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OF THE NINTH CIRCUIT

NOT FOR PUBLICATION

UNITED STATES BANKRUPTCY APPELLATE PANEL

OF THE NINTH CIRCUIT

In re: KIRK FRIEDMAN, Debtor.	BAP Nos. SC-05-1170-SPaMa SC-05-1180-SPaMa SC-05-1181-SPaMa SC-05-1182-SPaMa Bk. No. 04-09158
KIRK FRIEDMAN, Appellant, v. KENNETH BURNS; PAUL LISCOM; CALIFORNIA CORPORATIONS COMMISSION; JAMES L. KENNEDY, Chapter 7 Trustee, Appellees.	**MEMORANDUM**[1]

Argued and Submitted on
February 24, 2006 at San Diego, California

Filed - May 31, 2006

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

Honorable James W. Meyers, Bankruptcy Judge, presiding

Before: SMITH, PAPPAS and MARLAR, Bankruptcy Judges.

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

Kirk Friedman ("Debtor") appeals four related orders: 1) an order denying Debtor's motion to dismiss an involuntary chapter 7 petition[2] entered January 28, 2005; 2) an order denying a motion for its reconsideration entered April 28, 2005; 3) an order granting petitioning creditors' motion for summary judgment entered April 28, 2005; and 4) an order directing Debtor to file schedules and statement of financial affairs entered April 27, 2005 (collectively, the "Orders"). The Notices of Appeal were filed on April 29, 2005. As the Orders are interrelated and revolve around a single issue -- whether the statutory requirements for commencing an involuntary petition were satisfied -- all four appeals are addressed in this memorandum. We REVERSE and REMAND.

I. FACTS

On June 27, 2002, the California Corporations Commission ("Commission") filed a complaint against Debtor and others[3] (collectively, "Defendants") in Los Angeles Superior Court. The complaint alleged that Defendants had fraudulently solicited investments and sold unregistered securities to approximately 72 persons or entities in the total amount of $2,932,465 for Green Screen Partners, LLC and to approximately 138 persons or entities

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[2] 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.

[3] Debtor's co-defendants include Richard Houghton, Sean Andrew O'Neal, and Jeffrey Shuken. Petitioning Creditors filed involuntary chapter 7 petitions against each Defendant on October 21, 2004.

in the total amount of $5,159,964 for Treasure Hunt Entertainment II. The Commission sought a permanent injunction, civil penalties, and restitution for the defrauded investors pursuant to California Corporations Code ("Cal. Corp. Code") §§ 25110 and 25401.

On September 5, 2002, the Commission and Defendants stipulated to the entry of a final judgment including a permanent injunction and other ancillary relief (the "Consent Judgment"). Pursuant to the Consent Judgment, the Commission agreed not to take any administrative or civil action against Defendants based upon the complaint. In return, Defendants agreed to be jointly and/or severally liable to the Commission for restitution in the amount of $8,092,429.55 and civil penalties in the amount of $10,500,000.

Debtor subsequently failed to make any of the payments required under the Consent Judgment. On October 21, 2004, the Commission, along with two of the affected investors, Kenneth Burns ("Burns") and Paul Liscom ("Liscom") (collectively, "Petitioning Creditors"), filed an involuntary petition against Debtor pursuant to § 303(b). The involuntary petition alleged that Debtor had at least 12 creditors and described Petitioning Creditors' claims as arising from securities fraud and violations of Cal. Corp. Code § 25000 et seq.

On November 15, 2004, Debtor moved to dismiss the involuntary petition on the grounds that the statutory requirements of § 303(b) had not been satisfied. Debtor argued that 1) Burns and Liscom did not qualify as eligible petitioning creditors because neither held a claim separate and distinct from

the Commission's claim under the Consent Judgment, 2) even if they held claims independent of the Consent Judgment, such claims were time barred, and therefore, the subject of a bona fide dispute, and 3) Debtor's acknowledgment of liability to the Commission under the Consent Judgment did not extend to Burns and Liscom.

The Petitioning Creditors responded that as beneficiaries of the restitution award referenced in the Consent Judgment, Burns and Liscom held claims against Debtor that were not contingent as to liability nor subject of a bona fide dispute. Relying on Cal. Corp. Code § 25530,[4] they maintained that subsection (b) of the

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[4] Cal. Corp. Code § 25530 provides

> (a) Whenever it appears to the commissioner that any person has engaged or is about to engage in any act or practice constituting a violation of any provision of this division or any rule or order hereunder, the commissioner may in the commissioner's discretion bring an action in the name of the people of the State of California in the superior court to enjoin the acts or practices or to enforce compliance with this law or any rule or order hereunder . . . .
>
> (b) If the commissioner determines it is in the public interest, the commissioner may include in any action authorized by subdivision (a) a claim for ancillary relief, including but not limited to, a claim for restitution or disgorgement or damages on behalf of the persons injured by the act or practice constituting the subject matter of the action, and the court shall have jurisdiction to award additional relief.
>
> (c) In any case in which a defendant is ordered by the court to pay restitution to a victim, the court may in its order require

(continued...)

statute authorized the Commission to seek a restitution judgment "on behalf of" the persons injured by Debtor's acts, including Burns and Liscom, and subsection (c) provided such persons with the individual right to enforce their share of the restitution award as a separate civil judgment. Thus, the argument concluded, Burns and Liscom effectively each held separate civil judgments against Debtor pursuant to Cal. Corp. Code § 25530(c). In addition, Petitioning Creditors argued that Debtor's voluntary signature on the Consent Judgment constituted an acknowledgment of his obligation to both the Commission and the investors, and therefore, under California Code of Civil Procedure ("C.C.P.") § 360, the statute of limitations did not apply.

A hearing on the motion to dismiss was held on December 16, 2004. The bankruptcy court rejected Debtor's interpretation of Cal. Corp. Code § 25530(c) and determined that the statute provided Burns and Liscom with individual claims for purposes of § 303(b), holding

> I think after listening to the argument of counsel and reading the pleading, that . . . it would be considered a technical view of the bankruptcy requirements and rule that there aren't sufficient creditors here under this scenario. I think that would not reflect the actuality of what is going on in this process . . . . The Department of Corporations has its own claim. The State of

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[4](...continued)

> the payment as a money judgment, which shall be enforced by a victim as if the restitution order were a separate civil judgment, and enforceable in the same manner as is provided for the enforcement of any other money judgment . . . .

Cal. Corp. Code § 25530.

> California has its own claim. But in addition, the second cause of action, of which the $8 somewhat million dollars is awarded for, they're acting in a representative capacity of a number of individuals, at least two of which, apparently would, on this record, join in this and therefore, I would think it would be not be a very practical view to construe this in a technical manner and I find that the motion should be denied . . . .

Following the hearing, on January 10, 2005, Debtor filed an answer to the involuntary petition asserting as affirmative defenses the same arguments raised in the motion to dismiss.

Believing that the bankruptcy court had misinterpreted Cal. Corp. Code § 25530(c), Debtor filed a motion for reconsideration on February 7, 2005. Debtor argued that § 25530(c) was not self-executing and that only individuals or entities actually named in the restitution award could enforce it as a civil judgment. Stated otherwise, as the Commission was the only named obligee, the Consent Judgment created a <u>single</u> enforceable claim, not several individual enforceable claims. Thus, according to Debtor, for purposes of § 303(b), the Petitioning Creditors represented one claim, not three.

On February 9, 2005, Petitioning Creditors filed a motion for summary judgment. They reasoned that because the bankruptcy court had already ruled in their favor on the defenses Debtor alleged in the answer, and since no additional legal defenses or genuine issues of material fact were raised, they were entitled to the entry of an order for relief as a matter of law.

Debtor countered that Petitioning Creditors had failed to meet their burden of proof as to each element of their claim and to attach affidavits supporting the allegations as required by

Fed. R. Civ. P. 56. In addition, Petitioning Creditors had not introduced evidence demonstrating Debtor's failure to pay debts as they became due as required under § 303(h).

Relying on the totality of the circumstances test discussed in In re Vortex Fishing Sys., Inc., 277 F.3d 1057 (9th Cir. 2002), Petitioning Creditors maintained that the unpaid Consent Judgment, which represents an overwhelming proportionate share of Debtor's overall debt, alone, was enough to satisfy § 303(h).

On April 15, 2005, the bankruptcy court heard both motions and concluded the hearing by denying the reconsideration motion and granting the summary judgment motion. The bankruptcy court reasoned

> I think given the judgment we're dealing with, I do think that that [sic] provides the basis for the individual claims that justifies the petition. And I think that on this record that the Debtors have admitted not paying the debts as they become due, and therefore I do think this motion for summary judgment should be granted . . . .

Debtor appeals.

II. ISSUE

Whether the bankruptcy court erred in determining that for purposes of § 303(b) Petitioning Creditors each held separate and distinct claims under the Consent Judgment.

III. JURISDICTION

Federal subject matter jurisdiction is founded under 28 U.S.C. §§ 1334(b) and 157(b)(1). We have appellate jurisdiction over final orders pursuant to 28 U.S.C. § 158(c).

IV. STANDARD OF REVIEW

We review the bankruptcy court's legal conclusions de novo, findings of fact for clear error, and mixed questions of law and fact de novo. In re Roberts, 331 B.R. 876, 880 (9th Cir. BAP 2005). Moreover, a bankruptcy court's interpretation of state law and orders granting or denying summary judgment are also reviewed de novo. Id.; In re Paine, 283 B.R. 33, 36 (9th Cir. BAP 2002).

V. DISCUSSION[5]

Debtor contends that the claims of Burns and Liscom are not separate and distinct from the claim held by the Commission under the terms of the Consent Judgment, and therefore, the bankruptcy court erred when it denied the dismissal motion and entered the order for relief. We agree.

A. The Requirements of § 303(b)

Only creditors with certain claims are eligible to commence an involuntary petition under § 303(b). Section 303(b) provides, in relevant part:

> (b) An involuntary case against a person is commenced by the filing with the bankruptcy court of a petition under chapter 7 or 11 of this title–
>
> (1) by three or more entities, each of which is either a holder of a claim against such person that is not contingent as to liability or the

[5] Shortly before the time set for oral argument before this panel, Appellees' counsel faxed a one-sentence letter to the Clerk advising that he would not be presenting oral argument. Due to this unanticipated absence, we had to rely solely on Appellees' arguments provided in the brief and were unable to engage Appellees regarding various issues concerning the interplay between Cal. Corp. Code § 25530 and § 303(b).

> subject of a bona fide dispute, or an indenture trustee representing such a holder, if such claims aggregate at least $12,300 more than the value of any lien on property of the debtor securing such claims held by the holders of such claims
>
> (2) if there are fewer than 12 such holders, excluding any employee or insider of such person and any transferee of a transfer that is voidable under section 544, 545, 547, 548, 549, or 724(a) of this title, by one or more of such holders that hold in the aggregate at least $12,300 of such claims

11 U.S.C. § 303(b).

In determining whether the requirements of § 303(b) have been met, a court must closely examine the entities who have commenced the involuntary case. 4 Collier on Bankruptcy ¶ 303.03[2] (15th ed. rev. 2005). For a debtor who has 12 or more eligible creditors, at least three of the petitioning creditors must hold separate and distinct claims. See 11 U.S.C. § 303(b)(1).

B. The Bankruptcy Court Erred In Finding That Burns and Liscom Held Separate and Distinct Claims Under the Consent Judgment

Debtor argues that as the Consent Judgment only named the Commission as the entity to whom Debtor owed payment of the restitution award, Cal. Corp. Code § 25530(c) does not apply to Burns and Liscom. Consequently, Burns and Liscom are ineligible petitioning creditors because they cannot assert that they each have distinct and separate claims based upon the Consent Judgment.

1. Burns and Liscom are entitled to a share of the restitution awarded in the Consent Judgment based on §§ 25530(a) and (b)

Cal. Corp. Code § 25530(a) provides the Commission with the authority to "bring an action in the name of the people of the State of California . . . to enjoin the act or practices or to enforce compliance" of any law or rule provided for in the Cal. Corp. Code. In addition, subsection (b) allows the Commission to "include in any action authorized by subdivision (a) a claim for restitution on behalf of the persons injured by the act or practice constituting the subject matter of the action." Cal. Corp. Code § 25530(b).

In examining the Consent Judgment in relation to the complaint and Cal. Corp. Code § 25530, the Commission was clearly acting on behalf of the defrauded investors, and not itself, when it pursued the $8 million claim for restitution. When examined concurrently, the complaint and the Consent Judgment clearly reflect that the Commission's intent was to obtain full restitution for those injured by Debtor's actions. Accordingly, as apparent victims of Debtor's securities fraud, Burns and Liscom are entitled to claim a share in the restitution award.[6] Whether such entitlement constitutes an eligible claim for § 303(b) purposes, however, requires an analysis of the language

[6] A restitution award to the Commission on behalf of defrauded investors is paid to the Department of Corporations as the agent for the individual investors. The Commission then distributes the award to the investors on a pro-rata basis determined by the proofs of claim filed by each of them prior to disbursement.

and scope of both Cal. Corp. Code § 25530(c) and the Consent Judgment.

2. Cal. Corp. Code § 25530(c) and the terms of the Consent Judgment are not sufficient to establish separate and distinct individual claims for purposes of §303(b)

Cal. Corp. Code § 25530(c) provides,

> In any case in which a defendant is ordered by the court to pay restitution to a victim, the court may in its order require the payment as a money judgment, which shall be enforceable by the victim as if the restitution order were a separate civil judgment, and enforceable in the same manner as is provided for the enforcement of any other money judgment. Any order issued under this subdivision shall contain provisions that are designed to achieve a fair and orderly satisfaction of the judgment.

Cal. Corp. Code § 22530(c)(emphasis added).

In determining whether subsection (c) is applicable to Burns and Liscom, we must examine the express language of the statute. See Chevron U.S.A., Inc. v. Natural Res. Def. Council, 467 U.S. 837, 842-44 (1984); U.S. v. Buckland, 289 F.3d 558, 564 (9th Cir. 2002). "[A]s long as the statutory scheme is coherent and consistent, there generally is no need for a court to inquire beyond the plain language of the statute." U.S. v. Ron Pair Enters., 489 U.S. 235, 240-41 (1989).

Subsection (c) applies "[i]n any case in which a defendant is ordered by the court to pay restitution to a victim." This language suggests that for subsection (c) to be applicable payment of the restitution must be ordered to a victim. Logically and practically, it follows that a restitution order can only be enforceable as a money judgment if the victim is

actually identified in the order. Otherwise a restitution judgment enforceable by unnamed persons could undermine the intended goal of achieving a "fair and orderly satisfaction of the judgment." See Cal. Corp. Code § 25530(c).

Moreover, the underlying public policy purpose of § 25530 supports a narrow reading of subsection (c). The "intent behind § 25530 was to create a governmental cause of action to protect the public interest by enjoining defendants from similar illegal conduct in the future." People v. Martinson, 233 Cal. Rptr. 617, 620 (Cal. Ct. App. 1986). Subsection (c) was included by the legislature as a way for the Commission to obtain restitution on behalf of defrauded investors, thereby relieving victims of the burden of pursuing the violators on their own. Restitution, however, is not the only avenue for recovery available to wronged investors. Id. Defrauded investors are also provided private rights of action for reimbursement pursuant to Cal. Corp. Code § 25503. This being the case, there is no reason to interpret subsection (c) more broadly than what is expressed in the plain language of the statute.

In applying § 25530, Petitioning Creditors argue that because subsection (c) does not expressly require victims to be specifically named in a court order, the Commission's right to payment under the Consent Judgment can be interpreted as a right to payment also held by Burns and Liscom as the direct intended beneficiaries of the Consent Judgment. However, this application of subsection (c) does not comply with its plain meaning. If the Petitioning Creditors' application is correct, then the Consent Judgment could be enforced by anyone claiming to have been harmed

by Debtor, whether or not such harm actually occurred, to the detriment of legitimate victims. Clearly, this is not what the California legislature intended.

Nor does Petitioning Creditors' interpretation make practical sense from an enforcement standpoint. Though the Consent Judgment expressly requires Debtor to pay restitution to the Commission in the form of a money judgment, it is absent of any language indicating to whom the restitution award is payable to other than the Commission. The language in the Consent Judgment would provide a future court with no indication that Burns and Liscom were victims. As a result, we believe the bankruptcy court erred in finding that Burns and Liscom were entitled to enforce payment of their pro-rata share of the restitution award against Debtor under Cal. Corp. Code § 55230(c). Because § 55230(c) is inapplicable to Burns' and Liscom's claims, Petitioning Creditors have failed to show that the claims are separate and independent from the Commission's under the Consent Judgment. Thus, Burns and Liscom do not qualify as petitioning creditors under § 303(b).

C. <u>There Is No Evidence that Petitioning Creditors Filed the Involuntary Petition In Bad Faith</u>

Debtor asserts that Petitioning Creditors filed the involuntary petition in bad faith and for an improper purpose -- routine debt collection. Debtor contends that the petition was filed because Petitioning Creditors were unable to collect the Consent Judgment and they believed that Defendants were improperly transferring assets. However, there is no evidence in the record to support these allegations except a statement by the

Commission, made in the motion to dismiss, that

> Due primarily to the frustration of its collection efforts, together with evidence that the defendants were moving assets, the Department of Corporations, in consultation with counsel and the investors, decided to file the Petitions . . . .

This statement, by itself, is insufficient to establish that Petitioning Creditors were acting in bad faith when they filed the petition.

VI. CONCLUSION

We REVERSE the Orders entered by the bankruptcy court finding that Petitioning Creditors satisfied the three-creditor requirement of § 303(b) on the basis that Burns and Liscom held separate and distinct claims under the Consent Judgment. However, as the bankruptcy court made no findings regarding the claims, if any, held by Burns and Liscom independent of the Consent Judgment, we REMAND to the bankruptcy court to consider and decide 1) whether Burns and Liscom hold such claims, and if so, 2) whether such claims qualify them as petitioning creditors under § 303(b).