE

Whether the appeal is moot in light of the chapter 13 trustee's distributions pursuant to the debtors' confirmed chapter 13 plan.

III. STANDARDS OF REVIEW

We review de novo issues of mootness. Foster v. Carson, 347 F.3d 742, 745 (9th Cir. 2004).

IV. JURISDICTION

We cannot exercise jurisdiction over a moot appeal. I.R.S. v. Pattullo (In re Pattullo), 271 F.3d 898, 900 (9th Cir. 2001). See also GTE Cal., Inc. v. FCC, 39 F.3d 940, 945 (9th Cir. 1994) ("The jurisdiction of federal courts depends on the existence of a 'case or controversy' under Article III of the Constitution."). A moot case is one where the issues presented are no longer live, and no case or controversy exists. Pilate v. Burrell (In re Burrell), 415 F.3d 994, 998 (9th Cir. 2005). The test for mootness is whether we can still grant effective relief to the prevailing party if we decide the merits in his or her favor. Id. If a case becomes moot while the appeal is pending, we must dismiss the appeal. Pattullo, 271 F.3d at 900.

"Bankruptcy appeals may become moot in one of two (somewhat overlapping) ways." Focus Media, Inc. v. NBC (In re Focus Media, Inc.), 378 F.3d 916, 922 (9th Cir. 2004). First, events may occur that make it impossible for us to grant effective relief. Id. See also Pattullo, 271 F.3d at 901 (quoting United States v. Arkison (In re Cascade Rds., Inc.), 34 F.3d 756, 759 (9th Cir.

1994)). In this instance, the party asserting mootness bears a heavy burden to establish that no effective relief remains for us to provide. Focus Media, Inc., 378 F.3d at 923.

Examples of situations where we cannot grant effective relief are when funds have been disbursed to non-parties or when the property at issue has been sold to a good faith purchaser. See Beatty v. Traub (In re Beatty), 162 B.R. 853, 856 (9th Cir. BAP 1994).

Second, the appeal may become equitably moot when the appellant fails diligently to pursue remedies available to him or her to obtain a stay of the bankruptcy court's objectionable orders, thereby creating "'such a comprehensive change of circumstances'" as to render it inequitable for us to consider the merits. Focus Media, Inc., 378 F.3d at 923 (quoting Trone v. Roberts Farms, Inc. (In re Roberts Farms, Inc.), 652 F.2d 793, 798 (9th Cir. 1981)). That is, equitable principles may require dismissal of the case when the appellant neglects to obtain a stay pending appeal and the rights of third parties intervene. Spirtos v. Moreno (In re Spirtos), 992 F.2d 1004, 1006 (9th Cir. 1993). In this instance, the party asserting mootness must demonstrate that the case involves transactions "so complex or difficult to unwind" that equitable mootness applies. Lowenschuss v. Selnick (In re Lowenschuss), 170 F.3d 923, 933 (9th Cir. 1999).

The debtors contend that the appeal is moot because the chapter 13 trustee has made distributions pursuant to their confirmed chapter 13 plan, paying 100% of all allowed claims.

According to Deschenes and the debtors, the chapter 13

trustee indeed already has paid all of the allowed claims pursuant to the confirmed plan. The controversy at the crux of this appeal revolves around distribution of the class action settlement funds; if the funds are gone, we can do nothing to restore the earlier status quo. See Beatty, 162 B.R. at 856.

Deschenes contends that, if we reverse the Conversion Order and undo the order confirming the plan, he would not seek to recover funds from creditors already paid by the chapter 13 trustee. Rather, he would require the debtors to return the surplus funds. Deschenes then would solicit creditors who did not file proofs of claim to do so. Using the surplus funds he obtained from the debtors, he would pay those creditors who tardily filed their claims and pay interest to those creditors who already had received payment on their claims.

We do not believe that the scheme proposed by Deschenes would be practical or feasible. The debtors already have spent most, if not all, of the surplus funds and have no other assets that Deschenes could liquidate to generate funds for creditors. In these circumstances, we cannot grant effective relief in this appeal, and this appeal must be dismissed.

Although we commend Deschenes for his determination in trying to pay all of the creditors, like the bankruptcy court, we believe that those creditors who failed to file proofs of claim, when given two separate opportunities and deadlines to do so, "slept on their rights." Once notice of the claims bar deadline has been properly sent to unsecured creditors, they bear the responsibility for filing their proofs of claim if they wish to participate in any distribution in a bankruptcy case. Rule

3002(a). See also Collier on Bankruptcy ¶¶ 3002.01[1], 3002.03[1] (15th ed. rev. 2007).

Alternatively, we dismiss the appeal as equitably moot. Deschenes did not diligently pursue his available remedies to obtain stays of the bankruptcy court's orders. Although he attempted to obtain a stay of the chapter 13 case, once the bankruptcy court refused to impose the stay, he should have moved for a stay of the chapter 13 case at the appellate level. Also, although he moved to stay distributions by the chapter 13 trustee after confirmation of the debtors' plan, Deschenes was too late, as he requested the stay the day before the chapter 13 trustee made plan distributions.

The Conversion Order alone did not effect a comprehensive change of circumstances in the case. However, the order confirming the plan wrought such a change of circumstances as to render it inequitable for us to consider whether the Conversion Order was improper. See, e.g., Blackwell v. Little (In re Little), 253 B.R. 427, 430-31 (8th Cir. BAP 2000). Once the plan was confirmed, the rights of the creditors came into play; they had the justifiable expectation that they would receive 100% payment on their claims in short order. To grant effective relief to Deschenes, we would have to "undo" the conversion, which would nullify the order confirming the plan and all of the actions taken in reliance on the order confirming the plan. Not only could such transactions be difficult to unwind, but it would be inequitable to the creditors who, expecting full payment on their claims, presumably refrained from objecting to confirmation of the plan and relied on the confirmation order. When Deschenes

neglected to obtain a stay of the order confirming the plan, the rights of the creditors intervened, thereby making it impossible for us to fashion any kind of effective relief.

V. CONCLUSION

Because the funds at issue already have been distributed to creditors, preventing us from granting any effective relief, we DISMISS the appeal as MOOT.