NOT FOR PUBLICATION

**UNITED STATES BANKRUPTCY APPELLATE PANEL**

**OF THE NINTH CIRCUIT**

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| In re: | BAP No. CC-06-1169-BKMo |
| VIRGINIA-COAST HIGHWAY DEVELOPMENT, INC., | Bk. No. LA 05-50024-ER |
| Debtor. | |
| GREGORY GRANTHAM; DOUGLAS OLBRICH, | |
| Appellants, | |
| v. | **M E M O R A N D U M**[1] |
| ARTHUR SERRANO; CONNIE MADISON, | |
| Appellees. | |

Argued and Submitted on November 15, 2006
at Orange, California

Filed - December 26, 2006

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

Honorable Ernest M. Robles, Bankruptcy Judge, Presiding

Before: BRANDT, KLEIN and MONTALI, Bankruptcy Judges.

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

Gregory Grantham, debtor's former counsel, and Douglas Olbrich, debtor's president, (Appellants) appeal the bankruptcy court's order imposing sanctions and its order denying reconsideration. The bankruptcy court imposed sanctions based on a finding that the petition had been filed in bad faith under the "new debtor syndrome," and later denied reconsideration.

We AFFIRM in part, and VACATE and REMAND in part.

## I. FACTS

Virginia-Coast Highway Development, Inc., represented by Gregory Grantham, filed for relief under chapter 11[2] on 25 October 2005. In early December Ron Bender replaced Grantham as debtor's counsel.

Secured creditors Arthur Serrano and Connie Madison ("Appellees") moved for relief from stay to complete foreclosure on their second deed of trust encumbering the real property located in Laguna Beach, California (the "Property").

The bankruptcy court found that:

1. The Property was transferred to the debtor via three grant deeds, all recorded on the same day the petition was filed,[3]

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[2] Absent contrary indication, all "Code," chapter and section references are to the Bankruptcy Code, 11 U.S.C. §§ 101-1532, as amended by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. 109-8, 119 Stat. 23 (effective 17 October 2005).

All "Rule" references are to the Federal Rules of Bankruptcy Procedure, and all "FRCP" references are to the Federal Rules of Civil Procedure.

[3] (1) Sharon Phelan to Virginia-Coast Highway Development, Inc. (defective because Property was owned by Aliso Circle Irrevocable Trust); (2) Mervyn Phelan, Jr., Trustee of Aliso Circle Irrevocable Trust No. II to Sharon Phelan; and (3) Sharon Phelan to Virginia-Coast Highway Development, Inc.

2. Debtor was formed approximately six weeks pre-petition,

3. There was no evidence that the transfers of the Property were for any consideration,

4. Debtor had minimal assets other than the Property,

5. The majority of the unsecured debt listed on debtor's schedules was owed to Sharon Phelan, debtor's principal shareholder,

6. Debtor had only one employee, Olbrich, and its only ongoing business was the construction of a single-family residence on the Property, and

7. The Property appeared to be the only means of servicing debtor's debt. There was no other income stream and no evidence that debtor could obtain a capital contribution or would be able to qualify for and/or service any third-party financing.

Memorandum of Decision, 12 January 2006, pages 5-6. The bankruptcy court found appellees had made out a prima facie case of bad faith under the "new debtor syndrome," see In re Duvar Apt., Inc., 205 B.R. 196, 200-201 (9th Cir. BAP 1996), and noted that debtor's principals had previously hindered Serrano's foreclosure efforts by filing two state court lawsuits in which Serrano prevailed, and that the grant deeds were recorded one day after the denial of their state court motion for a preliminary injunction to prevent foreclosure. Id. at 5.

The bankruptcy court concluded that "[d]ebtor has failed to demonstrate a good faith business reason for the transfer and the bankruptcy filing, and to overcome [appellees'] prima facie showing of a bad faith filing." Id. at 8. The bankruptcy court granted relief from

stay but denied Appellees' request for sanctions, not specifying whether the denial was with or without prejudice. This order was not appealed.

On 25 January 2006 debtor moved to dismiss the case. The bankruptcy court granted the motion on 16 February 2006, explicitly retaining jurisdiction over, among other matters, motions for sanctions against debtor, its principals, and Grantham, and barring debtor from re-filing and from transferring the Property other than by foreclosure sale for 180 days.

Appellees thereafter moved for sanctions against debtor and Appellants under FRCP 11, applicable via Rule 9011. Neither Olbrich nor the debtor responded; Grantham filed a late objection on his own behalf but did not appear at the hearing. Olbrich appeared pro se. The bankruptcy court granted the motion, finding that the petition was filed "not for a proper purpose" and was frivolous for the reasons stated in the order granting relief from stay. Tentative Ruling, 15 March 2006 at page 14 (attached as an exhibit to, and adopted in, the order entered 16 March 2006). The bankruptcy court awarded Appellees their attorney's fees of $42,744.68 as sanctions, but denied their request for an additional $50,000 as a deterrent. On the same date, the court entered a money judgment against debtor and appellants in the amount of the sanctions imposed.

Appellants timely moved for reconsideration under FRCP 59(e), applicable via Rule 9023, arguing that the bankruptcy had been filed to stop Appellees' "fraudulent scheme to take the debtor's property in a non-judicial foreclosure sale by fraudulently inflating the amount of the debt . . . [,]" and "to obtain a forum in which the court would actually examine Serrano's claim as to the amount due." Motion for Reconsideration . . , at 8 and 10. They also stated they had initially

not responded because they assumed Bender would on debtor's behalf, but Bender had not been served with the motion for sanctions.

The bankruptcy court denied the motion because Appellants had not set forth sufficient evidence to warrant reconsideration under the grounds set forth in Rule 9023, Order Denying Reconsideration, 25 April 2006.

This appeal ensued.[4]

## II. JURISDICTION

The bankruptcy court had jurisdiction via 28 U.S.C. § 1334 and § 157(b)(1) and (b)(2)(A) and (O), and we do under 28 U.S.C. § 158(c).

## III. ISSUES

A. Whether the bankruptcy court abused its discretion in imposing sanctions.

B. Whether the bankruptcy court abused its discretion in denying Appellants' motion for reconsideration.

## IV. STANDARD OF REVIEW

We review orders imposing sanctions under Rule 9011 and orders denying reconsideration for abuse of discretion. In re Grantham Bros., 922 F.2d 1438, 1441 (9th Cir. 1991); In re Basham, 208 B.R. 926, 930 (9th Cir. BAP 1997), aff'd sub nom. In re Byrne, 152 F.3d 924 (9th Cir. 1998) (table).

[4] Although sanctions were imposed jointly and severally against Appellants and the debtor, debtor has not appeared in this appeal.

A bankruptcy court necessarily abuses its discretion if it bases its decision on an erroneous view of the law or clearly erroneous factual findings. Cooter & Gell v. Hartmarx Corp., 496 U.S. 384, 405 (1990). Under the abuse of discretion standard, we must have a definite and firm conviction that the bankruptcy court committed a clear error of judgment in the conclusion it reached before reversal is proper. In re Black, 222 B.R. 896, 899 (9th Cir. BAP 1998).

## V. DISCUSSION

### A. Rule 9011 Sanctions

Rule 9011 provides, in relevant part:

> (a) Signing of papers
>
> Every petition, pleading, written motion, and other paper, except a list, schedule, or statement, or amendments thereto, shall be signed by at least one attorney of record in the attorney's individual name. A party who is not represented by an attorney shall sign all papers. Each paper shall state the signer's address and telephone number, if any. An unsigned paper shall be stricken unless omission of the signature is corrected promptly after being called to the attention of the attorney or party.
>
> (b) Representations to the court
>
> By presenting to the court (whether by signing, filing, submitting, or later advocating) a petition, pleading, written motion, or other paper, an attorney or unrepresented party is certifying that to the best of the person's knowledge, information, and belief, formed after an inquiry reasonable under the circumstances,--
>
> (1) it is not being presented for any improper purpose, such as to harass or to cause unnecessary delay or needless increase in the cost of litigation;
>
> (2) the claims, defenses, and other legal contentions therein are warranted by existing law or by a nonfrivolous argument for the extension, modification, or reversal of existing law or the establishment of new law;
>
> (3) the allegations and other factual contentions have evidentiary support or, if specifically so identified,

> are likely to have evidentiary support after a reasonable opportunity for further investigation or discovery; and
>
> (4) the denials of factual contentions are warranted on the evidence or, if specifically so identified, are reasonably based on a lack of information or belief.

(c) Sanctions

If, after notice and a reasonable opportunity to respond, the court determines that subdivision (b) has been violated, the court may, subject to the conditions stated below, impose an appropriate sanction upon the attorneys, law firms, or parties that have violated subdivision (b) or are responsible for the violation.

(1) How initiated

(A) By motion

A motion for sanctions under this rule shall be made separately from other motions or requests and shall describe the specific conduct alleged to violate subdivision (b). It shall be served as provided in Rule 7004. The motion for sanctions may not be filed with or presented to the court unless, within 21 days after service of the motion (or such other period as the court may prescribe), the challenged paper, claim, defense, contention, allegation, or denial is not withdrawn or appropriately corrected, except that this limitation shall not apply if the conduct alleged is the filing of a petition in violation of subdivision (b). If warranted, the court may award to the party prevailing on the motion the reasonable expenses and attorney's fees incurred in presenting or opposing the motion. Absent exceptional circumstances, a law firm shall be held jointly responsible for violations committed by its partners, associates, and employees.

[emphasis added]

Rule 9011 sanctions against the signer of a paper are appropriate when the paper is either (1) frivolous or (2) filed for an improper purpose. Grantham Bros., 922 F.2d at 1441. An attorney's "conduct is measured objectively against a reasonableness standard, which consists of a competent attorney admitted to practice before the involved court." Id. (Citation omitted). An unrepresented signer's conduct is also subject to an objective standard. Navarro-Ayala v. Nunez, 968 F.2d 1421, 1425 (1st Cir. 1992).

**1. Sanctions against Grantham**

As noted, the bankruptcy court had previously found that debtor's petition had been filed in bad faith and granted relief from stay, which order was not appealed. Implicit in the court's prior ruling was the conclusion that the petition had been filed solely to hinder Appellees' foreclosure efforts. See Memorandum of Decision [re: Relief from Stay], 12 January 2006, at 5.

Grantham's primary argument in response to the motion for sanctions was that he no longer represented debtor. He complained that the moving parties had not complied with Rule 9011(c)(1)(A)'s "safe harbor" provision but, quoted above, as the bankruptcy court pointed out in its tentative ruling, that provision does not apply when the paper filed is a bankruptcy petition. This exception is a key difference from the comprehensive coverge of FRCP 11. Grantham does not challenge that aspect of the court's ruling.

Nor did Grantham address the propriety of filing a petition on behalf of a newly-created shell entity which owned no assets beyond property conveyed to it on the eve of foreclosure, and following unsuccessful state court litigation, nor did he offer any evidence of a reasonable pre-filing investigation, nor any argument that the legal contention implicit in the petition, that reorganization under chapter 11 was available for such an entity, was proper. He stated only that he did "not make decisions for the debtor." Grantham did not challenge the amount of the proposed sanction.

On appeal, Grantham argues that a reasonable attorney would have filed a chapter 11 petition to object to Appellees' allegedly fraudulently inflated claim. But he did not make this argument in response to the sanctions motion, but only later, in the motion for

reconsideration. It was not an abuse of discretion for the bankruptcy court to impose sanctions against Grantham.

**2. Sanctions against Olbrich**

Olbrich signed the bankruptcy petition as an officer of a corporate debtor, and he did not file or present the paper to the court.

Historically, courts were divided on the issue of whether a corporate officer who signs a petition on behalf of a corporation may be sanctioned under FRCP 11 or Rule 9011. In upholding a sanction under FRCP 11 against a non-party agency representative who had filed, under oath, a false statement with the court, the First Circuit Court of Appeals observed that "when a public official or corporate officer violates Rule 11 in the course of performing agentival duties, it is permissible – and frequently wise – from the standpoint of deterrence to direct that the offender pay a monetary sanction personally." Navarro-Ayala, 968 F.2d at 1427. See also Project 74 Allentown v. Frost, 143 F.R.D. 77, 83 n.7 (E.D. Penn. 1992), aff'd, 998 F.2d 1009 (3rd Cir. 1993) (table) ("The fact that the duties imposed by Rule 11 are personal and non-delegable . . . permits a court to sanction the individual who signed a paper on behalf of a corporation, as well as the corporation itself.").

On the other hand, in In re Chisholm Co., 166 B.R. 706 (D. Colo. 1994), the court held that the bankruptcy court had erred as a matter of law in imposing Rule 9011 sanctions against a corporate president who had signed the corporation's bankruptcy petition. The court relied on dicta in Business Guides, Inc. v. Chromatic Comm. Enters., Inc., 498 U.S. 533, 547-48 (1991) (opining that it would be anomalous to determine that an individual who is represented by counsel falls within the scope of FRCP

11, but a corporate client does not because it cannot sign documents but can only act through its agents), and the holdings of Leventhal v. New Valley Corp., 148 F.R.D. 109, 111-12 (S.D.N.Y. 1993) (holding corporate vice present and general counsel not personally liable for FRCP 11 sanctions because he was neither a party nor the attorney of record), and Paine Webber, Inc. v. Can Am Fin. Group, Ltd., 121 F.R.D. 324, 335-36 (N.D. Ill. 1988), aff'd, 885 F.2d 873 (7th Cir. 1989) (table) (corporation, not president, held liable under FRCP 11 for president's lies to attorneys leading to filing of improper pleading).

But in In re Rainbow Magazine, Inc., 77 F.3d 278 (9th Cir. 1996), the Ninth Circuit upheld Rule 9011 sanctions against a non-party who signed a document for filing with the court. The court noted: "Rule 9011 allows a bankruptcy court to sanction attorneys, parties, and individuals that file bad-faith documents before the court." Id. at 282 (footnote omitted). There, the sanctioned individual, a principal of the debtor, signed and filed a Statement of Financial Affairs on which he intentionally failed to list valuable assets of the estate. The court found that this action warranted sanctions under Rule 9011, and also upheld the imposition of sanctions under the bankruptcy court's inherent power for the principal's bad faith abuse of the bankruptcy process through his control of the debtor corporation. Id. at 285.

Accordingly, the bankruptcy court did not err as a matter of law in imposing Rule 9011 sanctions against Olbrich. But, although he did not respond to the motion for sanctions, Olbrich appeared at the hearing and argued (without being sworn) that he should not be sanctioned because he

> was president of the corporation at the time that it was formed, but as far as forming the corporation, as far as doing the filings, I had no knowledge or any involvement in any of that. The only reason I was placed as president of the corporation was, I was a superintendent for this construction

> project at the time. I had the most knowledge of what legitimate debtors [sic] were out there.

Transcript, 15 March 2006, page 2. The bankruptcy court rejected this argument and, following its tentative ruling, imposed sanctions on Olbrich solely because he had signed the petition and had failed to file a response to the motion for sanctions.

But Rule 9011 sanctions should not be imposed in the absence of evidence that the signer breached his duty to conduct a reasonable inquiry into the facts and the law. Navarro-Ayala, 968 F.2d at 1425. This is an objective standard that necessitates an examination of "all the circumstances, including the complexity of the subject matter, the party's familiarity with it, the time available for inquiry, and the ease (or difficulty) of access to the requisite information." Id. (citations omitted).

Here, the bankruptcy court made no findings in its tentative ruling or elsewhere regarding Olbrich's conduct. There is nothing in the record indicating he was involved in the pre-petition transactions that formed the basis of the bad faith finding, or that he either was or should have been aware of them. In contrast to Grantham, Olbrich did not file the petition or present it to the court. Accordingly, we will vacate the portions of the order and judgment imposing sanctions on Olbrich, and remand to the bankruptcy court for further proceedings.

This moots the appeal of the denial of reconsideration with respect to Olbrich.

**B. Reconsideration**

Reconsideration under FRCP 59 is appropriate only if the moving party demonstrates (1) manifest error of fact; (2) manifest error of law;

or (3) newly discovered evidence. Basham, 208 B.R. at 934. A motion for reconsideration may not be used to present a new legal theory or raise arguments which could have been made at the original hearing. In re JSJF Corp., 344 B.R. 94, 102-104 (9th Cir. BAP 2006).

Appellants' motion for reconsideration was predicated on an "irregularity of proceedings," the asserted irregularity being the failure to serve debtor's then counsel, which "caused surprise, mistake and delay in serving opposition." Notice . . . and Motion for Reconsideration, at 7. The motion goes on to assert the movants' unclean hands and argues the propriety of the chapter 11 filing. There was nothing explaining or justifying why Grantham, named individually as a target of the motion for sanctions, relied on debtor's successor counsel, Bender, for a response to the motion. Nor was there any response to "new debtor syndrome" argument and previous bad faith finding on which the sanctions motion was predicated, and which were, as ably set forth by the bankruptcy court in its tentative ruling, the bases for the sanction imposed.

Rather, the motion and supporting declarations contain numerous allegations regarding Appellees' purported scheme to fraudulently inflate their claim. Grantham stated in the reconsideration motion that he "was not aware that facts regarding the fraudulent scheme of Appellees to inflate their claims to, in essence, steal the debtor's property through non-judicial foreclosure, had not been marshaled before the court." Id. at 7-8.

Even if it were appropriate in the circumstances, to prevail on this "newly discovered evidence" argument, Grantham had to show that "(1) the evidence was discovered after trial, (2) the exercise of due diligence would not have resulted in the evidence being discovered at an earlier

stage and (3) the newly discovered evidence is of such magnitude that production of it earlier would likely have changed the outcome of the case." In re La Sierra Financial Svcs., Inc., 290 B.R. 718, 733 (9th Cir. BAP 2002) (quoting Defenders of Wildlife v. Bernal, 204 F.3d 920, 928-29 (9th Cir. 2000)). He made no such showing, and the conduct complained of in the motion for reconsideration took place well before the motion for sanctions was filed, and much had been litigated in state court before the petition date. Accordingly, the facts recited in the motion and supporting declaration do not qualify as "newly discovered evidence."

Grantham points to no error of law. While he implicitly disputes the bankruptcy court's finding of bad faith, this finding was contained in a ruling that became final before the motion for sanctions was filed, which was expressly invoked in appellees' notice and motion for sanctions. And whether or not chapter 11 petitions for debtor's principals might have been appropriate to challenge the propriety of appellees' foreclosure, Grantham simply ignored the bad faith and the improper purpose implicated by his filing of the debtor's petition.

Finally, Grantham argued that reconsideration was warranted because debtor's counsel was not served with the motion, as required by local rule. But this is irrelevant to whether sanctions against Grantham were appropriate: he did receive notice, and his opposition was entirely predicated on Rule 9011's inapplicable "safe harbor" provision.

In short, Grantham raised no issues which could not have been addressed at the original hearing, In re Agric. Research & Tech Group, Inc., 916 F.2d 528, 542 (9th Cir. 1990). He has not shown the bankruptcy court abused its discretion in denying the motion for reconsideration.

## VI. CONCLUSION

Grantham has not shown that the bankruptcy court abused its discretion in imposing sanctions on him or in denying reconsideration. However, the imposition of sanctions against Olbrich without sufficient factual findings is an abuse of discretion. We therefore AFFIRM as to Grantham, but VACATE the Order and Judgment as to Olbrich and REMAND for further proceedings.