

DEC 26 2006

NOT FOR PUBLICATION

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

**UNITED STATES BANKRUPTCY APPELLATE PANEL
OF THE NINTH CIRCUIT**

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 M¹

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.

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

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

8

9

I. FACTS

10 Virginia-Coast Highway Development, Inc., represented by Gregory
11 Grantham, filed for relief under chapter 11² on 25 October 2005. In
12 early December Ron Bender replaced Grantham as debtor's counsel.

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

17 The bankruptcy court found that:

- 18 1. The Property was transferred to the debtor via three grant
19 deeds, all recorded on the same day the petition was filed,³
20

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

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

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

- 1 2. Debtor was formed approximately six weeks pre-petition,
- 2 3. There was no evidence that the transfers of the Property were
- 3 for any consideration,
- 4 4. Debtor had minimal assets other than the Property,
- 5 5. The majority of the unsecured debt listed on debtor's
- 6 schedules was owed to Sharon Phelan, debtor's principal
- 7 shareholder,
- 8 6. Debtor had only one employee, Olbrich, and its only ongoing
- 9 business was the construction of a single-family residence on
- 10 the Property, and
- 11 7. The Property appeared to be the only means of servicing
- 12 debtor's debt. There was no other income stream and no
- 13 evidence that debtor could obtain a capital contribution or
- 14 would be able to qualify for and/or service any third-party
- 15 financing.

16 Memorandum of Decision, 12 January 2006, pages 5-6. The bankruptcy court
17 found appellees had made out a prima facie case of bad faith under the
18 "new debtor syndrome," see In re Duvar Apt., Inc., 205 B.R. 196, 200-201
19 (9th Cir. BAP 1996), and noted that debtor's principals had previously
20 hindered Serrano's foreclosure efforts by filing two state court lawsuits
21 in which Serrano prevailed, and that the grant deeds were recorded one
22 day after the denial of their state court motion for a preliminary
23 injunction to prevent foreclosure. Id. at 5.

24 The bankruptcy court concluded that "[d]ebtor has failed to
25 demonstrate a good faith business reason for the transfer and the
26 bankruptcy filing, and to overcome [appellees'] prima facie showing of
27 a bad faith filing." Id. at 8. The bankruptcy court granted relief from
28

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

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

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

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

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

3 The bankruptcy court denied the motion because Appellants had not
4 set forth sufficient evidence to warrant reconsideration under the
5 grounds set forth in Rule 9023, Order Denying Reconsideration, 25 April
6 2006.

7 This appeal ensued.⁴

8

9

II. JURISDICTION

10 The bankruptcy court had jurisdiction via 28 U.S.C. § 1334 and
11 § 157(b) (1) and (b) (2) (A) and (O), and we do under 28 U.S.C. § 158(c).

12

13

III. ISSUES

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

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

18

19

IV. STANDARD OF REVIEW

20 We review orders imposing sanctions under Rule 9011 and orders
21 denying reconsideration for abuse of discretion. In re Grantham Bros.,
22 922 F.2d 1438, 1441 (9th Cir. 1991); In re Basham, 208 B.R. 926, 930 (9th
23 Cir. BAP 1997), aff'd sub nom. In re Byrne, 152 F.3d 924 (9th Cir. 1998)
24 (table).

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26

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

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

8 9 V. DISCUSSION

10 A. Rule 9011 Sanctions

11 Rule 9011 provides, in relevant part:

12 (a) Signing of papers

13 Every petition, pleading, written motion, and other paper,
14 except a list, schedule, or statement, or amendments thereto,
15 shall be signed by at least one attorney of record in the
16 attorney's individual name. A party who is not represented by
17 an attorney shall sign all papers. Each paper shall state the
18 signer's address and telephone number, if any. An unsigned
19 paper shall be stricken unless omission of the signature is
20 corrected promptly after being called to the attention of the
21 attorney or party.

18 (b) Representations to the court

19 By presenting to the court (whether by signing, filing,
20 submitting, or later advocating) a petition, pleading, written
21 motion, or other paper, an attorney or unrepresented party is
22 certifying that to the best of the person's knowledge,
23 information, and belief, formed after an inquiry reasonable
24 under the circumstances,--

25 (1) it is not being presented for any improper purpose,
26 such as to harass or to cause unnecessary delay or
27 needless increase in the cost of litigation;

28 (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,

1 are likely to have evidentiary support after a reasonable
2 opportunity for further investigation or discovery; and

3 (4) the denials of factual contentions are warranted on
4 the evidence or, if specifically so identified, are
5 reasonably based on a lack of information or belief.

6 (c) Sanctions

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

13 (1) How initiated

14 (A) By motion

15 A motion for sanctions under this rule shall be made
16 separately from other motions or requests and shall describe
17 the specific conduct alleged to violate subdivision (b). It
18 shall be served as provided in Rule 7004. The motion for
19 sanctions may not be filed with or presented to the court
20 unless, within 21 days after service of the motion (or such
21 other period as the court may prescribe), the challenged
22 paper, claim, defense, contention, allegation, or denial is
23 not withdrawn or appropriately corrected, except that this
24 limitation shall not apply if the conduct alleged is the
25 filing of a petition in violation of subdivision (b). If
26 warranted, the court may award to the party prevailing on the
27 motion the reasonable expenses and attorney's fees incurred in
28 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 **1. Sanctions against Grantham**

2 As noted, the bankruptcy court had previously found that debtor's
3 petition had been filed in bad faith and granted relief from stay, which
4 order was not appealed. Implicit in the court's prior ruling was the
5 conclusion that the petition had been filed solely to hinder Appellees'
6 foreclosure efforts. See Memorandum of Decision [re: Relief from Stay],
7 12 January 2006, at 5.

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

16 Nor did Grantham address the propriety of filing a petition on
17 behalf of a newly-created shell entity which owned no assets beyond
18 property conveyed to it on the eve of foreclosure, and following
19 unsuccessful state court litigation, nor did he offer any evidence of a
20 reasonable pre-filing investigation, nor any argument that the legal
21 contention implicit in the petition, that reorganization under chapter
22 11 was available for such an entity, was proper. He stated only that he
23 did "not make decisions for the debtor." Grantham did not challenge the
24 amount of the proposed sanction.

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

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

3

4 **2. Sanctions against Olbrich**

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

7 Historically, courts were divided on the issue of whether a
8 corporate officer who signs a petition on behalf of a corporation may be
9 sanctioned under FRCP 11 or Rule 9011. In upholding a sanction under
10 FRCP 11 against a non-party agency representative who had filed, under
11 oath, a false statement with the court, the First Circuit Court of
12 Appeals observed that "when a public official or corporate officer
13 violates Rule 11 in the course of performing agentival duties, it is
14 permissible - and frequently wise - from the standpoint of deterrence to
15 direct that the offender pay a monetary sanction personally."
16 Navarro-Ayala, 968 F.2d at 1427. See also Project 74 Allentown v. Frost,
17 143 F.R.D. 77, 83 n.7 (E.D. Penn. 1992), aff'd, 998 F.2d 1009 (3rd Cir.
18 1993) (table) ("The fact that the duties imposed by Rule 11 are personal
19 and non-delegable . . . permits a court to sanction the individual who
20 signed a paper on behalf of a corporation, as well as the corporation
21 itself.").

22 On the other hand, in In re Chisholm Co., 166 B.R. 706 (D. Colo.
23 1994), the court held that the bankruptcy court had erred as a matter of
24 law in imposing Rule 9011 sanctions against a corporate president who had
25 signed the corporation's bankruptcy petition. The court relied on dicta
26 in Business Guides, Inc. v. Chromatic Comm. Enters., Inc., 498 U.S. 533,
27 547-48 (1991) (opining that it would be anomalous to determine that an
28 individual who is represented by counsel falls within the scope of FRCP

1 11, but a corporate client does not because it cannot sign documents but
2 can only act through its agents), and the holdings of Leventhal v. New
3 Valley Corp., 148 F.R.D. 109, 111-12 (S.D.N.Y. 1993) (holding corporate
4 vice present and general counsel not personally liable for FRCP 11
5 sanctions because he was neither a party nor the attorney of record), and
6 Paine Webber, Inc. v. Can Am Fin. Group, Ltd., 121 F.R.D. 324, 335-36
7 (N.D. Ill. 1988), aff'd, 885 F.2d 873 (7th Cir. 1989) (table)
8 (corporation, not president, held liable under FRCP 11 for president's
9 lies to attorneys leading to filing of improper pleading).

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

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

26 was president of the corporation at the time that it was
27 formed, but as far as forming the corporation, as far as doing
28 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

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

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

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

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

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

25
26 **B. Reconsideration**

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

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

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

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

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

1 stage and (3) the newly discovered evidence is of such magnitude that
2 production of it earlier would likely have changed the outcome of the
3 case." In re La Sierra Financial Svcs., Inc., 290 B.R. 718, 733 (9th
4 Cir. BAP 2002) (quoting Defenders of Wildlife v. Bernal, 204 F.3d 920,
5 928-29 (9th Cir. 2000)). He made no such showing, and the conduct
6 complained of in the motion for reconsideration took place well before
7 the motion for sanctions was filed, and much had been litigated in state
8 court before the petition date. Accordingly, the facts recited in the
9 motion and supporting declaration do not qualify as "newly discovered
10 evidence."

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

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

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

28

1 **VI. CONCLUSION**

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

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