NOT FOR PUBLICATION

UNITED STATES BANKRUPTCY APPELLATE PANEL

OF THE NINTH CIRCUIT

In re:	BAP No. EC-06-1000-SJB
BAXTER M. GILTON and TAMARA E. GILTON,	Bk. No. 05-91185
Debtors.	
ARMELIN DeSOUSA and MARIA DeSOUSA,	
Appellants,	
v.	**M E M O R A N D U M**[1]
BAXTER M GILTON and TAMARA E. GILTON,	
Appellees.	

Argued and Submitted on September 13, 2006
at Sacramento, California

Filed - September 29, 2006

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

Hon. Michael S. McManus, Chief Bankruptcy Judge, Presiding.

Before: SMITH, JURY[2] and BRANDT, Bankruptcy Judges.

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[1] This disposition is not appropriate for publication and may not be cited except when relevant under the doctrine of law of the case or rules of res judicata, including claim preclusion and issue preclusion. See 9th Cir. BAP Rule 8013-1.

[2] Hon. Meredith A. Jury, United States Bankruptcy Judge for the Central District of California, sitting by designation.

Following the confirmation of a chapter 13[3] plan, creditors filed a motion to dismiss debtors' bankruptcy petition for bad faith. The bankruptcy court denied the motion. A timely notice of appeal was filed on January 6, 2006. We AFFIRM.

I. FACTS

Prior to the filing of the bankruptcy case, debtors Baxter and Tamara Gilton ("Debtors") entered into a contract to sell real property to Armelin and Maria deSousa ("Appellants") for $800,000. Appellants alleged that Debtors breached this agreement, both by contracting to sell the property to another person, Wendel Trinkler ("Trinkler"), and by refusing to consummate the sale. On December 16, 2004, based on the alleged breach, they commenced an action for specific performance in state court to compel Debtors to sell the property to them (the "state court action"). During the course of the litigation, Debtors apparently threatened to file bankruptcy if a settlement could not be reached.[4]

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[3] 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 1001-9036, as enacted and promulgated prior to the effective date (October 17, 2005) of The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. 109-8, Apr. 20, 2005, 119 Stat. 23.

[4] In support of Debtors' alleged threat of bankruptcy, Appellants submitted a declaration of their counsel, Cory B. Chartrand, declaring that

> [i]n early June 2005, [D]ebtors' attorney in the state court action left a voicemail message for [me] stating that if [Appellants] did not accept [D]ebtors' offer to settle the state court litigation for attorneys' fees and costs and to forego all rights to the property in question, [D]ebtors would file Chapter 13 bankruptcy [sic] and have the contract and all obligations to [Appellants] "discharged."

(continued...)

Following unsuccessful settlement attempts, Debtors filed a chapter 13 bankruptcy petition on June 10, 2005. They listed the debt owed to Appellants on Schedule F (general unsecured claims) and on Schedule G (executory contracts and unexpired leases). The chapter 13 trustee served Debtors' proposed plan, which provided for the rejection of the executory contracts between Debtors and Appellants (as well as the contract with Trinkler),[5] together with the notice of commencement of case[6] and a proof of claim form. Appellants did not dispute receipt of this notice.

On September 16, 2005, Appellants moved to dismiss the bankruptcy pursuant to §§ 305 and 1307(c) on the grounds that the case was filed in bad faith for the sole purpose of rejecting the land sale contract and that had Debtors consummated the sale they could have paid all their creditors, secured and unsecured, in full. Instead, by Debtors failing to perform, Appellants were left with nothing, and Debtors enjoyed a windfall of $528,120, the amount of equity in the property after the encumbrances were paid off.

On September 26, 2005, the plan, which provided for a 100% distribution to general unsecured claim holders, was confirmed

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[4](...continued)
Cory B. Chartrand Decl. ¶ 6 (submitted in support of the motion to dismiss).

[5] The bankruptcy court made no determination that the contracts were actually executory.

[6] The notice of commencement of case informed all parties in interest, including Appellants, that objections to the plan had to be filed and served no later than the 14 days following the first meeting of creditors (which was on July 27, 2005). The plan also contained the same notice.

without objection.[7]

The hearing on the motion to dismiss was held on December 12, 2005, well after the plan had been confirmed. Thereafter, the bankruptcy court issued a written memorandum denying the motion. Among other things, the court rejected the argument that Debtors would enjoy a substantial windfall to the detriment of their creditors, explaining that Appellants and Trinkler had the right to file claims in the estate for any damages caused by the rejection of their contracts. Further, "[i]n order to service the secured debt encumbering the property, to pay the [general unsecured claim holders] in full, and to pay the rejection claims, if any, in full with interest, the confirmed plan requires the [D]ebtors to sell the subject property." Memorandum at 4. Hence, Debtors were "not simply rejecting the executory contracts and then walking out of bankruptcy court with the property or its net value." Id.

In addition, the bankruptcy court ruled that the motion to dismiss was untimely. Relying on In re Valenti, 310 B.R. 138 (9th Cir. BAP 2004), it held that a motion to dismiss a bankruptcy petition must be prosecuted before a chapter 13 plan is confirmed, and that only when a debtor has concealed facts that prevent a creditor from seeking dismissal of the case prior to confirmation may a creditor seek dismissal based on pre-confirmation conduct.

The court also referenced In re Eisen, 14 F.3d 469 (9th Cir.

[7] The bankruptcy court recognized that the motion to dismiss was filed 10 days prior to the confirmation hearing, but did not construe it as an objection to the chapter 13 plan because it was not filed within the time allotted to object to the plan.

1994), in supporting its finding of untimeliness and interpreted the Ninth Circuit's holding to mean "that a petition filed in bad faith . . . means that any plan is proposed in bad faith. So, when a plan is confirmed, something that can only occur if the plan has been proposed in good faith, it follows that the petition must have been filed in good faith." Memorandum at 7. Based on its interpretation of Eisen, the court reasoned that because a condition of confirmation is a finding that the chapter 13 plan is proposed in good faith, it is incumbent on a creditor to raise any issue regarding lack of good faith prior to confirmation. Here, in the court's view, Appellants failed to raise their allegation of bad faith prior to the confirmation of the plan and were, therefore, precluded from raising it after the plan was confirmed.[8]

Finally, the bankruptcy court found that Debtors had legitimate reasons for seeking chapter 13 relief:

> Both [Debtors] are 79 years of age, both have been retired for ten years or more, Mr. Gilton's health is declining, neither has ever before filed a bankruptcy petition, and their household subsists on $2,460 a month in social security and pension benefits. After paying Spartan living expenses, they will have a mere $100 a month in disposable income.
>
> The [Debtors'] debt, $116,163 in secured claims and $155,717 in unsecured claims (not taking into account rejection claims), largely was incurred in connection with an unsuccessful post-retirement attempt to develop

[8] The bankruptcy court disagreed with In re Powers, 135 B.R. 980 (Bankr. C.D. Cal. 1991), a case in which the court held that a creditor who fails to object to confirmation of a chapter 13 plan is not precluded from later moving for dismissal of the case based on the debtor's bad faith at the time of the filing, because it was inconsistent with Valenti and other decisions that have held that motions to dismiss based on a debtor's lack of eligibility for chapter 13 relief must be raised prior to confirmation.

> a cheese plant. The confirmed plan requires the contribution of their $100 in monthly disposable income for 36 months in order to pay this debt. Because this disposable income obviously will not be sufficient to retire the debt, the plan also requires [Debtors] to contribute a $3,800 semi-annual rent payment due them as well as the proceeds from the sale of the property . . . .
>
> Then there is the litigation between [Debtors], [Appellants], and [Trinkler]. The income listed on Schedule I suggests that [Debtors] do not have the ability to fund the litigation. And, given that there are two parties, [Appellants] and [Trinkler], claiming a right to buy the property, giving up and selling the property to [Appellants] will not end the litigation.

Id. at 9-10.

Appellants appeal.

II. JURISDICTION

The bankruptcy court had jurisdiction under 28 U.S.C. § 1334 and §§ 157(b)(1), (b)(2)(A), and (2)(B). We have jurisdiction under 28 U.S.C. §§ 158(b)(1) and (c)(1).

III. ISSUES

1. Whether a motion to dismiss a bankruptcy petition based on bad faith that is not heard prior to confirmation of the chapter 13 plan is rendered moot.
2. Whether Debtors' chapter 13 bankruptcy petition was filed in bad faith.

IV. STANDARD OF REVIEW

A chapter 13 petition filed in bad faith may be dismissed "for cause" pursuant to § 1307(c). In re Eisen, 14 F.3d at 470; In re Powers, 135 B.R. at 991. We review for clear error a finding of bad faith. In re Eisen, 14 F.3d at 470; In re Metz, 820 F.2d 1495, 1497 (9th Cir. 1987). In determining bad faith, the bankruptcy court must review the "totality of circumstances."

In re Goeb, 675 F.2d 1386, 1391 (9th Cir. 1982). The relevant factors include whether the debtor misrepresented the facts in his petition or the plan, unfairly manipulated the Bankruptcy Code, or otherwise filed the chapter 13 petition or plan in an inequitable manner. Id. at 1390. Bad faith can also exist where the debtor only intended to defeat state court litigation. In re Chinichian, 784 F.2d 1440, 1445-46 (9th Cir. 1986).

V. DISCUSSION

A. A Motion to Dismiss is Not Barred Subsequent to Plan Confirmation

Appellants argue that the bankruptcy court erred in relying on Valenti in determining that a motion to dismiss cannot be granted after a chapter 13 plan has been confirmed. In Valenti, the issue before the court was whether a chapter 13 plan was proposed in good faith – not whether the bankruptcy petition itself was filed in good faith. Unlike Valenti, Appellants submit the issue in the instant matter is whether the chapter 13 case itself was commenced in bad faith, not whether the chapter 13 plan was proposed in bad faith.

Appellants contend that the proper application of the law should have been as described in Powers, a case where the bankruptcy court held that the confirmation of a chapter 13 plan does not necessarily preclude a subsequent motion to dismiss on the basis of bad faith.

In Powers, a creditor moved to dismiss the debtor's chapter 13 petition, post-confirmation, on the ground that the case had been filed in bad faith. 135 B.R. at 982-83. The bankruptcy court acknowledged the position of a number of courts which found

that if a properly noticed creditor fails to object to confirmation of the chapter 13 plan, the order confirming the plan precludes the litigation of all issues relating to confirmation of the plan that could have been raised prior to confirmation, such as whether the plan was filed in good faith. Id. However, the court drew a distinction between a challenge to the plan and a challenge to the propriety of the bankruptcy filing itself. Id. at 989. In this regard, the court opined

> There are perhaps several reasons why failure to object to the bona fides of debtor's plan should not proscribe a later inquiry into debtor's bona fides at the time of filing of the petition. Primarily, however, this court believes there are two separate interests being protected under Sections 1325(a) and 1307 - and different time limitations applicable to raising issues under these sections is appropriate. The first protected interest has to do with the right of creditors and trustee to object on compliance grounds and the treatment they will receive under the plan proposed. A second interest to be protected is that of the court, the trustee, the Office of the United States Trustee, and creditors to object where the Code and bankruptcy courts are being misused and/or abused for an improper purpose.
>
> This Court has found no authority which sets a deadline as to the time during which a motion to dismiss a Chapter 13 case must be brought. Since this is a court of equity, one can only surmise that the proper time requirement would be "within a reasonable time: - where reasonable would be determined on a "case by case basis" and after consideration of "all the circumstances" of the case.

Id. Thus, the court in Powers concluded that it had the authority to protect the integrity of the judicial process and that the confirmation of the plan did not absolutely preclude dismissal where bad faith at the inception of the case existed. Id. at 989-90. We agree.

As Appellants filed their motion to dismiss ten days prior to the confirmation hearing, we find the motion to be timely and

not precluded by the entry of the confirmation order.

Moreover, Valenti does not, as Debtors urge, stand for the proposition that a motion to dismiss is barred following plan confirmation. In that case, we stated that "all issues that could have or should have been litigated at the confirmation hearing," referred to all issues pertaining to the plan. In re Valenti, 310 B.R. at 150. In fact, a close reading of Valenti reflects a contrary conclusion than the one advanced by Debtors:

> [R]es judicata will not necessarily defeat a future motion to convert or dismiss Debtor's bankruptcy case under Section 1307(c) based on preconfirmation matters, where the debtor's own conduct (such as concealment) would amount to estoppel to bar that defense.
>
> . . . .
>
> We hasten to add that the Section 1307(c) issues were not fully developed before the bankruptcy court and we might not have all the relevant facts. Our comments are simply intended to avoid any implication that res judicata, per se, bars relief under Section 1307(c).

Id. at 151-52.

We are equally unpersuaded by Debtors' argument, based on a flawed reading of Eisen, that finding a plan has been proposed in good faith necessarily means that the case was commenced in good faith. In Eisen, the Ninth Circuit determined that a debtor's successive chapter 13 petition on the eve of a state court enforcement action was filed in bad faith and required dismissal. 14 F.3d at 470. As guidance with regard to the proper standard of review, the Ninth Circuit stated that: "to determine if a petition has been filed in bad faith[,] courts are guided by the standards used to evaluate whether a plan has been proposed in bad faith." Id. (emphasis added). Contrary to Debtors'

presumption, nowhere does Eisen hold that a petition filed in bad faith necessarily means that any plan is also proposed in bad faith. Furthermore, Debtors eschew the language of the standard of review in an attempt to create a rule that is unsupported by legal authority. In sum, a confirmed plan does not necessarily mean that the bankruptcy petition was filed in good faith.

Therefore, we conclude that the bankruptcy court erred in determining that Appellants' motion to dismiss was filed untimely, or barred by claim or issue preclusion.

B. Notwithstanding the Bankruptcy Court's Error in Its Interpretation of the Law, There is No Evidence of Bad Faith

Relying principally on Eisen and In re Chinichian, 78 F.2d 1440 (9th Cir. 1986), Appellants argue that the bankruptcy court erred in finding the absence of bad faith because the petition was filed for the sole purpose of avoiding the state court action. They support their allegation by referring to 1) the Chartrand declaration, stating that he was left a message by Debtors' counsel threatening that Debtors would file bankruptcy if Appellants did not settle the state court action; and 2) post-confirmation representations to the court that reflect two diametrically opposed positions held by Debtors, i.e., to either hold on to the property or sell/refinance the property.

A chapter 13 petition filed in bad faith may be dismissed "for cause" pursuant to § 1307(c)[9]. Bad faith is determined by

[9] Section 1307(c) provides

> Except as provided in subsection (e) of this section, on request of a party in interest or the United States trustee and after notice and a hearing, the court may (continued...)

examining the "totality of the circumstances." In re Eisen, 14 F.3d at 470. Factors for consideration include:

> (1) whether the debtor misrepresented facts in his [petition or] plan, unfairly manipulated the Bankruptcy Code, or otherwise [filed] his Chapter 13 [petition or] plan, in an inequitable manner;
> (2) the debtor's history of filings and dismissals;

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[9](...continued)
convert a case under this chapter to a case under chapter 7 of this title, or may dismiss a case under this chapter, whichever is in the best interests of creditors and the estate, for cause, including -

(1) unreasonable delay by the debtor that is prejudicial to creditors;
(2) nonpayment of any fees and charges required under chapter 123 of title 28;
(3) failure to commence making timely payments under section 1321 of this title;
(4) failure to commence making timely payments under section 1326 of this title;
(5) denial of confirmation of a plan under 1325 of this title and denial of a request made for additional time for filing another plan or a modification of a plan;
(6) material default by the debtor with respect to a term of a confirmed plan;
(7) revocation of the order of confirmation under section 1330 of this title, and denial of confirmation of a modified plan under section 1329 of this title;
(8) termination of a confirmed plan by reason of the occurrence of a condition specified in the plan other than completion of payments under the plan;
(9) only on request of the United States trustee, failure of the debtor to file, within fifteen days, or such additional time as the court may allow, after the filing of the petition commencing such case, the information required by paragraph (1) of section 521; or
(10) only on request of the United States trustee, failure to timely file the information required by paragraph (2) of section 521.

11 U.S.C. § 1307(c). Although "bad faith" is not specifically listed as a "cause" to dismiss, the Ninth Circuit has determined it to be so in In re Leavitt, 171 F.3d 1219, 1224 (9th Cir. 1999)("We hold that bad faith is 'cause' for a dismissal of a Chapter 13 case with prejudice under § 349(a) and § 1307(c).").

> (3) whether the debtor only intended to defeat state court litigation; [and]
> (4) whether egregious behavior is present.

In re Leavitt, 171 F.3d 1219, 1224 (9th Cir. 1999)(citations omitted).

In this case, Debtors clearly filed the petition, at least in part, for the purpose of avoiding continued litigation of the state court action. Nevertheless, the weight to be given to that circumstance is within the discretion of the bankruptcy court, based on the "totality of the circumstances."

In Chinichian, the Ninth Circuit held that the debtors acted in bad faith when they filed their bankruptcy petition to evade the state court enforcement action. 784 F.2d at 1445-46. However, the Ninth Circuit specifically observed that "the strategic time of the [debtors] bankruptcy petition, which effectively frustrated enforcement of the contract in state court and the [debtors'] change of their bankruptcy petition to Chapter 13 when their motion to reject the contract was denied in the chapter 11 proceedings" reflected a bad faith bankruptcy petition. Id. In addition, the court adopted the following analysis by the district court:

> [T]here is a substantial question whether debtors were attempting to discharge a debt at all. Appellants have consistently argued that under certain California precedent, appellants' liability for appellee's loan on their property could all but wipe out debtors' equity in their residence. Appellee is concerned with specific performance. There would be no debt if appellants had performed under the contract. Appellants are simply attempting to keep their home. This is not a proper use of the Code.

Id.

Here, the fact that Debtors may very well have turned to bankruptcy relief to avoid the costs and consequences of the state court litigation must be balanced against all of the circumstances reflected in the record. Viewed in its entirety, the record adequately supports the court's determination that the petition was not filed in bad faith. In this regard, the court made specific findings as to Debtors' advanced ages, poor health, limited monthly income, lack of prior bankruptcy filings, inability to fund litigation with Appellants and Trinkler, and the existence of other substantial debt. Thus, Appellants' bad faith argument, which is based on Debtors' intent to avoid the state court litigation, is unconvincing when viewed in light of the totality of the circumstances.

In addition, Appellants suggested at oral argument that the confirmed plan itself is evidence of Debtors' bad faith in that the plan does not expressly provide for the sale or refinance of the property as a means of funding the 100% payout to creditors. However, having not objected to the confirmation of the plan, Appellants are estopped from using the confirmed plan terms, or lack thereof, as a basis for arguing that the petition was filed in bad faith. See In re Powers, 135 B.R. at 982-83.

Finally, Appellants contend that Debtors made post-confirmation representations that indicated that they may hold onto the property, enabling them to take advantage of the $528,120 windfall created by the rejection of the executory contracts. While Debtors may be able to maintain their ownership of the property, they can do so only by paying 100% of the allowed claims. Whether that occurs depends on the amounts

ultimately allowed on Appellants' and other claims, and whether Debtors can make the necessary payments, or refinance the property for an amount sufficient to do so. The possibility of that outcome does not establish any lack of good faith. Again, if they believed the plan was proposed in bad faith and inequitable, they could have, and should have, objected to the plan prior to confirmation. Having not done so, they are bound by the terms of the confirmed plan.[10]

In sum, the record adequately supports the bankruptcy court's finding that Debtors had "legitimate reasons for seeking chapter 13 relief", and therefore, we find that the court did not clearly err in denying the motion to dismiss.

VI. CONCLUSION

Based upon the foregoing, the bankruptcy court's order denying the motion to dismiss is AFFIRMED.

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[10] Appellants are entitled to a general unsecured claim based upon Debtors rejection of the executory contract. See 11 U.S.C. §§ 365(g)(1) & 502(g). Pursuant to California Civil Code § 3306,

> [t]he detriment caused by the breach of an agreement to convey an estate in real property, is deemed to be the price paid, and the expenses properly incurred in examining the title and preparing the necessary papers, the difference between the price agreed to be paid and the value of the estate agreed to be conveyed at the time of the breach, the expenses properly incurred in preparing to enter upon the land, consequential damages according to proof, and interest.

Thus, under the plan, Appellants will be entitled to a 100% distribution of their general unsecured claim, which, at a minimum, will be valued at the difference between the price agreed to be paid and the value of the property at the time of breach plus interest.