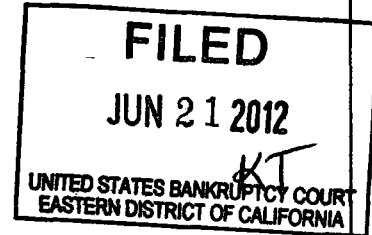


NOT FOR PUBLICATION



UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF CALIFORNIA

In re

Case No. 12-13170-A-11
DC No. (not assigned)

AUGUSTINE PENA, III

Debtor.

ORDER REGARDING RECONSIDERATION OF ORDER CONVERTING CASE TO CHAPTER 7;
REQUEST TO STAY ENFORCEMENT OF ORDER CONVERTING CASE TO CHAPTER 7
PENDING HEARING AND/OR APPEAL; AND REQUEST TO USE LIMITED CASH
COLLATERAL TO PRESERVE BANKRUPTCY ESTATE

Having considered the debtor's Motion for Reconsideration of Order Converting Case to Chapter 7, Request to Stay Enforcement of Order Converting Case to Chapter 7 Pending Appeal, and Request to Use Limited Cash Collateral to Preserve the Bankruptcy Estate, as well as supporting documents, the motion is denied.

History of the Case

On April 9, 2012, the debtor filed a voluntary petition for relief under Chapter 11 of the Bankruptcy Code. Voluntary Petition, ECF No. 1. Counsel for the debtor was J. M. Irigoyen. On the date of the petition the debtor owned 29 rental properties; 28 of those properties are encumbered by deeds of trust that contain assignment of rent clauses. Hr'g Tr. Mot. Use Cash Collateral at 5:3-14, May 30, 2012, ECF No. 50. Some have been vacant and some are or were "deemed nuisances," requiring repair. *Id.* at 14:2-7. The deeds of trust are

1 held by ten different creditors. *Id.* at 6:1-15. The deeds of trust
2 that contain assignments of rents were in the possession of debtor's
3 counsel at or near the commencement of the case. *Id.* at 11:6-12:2.

4 On April 12, 2012, the Clerk issued and served an order that
5 scheduled a Status Conference for June 6, 2012. Order Re Ch. 11
6 Status Conf., Apr. 12, 2012, ECF No. 6-7. Paragraph 3 of this order
7 informed counsel that among the subjects to be considered would be
8 "[t]he status of any stipulations or motions for use of cash
9 collateral" *Id.* It also included the sentence, "This is
10 notice that the court may, sua sponte, at the status conference, order
11 the case dismissed or converted to chapter 7, or may order the
12 appointment of a chapter 11 trustee." *Id.*

13 In April and again in May 2012, the debtor collected rents from
14 the occupied properties in the amount of \$48,000-50,000. Hr'g Tr.
15 8:12-9:7, ECF No. 50. Without the involved creditor's consent or the
16 approval of the court the debtor spent approximately \$16,000 of the
17 cash collateral (rents collected). *Id.* at 9:19-11:4.

18 Neither consent of the creditor, nor court order, was obtained
19 prior to debtor's use of cash collateral because debtor's counsel was
20 under the mistaken impression that the applicable deeds of trust did
21 not provide for the assignment of rents. *Id.* at 10:24-11:16. The
22 misapprehension stemmed from counsel's review of only the face pages
23 of the deeds of trust, rather than the entire deeds of trust, and
24 counsel's belief that the absence of the words, "and Assignment of
25 Rents" in the titles of the documents indicated that the deeds of
26 trust did not include assignments of rent. *Id.*

27 On May 21, 2012, the United States Trustee convened the meeting
28 of creditors and, during the course of that hearing, suggested to

1 Irigoyen that the deeds of trust likely contained assignment of rent
2 clauses. *Id.* at 11:11-17. In response, Irigoyen examined the entire
3 deeds of trust and learned of the presence of the assignment of rents
4 clauses. *Id.*

5 In response, also on May 21, 2012, the debtor filed his first
6 Motion to Use Cash Collateral. Mot. Use Cash Collateral and Grant
7 Adequate Protection, ECF Nos. 38-43. Simultaneously with that motion,
8 the debtor sought an order shortening time to May 23, 2012, for the
9 hearing on the motion. Ex Parte Appl. Shorten. Time, ECF No. 39. The
10 order shortening time was granted and the hearing was scheduled for
11 May 23, 2012. Order Granting Ex Parte Appl. Shorten. Time, ECF No.
12 45.

13 On May 23, 2012, the court heard the Motion for Authority to Use
14 Cash Collateral and warned debtor's counsel that it would consider
15 conversion of the case to Chapter 7 at the Status Conference on June
16 6, 2012. Hr'g Tr. at 38:17-39:22, ECF No. 50. The court then
17 continued the hearing on the motion to June 6, 2012.

18 At the status conference on June 6, 2012, after the continued
19 hearing and argument from the debtor, the U.S. Trustee, and creditors
20 on the issue of conversion, the court ordered the case converted to
21 Chapter 7. Cont. Hr'g Tr. Mot. Use Cash Collateral, June 6, 2012, ECF
22 No. 71; Order Convert. Case, April 12, 2012, ECF No. 70.

23 On June 14, 2012, the debtor filed his motion to reconsider, stay
24 enforcement of the order and for use cash collateral. Motion to
25 Reconsider, June 14, 2012, ECF No. 79-87. Heard on shortened time,
26 the matter was opposed by creditors Deutsche Bank National Trust
27 Company, The Bank of New York Mellon and East West Bank.

Reconsideration

The court may reconsider an order converting a case from Chapter 11 to Chapter 7. Fed. R. Civ. P. 59-60; Fed. R. Bankr. P. 9023, 9024. Reconsideration is appropriate if there is newly discovered evidence, clear error or the decision was manifestly unjust, or there is an intervening change in controlling law. *All Hawaii Tours, Corp. v. Polynesian Cultural Ctr.*, 116 F.R.D. 645, 648 (D. Haw. 1987), rev. on other grounds, 855 F.2d 860 (9th Cir. 1988). In this case, the debtor argues under the second of the three grounds for reconsideration: clear error or manifest injustice. This court finds that no such error or injustice exists.

Bankruptcy courts have authority to dismiss a Chapter 11 case or convert it to Chapter 7, sua sponte. 11 U.S.C. §§ 105(a), 1112(b); cf. *In re Rosson*, 545 F.3d 764, 771 n.8 (9th Cir. 2008) (stating that in Chapter 13 case, "[a]lthough the statute provides for conversion 'on request of a party . . . or the . . . trustee . . . there is no doubt that the bankruptcy court may also convert on its own motion.'" (citing 11 U.S.C. §§ 105(a), 1307(c))); *Tennant v. Rojas (In re Tennant)*, 318 B.R. 860, 869 (B.A.P. 9th Cir. 2004); *C-TC 9th Ave. P'ship v. Norton Co. (In re C-TC 9th Ave. P'ship)*, 113 F.3d 1304, 1312 (2d Cir. 1997). The statute speaks clearly on this point:

Except as provided in paragraph (2) and subsection (c), on request of a party in interest, and after notice and a hearing, the court shall convert a case under this chapter to a case under chapter 7 or dismiss a case under this chapter, whichever is in the best interests of creditors and the estate, for cause unless the court determines that the appointment under section 1104(a) of a trustee or an examiner is in the best interests of creditors and the estate.

11 U.S.C. § 1112(b) (1) (emphasis added). "Cause" includes the unauthorized use of cash collateral. 11 U.S.C. § 1112(b) (4) (D). In

1 this case, without leave of court or consent of the implicated
2 creditor, the debtor used cash collateral of \$16,000 during a span of
3 42 days. Hr'g Tr. At 11:7-17, ECF No. 50. This is precisely the type
4 of activity that § 1112(b) is designed to address. The court find
5 substantial harm to at least one creditor. First, the debtor has
6 spent \$16,000 of cash collateral; some of the money went to business
7 overhead and some to secured debt payment, though there was apparently
8 no effort to use rent collected from a particular property to pay the
9 deed of trust encumbering that property. Second, these funds have not
10 been segregated. 11 U.S.C. §363(c)(4). The debtor has not provided
11 an accounting of the precise expenditures of these funds. Third, and
12 finally, the court notes that as late as June 20, 2012, only two of
13 the required 29 debtor in possession accounts, 11 U.S.C. §363(c)(4),
14 accounts had actually been opened.

15 Subsection (b)(2) of § 1112(b) provides an exception to this
16 rule. It provides,

17 The court may not convert a case under this chapter to a case
18 under chapter 7 or dismiss a case under this chapter if the
19 court finds and specifically identifies unusual circumstances
20 establishing that converting or dismissing the case is not in
the best interests of creditors and the estate, and the debtor
or any other party in interest establishes that-

21 (A) there is a reasonable likelihood that a plan will be
22 confirmed within the timeframes established in sections
1121(e) and 1129(e) of this title, or if such sections do not
apply, within a reasonable period of time; and

23 (B) the grounds for converting or dismissing the case include
24 an act or omission of the debtor other than under paragraph
25 (4)(A) - (I) for which there exists a reasonable justification
for the act or omission; and (ii) that will be cured within a
reasonable period of time fixed by the court.

26 11 U.S.C. §1112(b)(2).

27 The court's authority to convert is thus limited by two
28 exceptions: unusual circumstances specifically identified that

1 indicate that neither conversion, nor a dismissal is in the best
2 interests of creditors, and a case in which the debtor is a family
3 farmer or non-moneyed corporation, unless the debtor requests
4 conversion. 11 U.S.C. § 1112(b)(2), (c). Neither is applicable in
5 this case.

6 Though § 1112(b) provides the court with a choice of remedies,
7 including conversion to Chapter 7, dismissal, appointment of a Chapter
8 11 trustee or the appointment of an examiner, the court finds that
9 conversion to Chapter 7 is the remedy that is in the best interests of
10 creditors. Dismissal is not an effective remedy as it leaves the
11 debts unresolved. The costs of an appointment of a Chapter 11 trustee
12 or examiner do not justify the benefits in this case. Both
13 alternative remedies carry a heavy administrative cost burden that the
14 estate will not bear in this case.

15 The debtor in this case is an individual. The court finds the
16 debtor does not have meaningful equity or cash flow to carry the cost
17 of a Chapter 11 trustee or an examiner. First, there is no meaningful
18 equity. Other than a fully exempt 401(k) and an IRA, the estate's
19 only assets are heavily encumbered real estate. Of the debtor's 29
20 properties, only 7 have equity. Schedule A, April 9, 2012, ECF No. 1.
21 Without considering costs of sale, the equity in all properties totals
22 \$291,300. Priority Claims total \$103,213.65. Schedule E, April 9,
23 2012, ECF No. 1. General unsecured debts total \$149,532. Schedule F,
24 April 9, 2012, ECF No. 1. Accordingly, assuming the debtor's
25 valuations are accurate and without considering costs of sale or
26 accounting for second deeds of trust that may assert unsecured claims
27 of \$410,000, equity exceeds priority and unsecured debts by only
28 \$38,554.35.

1 Second, contrary to the Ex Parte Application which argues that
2 there is a "surplus of close to \$10,000 per month after allocating for
3 adequate protection payments and covering operation expenses[,] " this
4 case has inadequate cash flow. Mem. P. & A. Supp. Debtor's Emer. Mot.
5 Recons. Convert., 6:9-10, June 14, 2012, ECF No. 82. At the hearing
6 on the original Motion for Use of Cash Collateral, debtor's counsel
7 stated that debtor could only afford to pay adequate protection
8 payments of 65% of the face value of the first deeds of trust and no
9 payments on second deeds of trust, after paying operating expenses,
10 leaving \$5,000, apparently for personal living expenses. Hr'g Tr. at
11 4:16-18, 6:18-7:21, 12:10-16:15, ECF No. 50. Accordingly, the court
12 finds that the case will not support the administrative expense
13 occasioned by the appointment of a trustee or examiner and that
14 liquidation under Chapter 7 is in the best interests of creditors.

15 The debtor has argued that conversion is not appropriate in this
16 case because the failure to seek consent or an order to use cash
17 collateral was occasioned by his former counsel's lack of due
18 diligence in reviewing the deeds of trust and the mistaken advice that
19 ensued. Hr'g Tr. at 10:24-12:5, ECF No. 50; Debtor's Emer. Mot.
20 Recons. Convert. Ex. 2, at 2 (Irigoyen Decl. ¶¶ 6-11). The court
21 agrees that due diligence requires counsel obtain and review deeds of
22 trust in a Chapter 11 where cash collateral issues may be involved.
23 *In re Withrow*, 391 B.R. 217, 228 (Bankr. D. Mass. 2008), *aff'd*, 405
24 B.R. 505 (B.A.P. 1st Cir. 2009); *In re Dean*, 401 B.R. 917, 924 (Bankr.
25 D. Idaho 2008); *In re Layo*, 460 F.3d 289, 293 (2d Cir. 2006) (review
26 of recorded documents deemed "the most basic type of due diligence").

27 But the court does not agree that inadequate legal advice is a
28 defense to a § 1112(b) dismissal or conversion. For at least 50

1 years, it has been well settled that mistaken legal advice does not
 2 relieve the client of the consequences of those acts or omissions.
 3 *Link v. Wabash R. Co.*, 370 U.S. 626, 634 (1962) (dismissal of
 4 adversary proceeding for failure to appear at scheduled status
 5 conference); *United States v. Boyle*, 469 U.S. 241 (1985) (taxpayer
 6 couldn't avoid interest and penalties caused by mishandling of return
 7 by attorney); *Cannon-Stokes v. Potter*, 453 F.3d 446 (7th Cir. 2006)
 8 (failure to schedule employment cause of action in bankruptcy
 9 schedules resulting in judicial estoppel barring claims); *In re*
 10 *DePugh*, 409 B.R. 84, 107 n.13 (Bankr. S.D. Tex. 2009) (failure to
 11 attach assignments to Proofs of Claim). Accordingly, counsel's failure
 12 to identify and address the cash collateral issue in a timely and
 13 appropriate fashion does not excuse the debtor, and the court properly
 14 converted the case to Chapter 7.

15 The motion to reconsider is denied.

16 **Request for Stay Enforcement of Order Converting Case to Chapter 7**
 17 **Pending Hearing and/or Appeal**

18 This court may stay the order converting the case from Chapter 11
 19 to Chapter 7 pending an appeal. Fed. R. Bankr. P. 8005. The decision
 20 to grant or deny a motion for stay pending appeal lies with the sound
 21 discretion of the court whose order is being appealed. *Prudential*
 22 *Mortg. Capital Co., LLC v. Faidi*, 444 Fed. Appx. 732 (5th Cir. 2011).
 23 The party seeking the stay has the burden of proof. *In re Shenandoah*
 24 *Realty Partners, L.P.*, 248 B.R. 505, 510 (W.D. Va. 2000). An
 25 appellant seeking a stay pursuant to Federal Rule of Bankruptcy
 26 Procedure 8005 must prove: "(1) appellant is likely to succeed on the
 27 merits of the appeal; (2) appellant will suffer irreparable injury;
 28 (3) no substantial harm will come to appellee; and (4) the stay will

1 do no harm to the public interest." *Universal Life Church v. United*
2 *States*, 191 B.R. 433, 444 (E.D. Cal. 1995) (Wanger, J); *In re Irwin*,
3 338 B.R. 839, 843 (E.D. Cal. 2006) (Ishii, J). The failure to satisfy
4 any of the four prongs of the analysis is fatal to the motion. *In re*
5 *Deep*, 288 B.R. 27, 30 (N.D. N.Y. 2003); *In re Irwin*, 338 B.R. 839, 843
6 (E.D. Cal. 2006) (Ishii, J).

7 In this case, the debtor has not carried his burden of proof as
8 to the first and third elements of the test articulated in *Universal*
9 *Life Church*. See *Universal Life Church*, 191 B.R. at 444. First, the
10 debtor has not demonstrated a likelihood that it will prevail on the
11 merits. The law is well settled that the unauthorized use of cash
12 collateral by a Chapter 11 debtor is cause for dismissal and that the
13 court, itself, may raise that issue. 11 U.S.C. § 1112(b)(1),
14 (b)(4)(D). *Tennant v. Rojas (In re Tennant)*, 318 B.R. 860, 869
15 (B.A.P. 9th Cir. 2004); *C-TC 9th Ave. P'ship v. Norton Co., (In re C-*
16 *TC 9th Ave. P'ship)*, 113 F.3d 1304, 1312 (2d Cir. 1997). That the
17 debtor did so is undisputed and shown by the admissions of his own
18 attorney. And the debtor does not now argue otherwise.

19 Second, the debtor has failed to demonstrate the lack of harm to
20 creditors. The debtor owns 29 properties, 28 of those properties are
21 encumbered by deeds of trust that contain assignment of rent clauses.
22 Hr'g Tr. at 5:3-14, ECF No. 50. The particular harm to creditors is
23 the delay occasioned by the appeal. The function of a Chapter 7
24 trustee is to ascertain rapidly which, if any, of the debtor's assets
25 have value for unsecured creditors, to liquidate those assets
26 expeditiously and to abandon the remainder. 11 U.S.C. §§ 704(a)(1),
27 554(a),(c). This is precisely the opposite of the attendant delay
28 occasioned by an appeal and, if eventually successful, a

1 reorganization under Chapter 11. The debtor makes no provision to
2 resolve this harm. Moreover, 28 of the 29 properties are subject to
3 first, and in some cases second, deeds of trust, requiring monthly
4 payments. Absent such payment the creditors will be forced to wait
5 for resolution of the appeal but without receiving the contractually
6 due payments. The debtor has not addressed this harm.

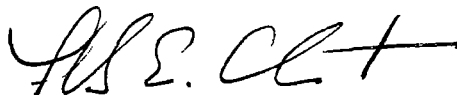
7 Accordingly, the request for stay pending appeal is denied.

8 **Motion to Use Cash Collateral**

9 It is the prerogative of the trustee or the debtor in possession
10 to seek leave to use cash collateral. 11 U.S.C. §§ 363(c)(2),
11 1107(a), 323(a), 348(e). The case now converted and the order
12 converting the case not stayed, the debtor lacks standing to present
13 such a motion.

14 The motion to use cash collateral is denied.

15
16 Dated: June 21, 2012

17 
18 _____
Fredrick E. Clement
United States Bankruptcy Judge

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