

MAR 31 2008

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U.S. BKCY. APP. PANEL
OF THE NINTH CIRCUIT

NOT FOR PUBLICATION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.

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.

1 The chapter 7 trustee, Gary Deschenes ("Deschenes"), appeals
2 the bankruptcy court's order granting the debtors' motion to
3 convert their case from chapter 7 to chapter 13.² Deschenes
4 argues that the debtors, Judy and Lee Bartelt, acted in bad faith
5 by moving to convert their case in an attempt to circumvent
6 distributions to creditors and to retain for themselves the
7 proceeds from the settlement of a class action lawsuit.

8 While this appeal was pending, the debtors proceeded under
9 chapter 13. The bankruptcy court confirmed the debtors' chapter
10 13 plan, which provided for 100% payment on all allowed claims.
11 As no stay was imposed on the confirmation order, the chapter 13
12 trustee made distributions pursuant to the plan.

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

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25 ² Unless otherwise indicated, all chapter, section and rule
26 references are to the Bankruptcy Code, 11 U.S.C. §§ 101-1330, and
27 to the Federal Rules of Bankruptcy Procedure, Rules 1001-9037, as
28 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.

1 **I. FACTS³**

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

5 Approximately one year later, Deschenes moved to reopen the
6 case to administer a tax refund, which the debtors had listed in
7 their schedules but did not claim as exempt. On October 26,
8 2004, the bankruptcy court entered an order reopening the case.
9 The case closed again on November 30, 2005.

10 On April 23, 2007, Deschenes again moved to reopen the case,
11 this time to distribute \$34,188.82 that the debtors were entitled
12 to receive through settlement of a class action lawsuit.

13 Although the class action claim arose prepetition,⁴ the debtors
14 neither scheduled nor claimed an exemption in the class action
15 lawsuit.⁵ The bankruptcy court entered an order reopening the
16

17 ³ The parties did not include a number of relevant documents
18 in the record on appeal. These documents were docketed and
19 imaged by the bankruptcy court. We have reviewed these documents
20 on the bankruptcy court's electronic docket and take judicial
21 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
22 relevant documents not included in the record on appeal from the
23 bankruptcy court clerk and taking judicial notice of them).

24 ⁴ According to Deschenes's motion for turnover, the class
25 action lawsuit, Costello v. Beneficial Montana, Inc., No. DV-03-
26 280 (Mont. 2d Jud. Dist. filed December 3, 2003), challenged the
27 policies and practices that Beneficial Montana, Inc. employed in
28 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...)

1 case on the same day.

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

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

10 On August 28, 2007, the bankruptcy court held a hearing (the
11 "Hearing") on the Motion to Convert. At the Hearing, Judy
12 Bartelt ("Judy") testified that she intended to pay all creditors
13 through the chapter 13 plan and, with any surplus funds
14 remaining, pay as many of her current medical expenses as
15 possible so that she and her husband, Lee Bartelt ("Lee"), "could
16 have a little time without the pressure" Tr. of August
17 28, 2007 Hr'g, 8:21-22. Given all of her medical expenses from
18 her cancer treatment, she feared that she would "leave [Lee]
19 bankrupted," so she wanted to "leave him as good as [she could]
20 under the circumstances." Tr. of August 28, 2007 Hr'g, 8:6-15.

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

25
26 ⁵(...continued)
amended Schedule F.

27
28 ⁶ The debtors had not previously moved to convert their case
from chapter 7 to chapter 13.

1 explained that her belief was based on a bad experience in the
2 chapter 7 case; there had been a substantial delay in the
3 distribution of the 2003 tax refund, which caused her to lose
4 "some confidence with that situation" Tr. of August 28,
5 2007 Hr'g, 10:9.

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

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

25
26 ⁷ Section 726 provides:

27 (a) Except as provided in section 510 of this title,
28 property of the estate shall be distributed -

(continued...)

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

10 After listening to Judy's testimony, the bankruptcy court
11 concluded that the debtors did not act in bad faith in moving to
12 convert their case. Rather, the debtors merely were "look[ing]
13 at some alternatives, trying to get some monies released that are
14 in excess of what is required to pay the creditors that have
15

16 ⁷(...continued)

17 . . .

18 (2) second, in payment of any allowed unsecured
19 claim, other than a claim of a kind specified in
20 paragraph (1), (3), or (4) of this subsection,
21 proof of which is -

22 . . .

23 (C) tardily filed under section 501(a) of this
24 title, if -

25 (i) the creditor that holds such claim did
26 not have notice or actual knowledge of the
27 case in time for timely filing of a proof of
28 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

1 filed claims, legitimate claims." Tr. of August 28, 2007 Hr'g,
2 22:7-10.

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

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

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

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

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

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

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

4 The debtors filed their initial chapter 13 plan on October
5 1, 2007, but filed two amended plans prior to the confirmation
6 hearing.⁸ The bankruptcy court held the confirmation hearing on
7 November 28, 2007, but continued confirmation to December 17,
8 2007. At the December 17, 2007 hearing, the bankruptcy court
9 denied confirmation, but allowed the debtors to file another
10 amended plan.

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

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

18 The amount of general unsecured claims filed as of the
19 claims bar date in the debtors' chapter 13 case totaled
20 \$48,010.57. However, the debtors filed objections to a number of
21 general unsecured claims, which the bankruptcy court sustained.
22

23
24 ⁸ The debtors filed their first amended plan on November 20,
25 2007, and their second amended plan on November 27, 2007. The
26 chapter 13 trustee objected to both the first amended and second
27 amended plans.

28 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.

1 Taking the sustained objections into account, a total of
2 \$20,964.37 in allowed general unsecured claims remained.
3 Notably, Deschenes did not file a proof of claim for his
4 administrative expenses.

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

9 On March 4, 2008, the debtors filed a motion to dismiss the
10 appeal as moot on the grounds that the chapter 13 trustee already
11 had made distributions pursuant to the confirmed plan, paying
12 100% of all allowed claims. We entered an order the following
13 day, requiring Deschenes to file a response to the debtors'
14 motion to dismiss the appeal and advising the parties to address
15 the issue of mootness at oral argument.

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

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

27

28

1 1994)). In this instance, the party asserting mootness bears a
2 heavy burden to establish that no effective relief remains for us
3 to provide. Focus Media, Inc., 378 F.3d at 923.

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

9 Second, the appeal may become equitably moot when the
10 appellant fails diligently to pursue remedies available to him or
11 her to obtain a stay of the bankruptcy court's objectionable
12 orders, thereby creating "'such a comprehensive change of
13 circumstances'" as to render it inequitable for us to consider
14 the merits. Focus Media, Inc., 378 F.3d at 923 (quoting Trone v.
15 Roberts Farms, Inc. (In re Roberts Farms, Inc.), 652 F.2d 793,
16 798 (9th Cir. 1981)). That is, equitable principles may require
17 dismissal of the case when the appellant neglects to obtain a
18 stay pending appeal and the rights of third parties intervene.
19 Sirtos v. Moreno (In re Sirtos), 992 F.2d 1004, 1006 (9th Cir.
20 1993). In this instance, the party asserting mootness must
21 demonstrate that the case involves transactions "so complex or
22 difficult to unwind" that equitable mootness applies.
23 Lowenschuss v. Selnick (In re Lowenschuss), 170 F.3d 923, 933
24 (9th Cir. 1999).

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

28 According to Deschenes and the debtors, the chapter 13

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

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

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

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

1 3002(a). See also Collier on Bankruptcy ¶¶ 3002.01[1],
2 3002.03[1] (15th ed. rev. 2007).

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

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

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

4
5 **V. CONCLUSION**

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