

SEP 29 2006

**HAROLD S. MARENUS, CLERK
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NOT FOR PUBLICATION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. EC-06-1000-SJB
)
 BAXTER M. GILTON and TAMARA E.) Bk. No. 05-91185
 GILTON,)
)
 Debtors.)
)
 _____)
 ARMELIN DeSOUSA and MARIA)
 DeSOUSA,)
)
 Appellants,)
)
 v.) **MEMORANDUM**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, JURY² and BRANDT, Bankruptcy Judges.

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.

1 Following the confirmation of a chapter 13³ plan, creditors
2 filed a motion to dismiss debtors' bankruptcy petition for bad
3 faith. The bankruptcy court denied the motion. A timely notice
4 of appeal was filed on January 6, 2006. We AFFIRM.

5 **I. FACTS**

6 Prior to the filing of the bankruptcy case, debtors Baxter
7 and Tamara Gilton ("Debtors") entered into a contract to sell
8 real property to Armelin and Maria deSousa ("Appellants") for
9 \$800,000. Appellants alleged that Debtors breached this
10 agreement, both by contracting to sell the property to another
11 person, Wendel Trinkler ("Trinkler"), and by refusing to
12 consummate the sale. On December 16, 2004, based on the alleged
13 breach, they commenced an action for specific performance in
14 state court to compel Debtors to sell the property to them (the
15 "state court action"). During the course of the litigation,
16 Debtors apparently threatened to file bankruptcy if a settlement
17 could not be reached.⁴

18 _____
19 ³ Unless otherwise indicated, all chapter, section and rule
20 references are to the Bankruptcy Code, 11 U.S.C. §§ 101-1330, and
21 to the Federal Rules of Bankruptcy Procedure, Rules 1001-9036, as
22 enacted and promulgated prior to the effective date (October 17,
23 2005) of The Bankruptcy Abuse Prevention and Consumer Protection
24 Act of 2005, Pub. L. 109-8, Apr. 20, 2005, 119 Stat. 23.

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

28 [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...)

1 Following unsuccessful settlement attempts, Debtors filed a
2 chapter 13 bankruptcy petition on June 10, 2005. They listed the
3 debt owed to Appellants on Schedule F (general unsecured claims)
4 and on Schedule G (executory contracts and unexpired leases).
5 The chapter 13 trustee served Debtors' proposed plan, which
6 provided for the rejection of the executory contracts between
7 Debtors and Appellants (as well as the contract with Trinkler),⁵
8 together with the notice of commencement of case⁶ and a proof of
9 claim form. Appellants did not dispute receipt of this notice.

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

19 On September 26, 2005, the plan, which provided for a 100%
20 distribution to general unsecured claim holders, was confirmed
21

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

24 ⁵ The bankruptcy court made no determination that the
25 contracts were actually executory.

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

1 without objection.⁷

2 The hearing on the motion to dismiss was held on December
3 12, 2005, well after the plan had been confirmed. Thereafter,
4 the bankruptcy court issued a written memorandum denying the
5 motion. Among other things, the court rejected the argument that
6 Debtors would enjoy a substantial windfall to the detriment of
7 their creditors, explaining that Appellants and Trinkler had the
8 right to file claims in the estate for any damages caused by the
9 rejection of their contracts. Further, "[i]n order to service
10 the secured debt encumbering the property, to pay the [general
11 unsecured claim holders] in full, and to pay the rejection
12 claims, if any, in full with interest, the confirmed plan
13 requires the [D]ebtors to sell the subject property." Memorandum
14 at 4. Hence, Debtors were "not simply rejecting the executory
15 contracts and then walking out of bankruptcy court with the
16 property or its net value." Id.

17 In addition, the bankruptcy court ruled that the motion to
18 dismiss was untimely. Relying on In re Valenti, 310 B.R. 138
19 (9th Cir. BAP 2004), it held that a motion to dismiss a
20 bankruptcy petition must be prosecuted before a chapter 13 plan
21 is confirmed, and that only when a debtor has concealed facts
22 that prevent a creditor from seeking dismissal of the case prior
23 to confirmation may a creditor seek dismissal based on pre-
24 confirmation conduct.

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

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

1 1994), in supporting its finding of untimeliness and interpreted
2 the Ninth Circuit's holding to mean "that a petition filed in bad
3 faith . . . means that any plan is proposed in bad faith. So,
4 when a plan is confirmed, something that can only occur if the
5 plan has been proposed in good faith, it follows that the
6 petition must have been filed in good faith." Memorandum at 7.
7 Based on its interpretation of Eisen, the court reasoned that
8 because a condition of confirmation is a finding that the chapter
9 13 plan is proposed in good faith, it is incumbent on a creditor
10 to raise any issue regarding lack of good faith prior to
11 confirmation. Here, in the court's view, Appellants failed to
12 raise their allegation of bad faith prior to the confirmation of
13 the plan and were, therefore, precluded from raising it after the
14 plan was confirmed.⁸

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

17 Both [Debtors] are 79 years of age, both have been
18 retired for ten years or more, Mr. Gilton's health is
19 declining, neither has ever before filed a bankruptcy
20 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.

21 The [Debtors'] debt, \$116,163 in secured claims and
22 \$155,717 in unsecured claims (not taking into account
23 rejection claims), largely was incurred in connection
with an unsuccessful post-retirement attempt to develop

24 ⁸ The bankruptcy court disagreed with In re Powers, 135 B.R.
25 980 (Bankr. C.D. Cal. 1991), a case in which the court held that
26 a creditor who fails to object to confirmation of a chapter 13
27 plan is not precluded from later moving for dismissal of the case
28 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.

1 a cheese plant. The confirmed plan requires the
2 contribution of their \$100 in monthly disposable income
3 for 36 months in order to pay this debt. Because this
4 disposable income obviously will not be sufficient to
5 retire the debt, the plan also requires [Debtors] to
6 contribute a \$3,800 semi-annual rent payment due them
7 as well as the proceeds from the sale of the property .
8 . . .

9 Then there is the litigation between [Debtors],
10 [Appellants], and [Trinkler]. The income listed on
11 Schedule I suggests that [Debtors] do not have the
12 ability to fund the litigation. And, given that there
13 are two parties, [Appellants] and [Trinkler], claiming
14 a right to buy the property, giving up and selling the
15 property to [Appellants] will not end the litigation.

16 Id. at 9-10.

17 Appellants appeal.

18 **II. JURISDICTION**

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

22 **III. ISSUES**

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

28 **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."

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

8 **V. DISCUSSION**

9 A. A Motion to Dismiss is Not Barred Subsequent to Plan 10 Confirmation

11 Appellants argue that the bankruptcy court erred in relying
12 on Valenti in determining that a motion to dismiss cannot be
13 granted after a chapter 13 plan has been confirmed. In Valenti,
14 the issue before the court was whether a chapter 13 plan was
15 proposed in good faith - not whether the bankruptcy petition
16 itself was filed in good faith. Unlike Valenti, Appellants
17 submit the issue in the instant matter is whether the chapter 13
18 case itself was commenced in bad faith, not whether the chapter
19 13 plan was proposed in bad faith.

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

25 In Powers, a creditor moved to dismiss the debtor's chapter
26 13 petition, post-confirmation, on the ground that the case had
27 been filed in bad faith. 135 B.R. at 982-83. The bankruptcy
28 court acknowledged the position of a number of courts which found

1 that if a properly noticed creditor fails to object to
2 confirmation of the chapter 13 plan, the order confirming the
3 plan precludes the litigation of all issues relating to
4 confirmation of the plan that could have been raised prior to
5 confirmation, such as whether the plan was filed in good faith.

6 Id. However, the court drew a distinction between a challenge to
7 the plan and a challenge to the propriety of the bankruptcy
8 filing itself. Id. at 989. In this regard, the court opined

9 There are perhaps several reasons why failure to object
10 to the bona fides of debtor's plan should not proscribe
11 a later inquiry into debtor's bona fides at the time of
12 filing of the petition. Primarily, however, this court
13 believes there are two separate interests being
14 protected under Sections 1325(a) and 1307 - and
15 different time limitations applicable to raising issues
16 under these sections is appropriate. The first
17 protected interest has to do with the right of
18 creditors and trustee to object on compliance grounds
19 and the treatment they will receive under the plan
20 proposed. A second interest to be protected is that of
21 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.

22 Id. Thus, the court in Powers concluded that it had the
23 authority to protect the integrity of the judicial process and
24 that the confirmation of the plan did not absolutely preclude
25 dismissal where bad faith at the inception of the case existed.

26 Id. at 989-90. We agree.

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

1 not precluded by the entry of the confirmation order.

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

9 [R]es judicata will not necessarily defeat a future
10 motion to convert or dismiss Debtor's bankruptcy case
11 under Section 1307(c) based on preconfirmation matters,
12 where the debtor's own conduct (such as concealment)
13 would amount to estoppel to bar that defense.

14

15 We hasten to add that the Section 1307(c) issues
16 were not fully developed before the bankruptcy court
17 and we might not have all the relevant facts. Our
18 comments are simply intended to avoid any implication
19 that res judicata, per se, bars relief under Section
20 1307(c).

21 Id. at 151-52.

22 We are equally unpersuaded by Debtors' argument, based on a
23 flawed reading of Eisen, that finding a plan has been proposed in
24 good faith necessarily means that the case was commenced in good
25 faith. In Eisen, the Ninth Circuit determined that a debtor's
26 successive chapter 13 petition on the eve of a state court
27 enforcement action was filed in bad faith and required dismissal.
28 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'

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

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

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

12 Relying principally on Eisen and In re Chinichian, 78 F.2d
13 1440 (9th Cir. 1986), Appellants argue that the bankruptcy court
14 erred in finding the absence of bad faith because the petition
15 was filed for the sole purpose of avoiding the state court
16 action. They support their allegation by referring to 1) the
17 Chartrand declaration, stating that he was left a message by
18 Debtors' counsel threatening that Debtors would file bankruptcy
19 if Appellants did not settle the state court action; and 2) post-
20 confirmation representations to the court that reflect two
21 diametrically opposed positions held by Debtors, i.e., to either
22 hold on to the property or sell/refinance the property.

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

25 _____
26 ⁹ Section 1307(c) provides

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

(continued...)

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

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

6 ⁹(...continued)

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

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

26 11 U.S.C. § 1307(c). Although "bad faith" is not specifically
27 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.
28 1999) ("We hold that bad faith is 'cause' for a dismissal of a
Chapter 13 case with prejudice under § 349(a) and § 1307(c).").

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

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

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

11 In Chinichian, the Ninth Circuit held that the debtors acted
12 in bad faith when they filed their bankruptcy petition to evade
13 the state court enforcement action. 784 F.2d at 1445-46.
14 However, the Ninth Circuit specifically observed that "the
15 strategic time of the [debtors] bankruptcy petition, which
16 effectively frustrated enforcement of the contract in state court
17 and the [debtors'] change of their bankruptcy petition to Chapter
18 13 when their motion to reject the contract was denied in the
19 chapter 11 proceedings" reflected a bad faith bankruptcy
20 petition. Id. In addition, the court adopted the following
21 analysis by the district court:

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

32 Id.

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

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

22 Finally, Appellants contend that Debtors made post-
23 confirmation representations that indicated that they may hold
24 onto the property, enabling them to take advantage of the
25 \$528,120 windfall created by the rejection of the executory
26 contracts. While Debtors may be able to maintain their ownership
27 of the property, they can do so only by paying 100% of the
28 allowed claims. Whether that occurs depends on the amounts

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

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

13 VI. CONCLUSION

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

16
17
18 ¹⁰ Appellants are entitled to a general unsecured claim
19 based upon Debtors rejection of the executory contract. See 11
20 U.S.C. §§ 365(g) (1) & 502(g). Pursuant to California Civil Code
21 § 3306,

22 [t]he detriment caused by the breach of an agreement to
23 convey an estate in real property, is deemed to be the
24 price paid, and the expenses properly incurred in
25 examining the title and preparing the necessary papers,
26 the difference between the price agreed to be paid and
27 the value of the estate agreed to be conveyed at the
28 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.