

NOT FOR PUBLICATION

NOV 14 2007

HAROLD S. MARENUS, CLERK
U.S. BKCY. APP. PANEL
OF THE NINTH CIRCUIT

UNITED STATES BANKRUPTCY APPELLATE PANEL
OF THE NINTH CIRCUIT

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28

In re:)	BAP No.	CC-07-1122-BaKPa
)		
CAPITAL FINANCE, INC.,)	Bk. No.	RS 02-19544-MG
)		
Alleged Debtor.)		
<hr/>			
N. DANIEL KLEIN,)		
)		
Appellant,)		
)		
v.)	MEMORANDUM¹	
)		
CAPITAL FINANCE, INC.,)		
)		
Appellee.)		
<hr/>			

Argued and Submitted on October 24, 2007
at Los Angeles, California

Filed - November 14, 2007

Appeal from the United States Bankruptcy Court
for the Central District of California

Honorable Mitchel R. Goldberg, Bankruptcy Judge, Presiding

Before: BARDWIL,² KLEIN 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.

2. Hon. Robert S. Bardwil, U.S. Bankruptcy Judge for the Eastern District of California, sitting by designation.

1 Appellant N. Daniel Klein ("Klein") appeals the bankruptcy
2 court's award of attorney's fees and costs to Capital Finance,
3 Inc. ("Capital Finance"), under 11 U.S.C. § 303(i)(1),³ following
4 the dismissal of Klein's involuntary chapter 7 petition against
5 Capital Finance. We hold that the bankruptcy court did not err
6 in determining that Capital Finance had standing to seek an award
7 under that section, and did not err in determining that Capital
8 Finance's motion was timely. We also conclude that the
9 bankruptcy court did not abuse its discretion in awarding
10 attorney's fees and costs to Capital Finance, based on the
11 totality of the circumstances. Therefore, we AFFIRM.

12
13 FACTS

14 On May 4, 2000, Klein obtained a default judgment in the
15 amount of \$2,400,000 in Riverside County Superior Court against
16 one D. Robert Johnson ("Johnson") and others. After
17 unsuccessfully attempting to collect on the judgment, Klein filed
18 an involuntary petition against Johnson in the bankruptcy court
19 for the Central District of California, as Case No. RS 01-28022
20 MG, and an order for relief was entered. Klein apparently
21 learned that entities related to Johnson had made a number of
22 transfers of real property to Capital Finance. Klein attempted

23
24
25 3. Unless otherwise indicated, all Code, chapter, section and
26 Rule references are to the Bankruptcy Code, 11 U.S.C. §§ 101-1330,
27 as enacted and promulgated prior to the effective date (October 17,
28 2005) of the Bankruptcy Abuse Prevention and Consumer Protection
Act of 2005, Pub. L. 109-8, 119 Stat. 23 (2005). "L.B.R." references are to the Local Bankruptcy Rules for the Central District of California.

1 to persuade the bankruptcy trustee in the Johnson case to act to
2 recover those transfers, but was unsuccessful.

3 On June 7, 2002, Klein, as the sole petitioning creditor,
4 filed an involuntary chapter 7 petition (the "involuntary
5 petition") against Capital Finance. Capital Finance responded
6 with a motion to dismiss the involuntary petition on the ground
7 that Klein was not a creditor of Capital Finance eligible to file
8 such a petition under § 303(b), and thus, did not have standing
9 to be a petitioning party. Capital Finance also alleged that the
10 petition had been filed in bad faith and that Capital Finance was
11 entitled to attorney's fees, costs, and actual and punitive
12 damages, pursuant to § 303(i)(1) and (2).

13 Klein's opposition to the motion to dismiss was comprised
14 primarily of a variety of attacks on Johnson and Jamal Dawood
15 ("Dawood"), the principal of Capital Finance. Klein accused
16 Dawood of forgery, mail and wire fraud, credit card fraud, and
17 identity theft, and alleged that Dawood and Johnson had arranged
18 a number of real property transfers in order to defraud Klein and
19 others. Klein also challenged the validity of Dawood's
20 incorporation of Capital Finance and its authority to do business
21 in California. Klein's objective, apparently, was to establish
22 that Capital Finance had no standing to defend against the
23 involuntary petition.

24 On the subject of his own standing as a creditor of Capital
25 Finance, Klein submitted copies of a number of deeds in lieu of
26 foreclosure from Johnson entities, as grantors, to Capital
27 Finance, as grantee, and concluded from these that, "[p]ursuant
28 to California Civil Code § 3439.08(b), [Klein] is entitled to a

1 judgment of \$2,800,000 [sic]⁴ against Capital Finance, Inc., and
2 that the claim is not subject to any bona fide dispute." Klein
3 testified in a declaration that the transfers were made without
4 consideration and solely to defraud him and other creditors, who
5 were, however, not named.

6 Capital Finance asserted, on the other hand, by way of a
7 declaration by Dawood, that the transfers had been made in
8 satisfaction of pre-existing debts owed by Johnson to Capital
9 Finance. Dawood also testified that Capital Finance was a Nevada
10 corporation in good standing and qualified to do business in
11 California as Nevada Capital Finance, that it had no long-term
12 obligations and was paying its operating expenses as they came
13 due, that it was not past due on any obligation to anyone, that
14 it owed no money or other obligation to Klein, and that it had
15 never done business with Klein.

16 At a hearing on September 9, 2002, on Capital Finance's
17 motion to dismiss the involuntary petition, the court stated its
18 findings and conclusions on the record, finding that the more
19 appropriate forum for Klein's claim against Capital Finance was
20 the state court, where he could "get a judgment, get a temporary
21 restraining order, get a restraint on selling the assets, do
22 whatever you need to do. And then maybe you can initiate the
23 involuntary." Tr. Hr'g 2:7-10 (September 9, 2002).

24 The bankruptcy court granted Capital Finance's motion to
25 dismiss the involuntary petition by order entered September 24,
26 2002 (the "dismissal order"). In the dismissal order, the court

27

28 4. The amount of the judgment was actually \$2,400,000.

1 also "reserve[d] jurisdiction to award attorney's fees, costs,
2 actual damages and punitive damages on any motion brought by
3 Capital Finance, Inc." Klein timely appealed the dismissal
4 order.

5 Klein's appeal was pending before this Panel from October 3,
6 2002 until August 19, 2003, when it was dismissed for failure to
7 prosecute. The bankruptcy case was closed on October 17, 2003.
8 In connection with Capital Finance's attempt to file a motion
9 under § 303(i), the case was reopened by the court sua sponte on
10 November 24, 2003. For reasons that are not fully explained, the
11 case was closed again on December 15, 2003. Capital Finance
12 filed a § 303(i) motion on March 8, 2004, and in response, the
13 court required that it also file a motion to reopen the case,
14 which was set for hearing on April 1, 2004.

15 In opposition to the motion to reopen, filed March 24, 2004,
16 Klein contended that, pursuant to Fed. R. Civ. P. 54, Capital
17 Finance was required to file its § 303(i) motion within 30 days
18 after entry of the order dismissing the case, and that having
19 waited 18 months instead, Capital Finance was time-barred. Klein
20 asserted he would "suffer extreme prejudice" if Capital Finance
21 were permitted to go forward, because he had allowed his appeal
22 to lapse "in reliance upon the passage of time and the statutory
23 bar to any request for fees or damages." He alleged that:

24 I would not have permitted the appeal in this case to
25 be dismissed if there were any pending request or award
26 for fees or damages. My perspective was that Jamal
27 Dawood was in jail, there were additional criminal
28 complaints against him, and the Honorable Mitchel R.
Goldberg did not want this case. It did not make sense
to me to try to further prosecute this case at the
appellate level if there was no claim by Capital Finance,
and if the bankruptcy court did not want this case.

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28

- (A) costs; or
- (B) a reasonable attorney's fee; or
- (2) against any petitioner that filed the petition in bad faith, for--
 - (A) any damages proximately caused by such filing; or
 - (B) punitive damages.

§ 303(i).

A. Capital Finance's Standing

We begin with the issue of Capital Finance's standing to seek fees and costs under § 303(i)(1). Klein's argument is that Capital Finance is not entitled to do business in the State of California. The record is to the contrary. Klein submitted to the bankruptcy court a copy of a January 15, 2002 order in which the Orange County Superior Court ruled that "[d]ue to lack of proof of standing, the third party claim by Capital Finance, Inc., is dismissed without prejudice." Capital Finance argues, but we cannot determine from the record, that this document was not admitted into evidence at the trial.

The significant points are that the state court found only that Capital Finance had not proven its standing to pursue the particular claim, and that the order predates Klein's filing of the involuntary petition, on June 7, 2002, by almost five months. Klein's own evidence reveals that in the interim, on January 18, 2002, Capital Finance, Inc., was incorporated in Nevada, and on April 2, 2002, registered with the California Secretary of State as an active Nevada corporation "which will do business in California as Nevada Capital Finance, Inc." Dawood testified

1 that Capital Finance "is currently a Nevada corporation, in good
2 standing and duly qualified to do business in California as
3 Nevada Capital Finance."⁷ Thus, we conclude that Capital Finance
4 had the requisite authority under state corporate law to defend
5 against the involuntary petition and to file the § 303(i) motion.

6
7 B. Timeliness of the § 303(i) Motion

8 We turn next to Klein's argument that the § 303(i)(1) motion
9 was not timely filed. Klein relies on L.B.R. 7054-1, and in the
10 bankruptcy court, Klein also cited Fed. R. Civ. P. 54(d). Klein
11 argues that L.B.R. 7054-1 required Capital Finance to file its
12 § 303(i) motion within 30 days from entry of the dismissal order,
13 and that because it did not, the motion should have been denied.
14 We reject this proposition.

15 The pertinent subsections of the rule are as follows:

16 **(a) WHO MAY BE AWARDED COSTS**

17 When costs are allowed by the F.R.B.P. or other
18 applicable law, the court may award costs to the
19 prevailing party. . . .

20 **(b) BILL OF COSTS**

21 The prevailing party who is awarded costs shall have 30
22 days after entry of judgment to file and serve a Bill
23 of Costs. Each item claimed shall be set forth
24 separately in the Bill of Costs. The prevailing party,
25 or the party's attorney or agent having knowledge of
26 the facts shall file a declaration with the Bill of
27 Costs. The declaration shall verify that:

- 28 (1) The items claimed as costs are correct;
- (2) The costs have been necessarily incurred in the case;

27 7. Klein admitted that he was aware of the fact of Capital
28 Finance's incorporation in Nevada on January 18, 2002, and its
registration with the California Secretary of State on April 2,
2002, before he filed the involuntary petition.

- 1 (3) The services for which fees have been charged were
2 actually and necessarily performed; and
3 (4) The costs have been paid or the obligation for
4 payment has been incurred.

5 **(f) MOTION FOR ATTORNEYS' FEES**

6 If not previously determined at trial or other hearing,
7 any motion for attorneys' fees where such fees may be
8 awarded shall be served and filed within 30 days after
9 the entry of judgment or other final order, unless
10 otherwise ordered by the court. Such motions and their
11 disposition shall be governed by Local Bankruptcy Rule
12 9013-1.

13 L.B.R. 7054-1(a), (b), (f).

14 The bankruptcy court issued its oral ruling on this issue on
15 December 28, 2006. The crux of the ruling was a distinction
16 between a contract cause of action, for example, in which the
17 prevailing party is entitled to attorney's fees and costs,
18 ancillary to the trial on the merits, and on the other hand, an
19 involuntary bankruptcy petition, where the right to attorney's
20 fees is not absolute, but only presumed, and where the court, as
21 a separate matter, considers the totality of the circumstances of
22 the petitioning creditor's conduct in determining whether the
23 alleged debtor will be awarded fees and costs. The bankruptcy
24 court concluded that the former would be subject to the filing
25 deadline imposed by Fed. R. Civ. P. 54(d); the latter would not.⁸
26 The court clarified later at the hearing that its findings
27 pertained to both Fed. R. Civ. P. 54(d) and L.B.R. 7054-1.

28 We agree with the bankruptcy court that Fed. R. Civ. P.
54(d) and L.B.R. 7054-1 regarding "prevailing parties" do not

8. The court noted that the alleged debtor "[has] no right by law to attorneys fees as the prevailing party." Tr. Hr'g 15:2-6 (December 28, 2006).

1 apply. The key distinction is that § 303(i) is substantive law
2 providing an independent claim to an alleged debtor whenever an
3 involuntary petition is dismissed without the alleged debtor
4 having waived that claim.⁹

5 Moreover, Fed. R. Civ. P. 54(d) does not apply in bankruptcy
6 proceedings at all. Rule 7054 incorporates in bankruptcy
7 adversary proceedings subsections (a) through (c) of Fed. R. Civ.
8 P. 54, but not subsection (d). Rule 1018, in turn, makes Rule
9 7054 applicable in proceedings relating to a contested
10 involuntary petition.

11 While the inapplicability of Fed. R. Civ. P. 54(d) is
12 dispositive as to that aspect of the argument, we note that,
13 even if the rule were applicable in bankruptcy matters generally,
14 an attorney's fee award under § 303(i)(1) is not of the sort that
15 would be governed by that rule.¹⁰ We also conclude that a
16 § 303(i)(1) fee award is not of the type governed by L.B.R.
17 7054-1.¹¹

18 Section 303(i) is inherently different from a prevailing
19 party statute. First, § 303(i) is "intended to be the exclusive

20 _____
21 9. We find Klein's reliance on White v. N. H. Dep't of
22 Employment Sec., 455 U.S. 445 (1982), and Bender v. Freed, 436 F.3d
23 747 (7th Cir. 2006), to be misplaced. Neither case pertains to the
filing of involuntary bankruptcy petitions or to an alleged
debtor's remedies when such a petition is dismissed.

24 10. Fed. R. Civ. P. 54(d)(2)(A) provides that "[c]laims for
25 attorneys' fees and related nontaxable expenses shall be made by
26 motion unless the substantive law governing the action provides for
the recovery of such fees as an element of damages to be proved at
trial."

27 11. Under Rule 9029(a)(1), a local bankruptcy rule may not be
28 inconsistent with the Federal Rules of Bankruptcy Procedure. We
conclude that L.B.R. 7054-1 would be invalid as applied to a
§ 303(i)(1) award, although it may be perfectly valid as applied in
other contexts.

1 remedy for regulating abuse of the involuntary bankruptcy
2 process." Wechsler, 370 B.R. at 249 (emphasis in original),
3 citing Miles v. Okun (In re Miles), 430 F.3d 1083, 1089-91 (9th
4 Cir. 2005).

5 Further, we must view § 303(i) as an integrated whole,
6 reading subdivisions (i)(1) and (i)(2) together.

7 [T]he doctrine of "whole statute" interpretation
8 requires that "a subsection may not be considered in a
9 vacuum, but must be considered in reference to the
statute as a whole and in reference to statutes dealing
with the same general subject matter."

10 Wechsler, 370 B.R. at 252, quoting 2A NORMAN J. SINGER, SUTHERLAND
11 STATUTORY CONSTRUCTION § 46:5 (5th ed. 1992).

12 In accordance with this principle of statutory construction,
13 the Panel has previously held, with regard to § 303(i) in
14 particular, that "[t]he § 303 (i) scheme [. . .] is construed as
15 an integrated whole in which each of its facets is assessed in
16 the context of the remaining facets." Michael N. Sofris, APC v.
17 Maple-Whitworth, Inc. (In re Maple-Whitworth, Inc.), 2007 Bankr.
18 LEXIS 3174 * 7-8 (9th Cir. BAP 2007), citing United States v.
19 Atl. Research Corp., 127 S. Ct. 2331, 2336, 168 L. Ed. 2d 28
20 (2007), Wechsler, 370 B.R. at 252.

21 The bankruptcy court applied this principle in this case,
22 recognizing that the two subsections of § 303(i) go hand-in-hand,
23 and observing the illogical result of applying a 30-day deadline
24 to a motion under § 303(i)(1) but no deadline to a motion under
25 § 303(i)(2). The alleged debtor would be required to file his
26 motion for attorney's fees and costs within 30 days from entry of
27 the order dismissing the case, but might file his motion for
28 damages at a later time, thus requiring the court to examine the

1 same set of facts twice, at different times.

2 The bankruptcy court also alluded to the inequity that would
3 result from requiring a debtor who has just gone through an
4 involuntary filing, "something he never entered into," to make
5 his decision whether to apply for fees and costs within 30 days.

6 Further, if the outcome in this case had been different, and
7 if the bankruptcy court had entered an order for relief, Klein
8 would have been under no such time constraint in deciding whether
9 and when to seek an allowance of his attorney's fees and costs
10 under § 503(b)(3)(A) and (b)(4). It would be incongruous at best
11 to impose a strict deadline on Capital Finance, whose involvement
12 in the involuntary proceeding was truly involuntary, when Klein,
13 whose participation was the result of his own choice, would have
14 been under no such deadline.¹²

15 We conclude that attorney's fees and costs are under the
16 umbrella of § 303(i), which encompasses all the potential
17 remedies that may be available to an alleged debtor who defeats
18 an involuntary petition. As such, attorney's fee and cost claims
19

20 12. As the Panel previously observed,

21 [our] analysis is further supported by the recognition
22 that, in the instance of involuntary petitions, the
23 availability of awards to successful petitioning
24 creditors and their counsel under §§ 503(b)(3)(A) and
25 (b)(4) are essentially symmetric with the rights of
26 alleged debtors to recover fees and costs under § 303(i)
27 when they successfully fend off an involuntary petition.
The language of § 303(i) does not admit of the
construction that the alleged debtor must actually have
a separately-reimbursable expense before fees and costs
could be awarded. An asymmetric construction of
§§ 503(b)(3)(A) and (b)(4) would be unfair and absurd.

28 Salomon N. Am. v. Knupfer (In re Wind N' Wave), 328 B.R. 176, 183
(9th Cir. BAP 2005), rev'd on other grounds, 2007 U.S. App. LEXIS
25507 (9th Cir. 2007).

1 are not the type of claims required to be asserted within the
2 time frame of L.B.R. 7054-1(f).

3 Having concluded that neither L.B.R. 7054-1 nor Fed. R. Civ.
4 P. 54(d) applied, the bankruptcy court went on to examine whether
5 the delay in filing the § 303(i) motion had been reasonable and
6 whether Klein had been prejudiced by the delay. The bankruptcy
7 court carefully considered and ruled on these issues, addressing
8 the reasons for the various delays, with specific reference to
9 each time period between relevant events. The court also
10 considered and rejected Klein's argument that he had been
11 prejudiced because he had allowed his appeal to lapse in reliance
12 on Capital Finance's failure to file a § 303(i) motion within 30
13 days from entry of the dismissal order.

14 Given the bankruptcy court's careful consideration of
15 Klein's arguments, and the broad discretion it enjoyed in
16 construing its own local rules, we conclude that the court did
17 not abuse that discretion when it determined that L.B.R. 7054-1
18 did not apply to Capital Finance's § 303(i) motion.¹³

19 However, even if we assume that L.B.R. 7054-1 applied to
20 Capital Finance's § 303(i) motion, we find that the motion
21 complied with the rule. Rule 7054-1(f) imposes a 30-day limit
22 specifically conditioned on "unless otherwise ordered by the
23 court." Capital Finance included a request for an award of
24 attorney's fees and costs, as well as damages, under § 303(i)(1)
25 and (2), in its motion to dismiss the involuntary petition. Not
26 only did Capital Finance expressly request such relief in the

27
28 13. District courts "have broad discretion in interpreting
and applying their local rules.'" Delange v. Dutra Constr., Co.,
183 F.3d 916, 919 n. 2 (9th Cir. 1999), citing Miranda v. Southern
Pac. Transp., 710 F.2d 516, 521 (9th Cir. 1983).

1 motion, it included argument and case authority for its
2 entitlement to such relief, and indicated it would present
3 evidence of its fees and costs, and actual damages, at a
4 subsequent evidentiary hearing if the dismissal motion was
5 granted.

6 After issuing its ruling on Capital Finance's motion to
7 dismiss, at the September 9, 2002 hearing, the court indicated it
8 would handle the fees and damages request at a later date. The
9 court engaged in a discussion with counsel for Capital Finance in
10 an attempt to select an acceptable date for the evidentiary
11 hearing and a corresponding date for additional papers to be
12 filed. Dates more than 30 days out were discussed, but because
13 of counsel's expressed wish to conduct discovery, the court
14 finally stated, "I'll reserve, you set it. . . . I reserve re
15 fees and sanctions, no hearing dates." Tr. Hr'g 10:6-14
16 (September 9, 2002). Klein's counsel was present during this
17 colloquy, and raised no objection.

18 The Panel concludes that this discussion, together with the
19 court's express reservation of jurisdiction, in the dismissal
20 order, "to award attorney's fees, costs, actual damages and
21 punitive damages on any motion brought by Capital Finance, Inc."
22 was an implicit extension of time, for purposes of L.B.R. 7054-
23 1(f). Thus, the motion was timely in the first instance.

24

25 C. Award of Fees and Costs

26 Finally, Klein contends the bankruptcy court erred in
27 awarding fees and costs under the totality of the circumstances.
28 We observe first that, while the totality of the circumstances is

1 the correct standard for an award under § 303(i)(1), the inquiry
2 properly begins with "a rebuttable presumption that reasonable
3 fees and costs are authorized." Wechsler, 370 B.R. at 249,
4 citing Higgins, 379 F.3d at 707.

5 [A]lthough the Code has liberalized standards for
6 instituting involuntary cases, because of the potential
7 adverse impact on the debtor and the need to encourage
8 discretion in filing such cases, unsuccessful
9 involuntary petitioners should routinely expect to pay
10 the debtor's legal expenses arising from the
11 involuntary filing.

12 Wechsler, 370 B.R. at 249, citing Higgins, 379 F.3d at 706; In re
13 Kidwell, 158 B.R. 203, 217 (Bankr. E.D. Cal. 1993). (Emphasis
14 added.)

15 In short, "[f]iling an involuntary petition 'should be a
16 measure of last resort because even if the petition is filed in
17 good-faith, it can 'chill[] the alleged debtor's credit and
18 sources of supply,' and 'scare away his customers.'" Higgins,
19 379 F.3d at 707, quoting In re Advance Press & Litho, Inc., 46
20 B.R. 700, 702 (Bankr. D. Colo. 1984).

21 The petitioning creditor must be given an opportunity to
22 rebut the presumption, but is not entitled to conduct additional
23 discovery and present additional evidence. Higgins, 379 F.3d at
24 707. "The rebuttable presumption framework allows the court,
25 which by this point in the process has heard all the evidence
26 surrounding dismissal, to make 'an informed examination of the
27 entire situation' without the burden of conducting another mini-
28 trial." Id., citing In re Scrap Metal Buyers of Tampa, Inc., 233
B.R. 162, 166 (Bankr. M.D. Fla. 1999).

In assessing the totality of the circumstances, the
bankruptcy court should consider, but is not limited to, these

1 factors: (1) the merits of the involuntary petition, (2) the
2 role of any improper conduct on the part of the alleged debtor,
3 (3) the reasonableness of the actions taken by the petitioning
4 creditors, and (4) the motivation and objectives behind filing
5 the petition. Higgins, 379 F.3d at 707, citing In re Scrap
6 Metal, 233 B.R. at 166.

7 Although it was not required to do so, the court conducted a
8 trial on the issue over a period of two days, on December 28,
9 2006 and January 18, 2007. The trial followed extensive briefing
10 from both sides of the issue, and Klein had conducted discovery,
11 both before he appealed the dismissal order and after that appeal
12 was dismissed. In short, all the issues Klein raised were
13 thoroughly explored, with virtually no limitation by the
14 bankruptcy court, at least none of which he now complains.

15 On January 18, 2007, the bankruptcy court made a detailed
16 oral ruling on Capital Finance's entitlement to fees and costs
17 under § 303(i)(1). The court relied on In re K.P. Enter., 135
18 B.R. 174 (Bankr. D. Me. 1992), which in turn, describes the
19 relevant factors as including "the reasonableness of the
20 petitioners' actions, their motivation and objectives, and the
21 merits of their view that the petition was proper and
22 sustainable." K.P. Enter., 135 B.R. at 177.

23 The bankruptcy court rejected Klein's argument, also raised
24 in this appeal, that he had relied on the advice of counsel in
25 filing the involuntary petition. "Involuntary is an extremely
26 harsh remedy and mere reliance on counsel is not an excuse. . . .
27 There is an independent duty to investigate." Tr. Hr'g 3:25 -
28 4:4 (January 18, 2007). The court focused on whether Klein had a

1 justifiable reason for filing the involuntary petition. The
2 court's findings included the following:

3 It is clear beyond any doubt that Mr. Klein was not a
4 creditor of the fictitious name Capital Finance,
5 Capital Finance, Inc., or Nevada Capital Finance, Inc.
6 doing business in California as Capital Finance. It is
7 clear that he was not a creditor of any of them.

8 What he was was a disputed claimant of the parties
9 because he had a triable issue of fact as to whether
10 the Johnsons and Dawood, on behalf of Capital Finance,
11 conspired to hide properties in the wake of the
12 onslaught between Mr. Hasso and Mr. Klein of putting
13 pressure to collect on a number of default judgments
14 against Johnson. . . .

15 Involuntaries are supposed to be a rare and extreme
16 circumstance to assure protection for the benefit of
17 all creditors. The testimony is clear. Mr. Klein had
18 no idea if there were any other creditors of Capital
19 Finance. That didn't matter to him. He was out to
20 protect what he perceived was a fraudulent transfer and
21 he was as frustrated as frustrated can be. He had
22 judgments against Johnson, Johnson had done everything
23 to hide properties. They [Klein and another] finally
24 put him [Johnson] in an involuntary and it even looked
25 like that wasn't going to work. And out of that
26 frustration and success of getting relief in the
27 Johnson bankruptcy, somehow came the belief that
28 involuntary was a tool to gain control. And it is.
But it has to be used extremely carefully.

In this case the tool was improperly used.

Tr. Hr'g 145:21 - 147:7.

The bankruptcy court addressed in some detail the impediment
that the Johnson bankruptcy posed to Klein's recovery of the
alleged fraudulent transfers, in terms of the Johnson bankruptcy
trustee's apparently exclusive standing to pursue the transfers.¹⁴
The court noted that before Klein commenced the involuntary
against Capital Finance, Klein's attorney approached the Johnson
bankruptcy trustee, but Klein was unwilling or unable to put up
the deposit the trustee would require to prosecute the transfers.

14. Any such impediment was created by Klein himself, as it
was his involuntary petition that had put Johnson into bankruptcy.

1 The bankruptcy court concluded, therefore, that prior to
2 commencing the involuntary, Klein was aware of appropriate
3 remedies against Capital Finance, including convincing the
4 Johnson trustee to pursue the transfers or offering to purchase
5 the causes of action. In other words, Klein's use of the
6 involuntary petition was not as "a measure of last resort." See
7 Higgins, 379 F.3d at 707. Rather, filing the involuntary
8 petition was a matter of convenience for Klein.

9 The court supplemented its findings on January 19, 2007,
10 clarifying that it was not holding that Klein acted in bad faith
11 when he filed the petition, but that he acted without making a
12 reasonable inquiry and for an invalid purpose.¹⁵

13 Klein argues that he held a non-contingent undisputed claim
14 against Capital Finance, and therefore, that he filed the
15 petition in good faith.¹⁶ He also contends that the allegedly
16 undisputed facts would have supported substantive consolidation

17
18 15. We observe, as did the bankruptcy court, that "in the
19 Ninth Circuit, the presumption is that, upon dismissal of an
20 involuntary petition, attorney's fees and costs are to be awarded
to the alleged debtor whether or not the filing was in bad faith." Wechsler, 370 B.R. at 255.

21 16. On this particular point, we reject Klein's argument that
22 the bankruptcy court dismissed the involuntary petition solely
23 because Klein had not reduced his claim to judgment. The court
24 merely suggested that the proper venue for Klein's claim against
25 Capital Finance was the state court, where the disputed factual
26 issues could be decided, including whether the real property
27 transfers were arms-length transactions or fraudulent transfers.
28 We agree. Klein's reliance on Chicago Title Ins. Co. v. Seko
Invs., Inc. (In re Seko Invs., Inc.), 156 F.3d 1005 (9th Cir.
1998), is similarly flawed. The case stands not for the
proposition that a petitioning creditor need not have a state court
judgment, but that "the existence of a counterclaim against a
creditor does not automatically render the creditor's claim the
subject of a 'bona fide dispute.'" 156 F.3d at 1008. Unlike the
claim of the petitioning creditor in Chicago Title, Klein's claim
against Capital Finance was unequivocally the subject of a bona
fide dispute.

1 with Johnson's pending chapter 7 case, and that involuntary
2 bankruptcy constitutes "lesser relief."

3 Klein argues in his reply brief that his objective here is
4 not to collaterally attack the order dismissing the involuntary
5 petition, which is now final, but to show "the merits of the
6 petition," which is one of the factors a court should consider in
7 ruling on a § 303(i)(1) request for fees and costs. Higgins, 379
8 F.3d at 707. The substantive consolidation argument also
9 concerns alleged improper conduct on the part of the alleged
10 debtor, which is another pertinent factor.

11 Klein's arguments depend on the underlying proposition that
12 "in a hearing on a motion to dismiss, all facts must be construed
13 in the light most favorable to the opposing party, and the
14 allegations of a petition or complaint must be accepted as being
15 true." (Klein Opening Br. at 18.) Klein does not cite a rule or
16 other authority; we presume, therefore, that he refers to Fed. R.
17 Civ. P. 12(b)(6). See Epstein v. Wash. Energy Co., 83 F.3d 1136,
18 1140 (9th Cir. 1996).

19 We reject this proposition because Capital Finance met
20 Klein's involuntary petition with a Fed. R. Civ. P. 12(b)(6)
21 motion to dismiss, to which Klein responded with a declaration
22 and extensive exhibits, thereby taking steps to convert the
23 motion to dismiss to a motion for summary judgment.¹⁷ "A federal
24 court must convert a 12(b)(6) motion to one for summary judgment
25 when the parties submit, and the court does not reject, material

26
27 17. A Fed. R. Civ. P. 12(b)(6) motion is an appropriate
28 procedure for presenting defenses and objections to an involuntary
petition. Rule 1011(b). Rules governing summary judgment are also
applicable in proceedings relating to a contested involuntary
petition. Rule 1018, incorporating Rule 7056, in turn
incorporating Fed. R. Civ. P. 56.

1 beyond the pleadings." Fernandez v. GE Capital Mortg. Servs. (In
2 re Fernandez), 227 B.R. 174, 179 (9th BAP 1998), citing Parrino
3 v. FHP, Inc., 146 F.3d 699, 706 n.4 (9th Cir. 1998), Cunningham
4 v. Rothery (In re Rothery), 143 F.3d 546 (9th Cir. 1998). Formal
5 notice of the conversion of the motion is not required; the
6 important point is that the parties have "a full and fair
7 opportunity to ventilate the issues involved in the motion."
8 Fernandez, 227 B.R. at 180, quoting Cunningham, 143 F.3d at 549.
9 "A party is 'fairly appraised' [sic] that the court will in fact
10 be deciding a summary judgment motion if that party submits
11 matters outside the pleadings to the judge and invites
12 consideration of them." Cunningham, 143 F.3d at 549, citing
13 Grove v. Mead School Dist. No. 354, 753 F.2d 1528, 1533 (9th Cir.
14 1985).

15 Although the bankruptcy court did not refer to the matter as
16 a summary judgment motion, it did take and consider the evidence
17 presented by both parties. Klein invited consideration of
18 evidence outside the pleadings when he submitted his declaration
19 and exhibits. He had no reason to expect the court to accept
20 them as "undisputed" simply because he presented them in the
21 context of an opposition to a motion nominally brought under Fed.
22 R. Civ. P. 12(b)(6).

23 Further, Klein's attempt to apply the Fed. R. Civ. P.
24 12(b)(6) standards to render his alleged facts "undisputed" would
25 turn the applicable burden of proof on its head. "The filing of
26 an involuntary case requires the petitioning creditor to meet the
27 burden of proof on the main elements of § 303." Cunningham, 143
28 F.3d at 548.

1 Additionally, in terms of his good faith in filing the
2 petition, the record supports no other conclusion than that
3 Klein's claims were hotly disputed, and that Klein knew it or, by
4 any standard of reasonableness, must have known it, given the
5 serious nature of his charges.¹⁸

6 Finally, to the extent, if any, that alleged grounds for
7 substantive consolidation should be considered in assessing the
8 totality of the circumstances, for purposes of a § 303(i)(1)
9 award, we observe that Klein addressed this issue in his
10 opposition to Capital Finance's motion to dismiss the involuntary
11 petition, and the issue was, therefore, presumably considered by
12 the bankruptcy court.

13 In summary, given the thoroughness with which the bankruptcy
14 court handled this matter, taking evidence over the course of two
15 days, and reviewing extensive and detailed briefing, given the
16 detail with which it rendered its ruling, and given the broad
17 discretion afforded the bankruptcy court under § 303(i)(1), we
18 cannot say that the court abused its discretion in finding that
19 Klein failed to conduct a reasonable inquiry into the relevant
20 facts and pertinent law before commencing this case, or in

21
22 18. See, e.g., Adell v. John Richards Homes Bldg. Co., L.L.C.
23 (In re John Richard Homes Bldg. Co., L.L.C.), 439 F.3d 248, 257
(6th Cir. 2006):

24 [T]he nature of Adell's claims was such that he would
25 certainly not require legal advice to understand that he
26 and JRH would have real and substantial legal and factual
27 disputes, and further that the litigation to resolve
28 these disputes would be lengthy and costly. Even before
JRH filed responsive pleadings, Adell could not have
reasonably concluded that JRH would simply admit that it
had committed the frauds and the other intentional wrongs
that he had alleged.

1 finding that he had no valid purpose for filing the involuntary
2 petition. Nor did the court abuse its discretion in awarding
3 Capital Finance its attorney's fees and costs.

4 CONCLUSION

5 We conclude that the bankruptcy court did not err in
6 determining that Capital Finance had standing to seek an award of
7 attorney's fees and costs, pursuant to § 303(i), and did not err
8 in determining that Capital Finance's motion for such an award
9 was timely filed. We also conclude that the court did not abuse
10 its discretion in awarding attorney's fees and costs to Capital
11 Finance. Therefore, we AFFIRM.

12
13
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28