

## FOR PUBLICATION

UNITED STATES BANKRUPTCY COURT  
EASTERN DISTRICT OF CALIFORNIA

In re: UMESH PATEL and LEE                     )  
PATEL,   )  
   )       Case No. 09-39791-C-11  
   )       Dkt. Control No. RPG-1  
   )

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## OPINION ON MOTION TO CONVERT OR DISMISS CHAPTER 11 CASE

Before: Christopher M. Klein, Bankruptcy Judge

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Marc C. Forsythe, Robert P. Goe, Goe & Forsythe, LLP, Irvine, CA,  
for 1332 Broadway Note LLC.

Timothy T. Huber, Law Offices of Timothy T. Huber, El Dorado  
Hills, CA, for Revested Debtors.

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CHRISTOPHER M. KLEIN, Bankruptcy Judge:

The individual debtors' chapter 11 plan committed all their  
"disposable income as defined in 11 U.S.C. § 1129(a)(15)(B)" to  
pay the unsecured class for 84 months. No such payments were  
made. At the end of the plan term, an unsecured creditor invoked  
the plan's default provision to request conversion or dismissal.  
The question is whether there ever was actual "disposable"  
income. Who has what burdens governs the outcome.

When a debtor promises all actual "disposable" income in a  
chapter 11 plan and undertakes to act as plan disbursing agent,  
the debtor assumes the burden of a duty to account – either by  
contract or as a fiduciary. Failure to account is a material  
plan default within the meaning of § 1112(b)(4)(N), hence,  
§ 1112(b)(1) "cause." Here, conversion to chapter 7 is in the  
best interests of creditors and the estate.

Findings of Fact<sup>1</sup>

Debtors Umesh and Lee Patel commenced this joint chapter 11 case in 2009 to save from foreclosure their 45-unit motel, the Gold Country Inn in Placerville, California, and confirmed a chapter 11 plan in 2011.<sup>2</sup>

Wells Fargo Bank, N.A. ("Wells Fargo") held the senior note and deed of trust, which it assigned to movant 1332 Broadway Note, LLC, in 2015.

A. Chapter 11 Plan and Performance

Until plan confirmation on September 19, 2011, the Debtors leased the motel to their wholly-owned S corporation, Eureka Investment Group, Inc., which employed them. Under the Plan, they terminated the lease and became sole proprietors.<sup>3</sup>

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<sup>1</sup>These findings of fact are made pursuant to Federal Rule of Civil Procedure 52, as incorporated by Federal Rules of Bankruptcy Procedure 7052 and 9014, after a multi-day trial.

<sup>2</sup>The Debtors also owned a residence in Eureka, California, that was given up to foreclosure early in the case.

<sup>3</sup>The Disclosure Statement explained:

The Debtors will terminate the lease between Debtors and their wholly owned S Corporation, EIG, for the operation of the Motel. There should be no repercussions since EIG has been in default of the lease terms since early 2009.

Debtors' Second Amended Disclosure Statement, ¶ III-F. Dkt. 162 ("Disclosure Statement").

The Plan provides:

On the Effective Date, the Debtors shall terminate the EIG lease for its default under its terms.

Debtors' Second Amended Plan of Reorganization, ¶ III-A-1. Dkt. 161 ("Plan").

1 Deed of trust claims included Wells Fargo for \$1,630,061,  
2 followed by Resource Capital for \$1,124,000.

3 By agreement, the motel was valued at \$1,200,000. Thus, the  
4 Wells Fargo claim was bifurcated to \$1,200,000 secured and  
5 \$430,061 unsecured. Resource Capital's \$1,124,000 claim was all  
6 unsecured. They amount to 82 percent of all unsecured class.

7 The Plan provides for Wells Fargo to retain its lien, with  
8 its \$1,200,000 secured claim paid by 84 monthly payments of  
9 \$9,303.59, at 7.0 percent interest, followed by a balloon payment  
10 of \$951,214.63 due on September 1, 2018.

11 The unsecured class would be paid all disposable income as  
12 defined in § 1129(a)(15) for the 84 months of the Plan. Payments  
13 would be quarterly, commencing January 1, 2012.<sup>4</sup>

14 The Debtors represented in their Disclosure Statement that  
15 the motel constituted their "only sources of income" and that the  
16 means for Plan implementation would be from motel operations.<sup>5</sup>

17 \_\_\_\_\_  
18 <sup>4</sup>Specifically: "Debtors will make payments to unsecured  
19 creditors of 100% of the Debtors' disposable income as defined in  
20 11 U.S.C. § 1129(a)(15)(B) of the Bankruptcy Code (the  
"Disposable Income"), by using revenue from Debtors' continued  
operation of the Motel as a going concern." Plan, Introduction.

21 Further: "Total amt of [unsecured] claims \$1,873,397  
22 including Resource Capital and WFB unsecured amounts; Pymt  
23 interval Quarterly; Pymt amt Varies; Begin date 1/1/2012; End  
date 9/1/2018; Interest rate 0%; Total payout Unknown based on  
100% of Disposable Income." Plan, ¶ II-C-3.

24 <sup>5</sup>Income: "The Debtors' only sources of income are the salary  
25 paid to them as the day to day operating managers of the Motel, S  
26 Corporation distributions from EIG, if any, and the rent paid by  
EIG under the operating lease." Disclosure Statement, ¶ II-A.

27 Means of Implementing Plan: "Payments and distributions  
28 under the Second Amended Plan will be funded by the cash flow of  
revenues obtained by the Debtors in excess of operating expenses  
from the operation of the Motel as a going concern, as well as

1 The Debtors agreed to restrict themselves to a \$30,000/yr,  
2 salary together with use of the on-site manager's apartment.  
3 They explained they had a wealth of motel management experience  
4 and could not hire managers for such a modest amount.<sup>6</sup>

5 Upon default, the Plan contemplates a motion to convert or  
6 dismiss and, if converted to chapter 7, provides for all  
7 remaining property that was property of the estate to revert in  
8 the chapter 7 estate and be protected by the automatic stay.<sup>7</sup>

9  
10 the \$48,672.72 in cash reserves held in trust during the course  
of this proceeding as set forth in Exhibit G." Id., ¶ III-D-1

11 <sup>6</sup>Post-confirmation management:

12 The Debtors, as Post-Confirmation Managers of the  
13 Debtors, shall be compensated at a set amount of \$30,000 per  
14 year, plus the managers' apartment, which are included in  
the operating expenses.

15 Disclosure Statement, ¶ III-D-2.

16 The Debtors, as Post-Confirmation Managers of the  
17 Motel, shall be compensated with a salary of \$30,000 plus  
18 use of the manager's apartment for 24/7/365 management  
19 services of the Motel. This level of compensation is  
20 substantially less than the cost for third party employees  
to provide that many hours of management. The Debtors have  
many years of experience in operating independent motel  
properties such as the Motel.

21 Plan, ¶ II-D-2.

22 Although projections attached to the Plan indicate pay  
23 increases, Umesh Patel testified in state court in 2018 that "I  
24 am not allowed by the court approved Plan to receive any  
compensation from the motel in excess of \$30,000." Compare  
Declaration of Umesh Patel, March 6, 2018, with Plan, Ex. 3.

25 <sup>7</sup>Post-Confirmation Conversion/Dismissal:

26 A creditor or party in interest may bring a motion to  
27 convert or dismiss the case under § 1112(b), after the Plan  
is confirmed, if there is a default in performing the Plan.  
28 If the Court orders the case converted to Chapter 7 after  
the Plan is confirmed, then all property that had been

1 The Revested Debtors undertook to act as Plan disbursing  
2 agent,<sup>8</sup> and obliged themselves to make quarterly disbursements  
3 and regular 120-day status reports for the 84-month life of the  
4 Plan ("120-day Plan reports"), which reports were to be served on  
5 the twenty largest unsecured creditors.<sup>9</sup> United States trustee  
6 quarterly reports were also required while the case was open.

7 No discharge may be entered before completion of all  
8 payments under the Plan.<sup>10</sup>

9  
10 property of the Chapter 11 estate, and that has not been  
11 disbursed pursuant to the Plan, will revert in the Chapter 7  
12 estate, and the automatic stay will be reimposed upon the  
revested property only to the extent that relief from stay  
was not previously granted by the Court during this case.

13 Plan, ¶ IV-F.

14 <sup>8</sup>The paragraph "Disbursing Agent" provides:

15 Debtors shall act as the disbursing agent for the  
16 purpose of making all distributions provided for under the  
17 Plan. The Disbursing Agent shall serve without and shall  
not be compensated [for] distribution services rendered  
pursuant to the Plan.

18 Plan, ¶ II-D-3.

19 <sup>9</sup>The paragraph "Post-Confirmation Status Report" provides:

20 Within 120 days of the entry of the order confirming  
21 the Plan, Plan Proponent shall file a status report with the  
22 Court explaining what progress has been made toward  
23 consummation of the confirmed Plan. The status report shall  
24 be served on the United States Trustee, the twenty largest  
unsecured creditors, and those parties who have requested  
special notice. Further status reports shall be filed every  
120 days and served on the same entities.

25 Plan, ¶ IV-D.

26 <sup>10</sup>The discharge provision is:

27 This Plan provides that upon completion of all payments  
28 under the Plan, Debtors shall be discharged of liability for  
payment of debts incurred before confirmation of the Plan,

1 Although required every 120 days for the 84-month life of  
2 the Plan, the status reports ceased after month 24 (as of  
3 September 30, 2013). There has been no explanation why the  
4 Revested Debtors stopped making their 120-day Plan reports.

5 Quarterly post-confirmation status reports required by the  
6 United States trustee were filed through September 30, 2014, and  
7 ceased when the case was closed subject to being reopened for  
8 entry of discharge upon completion of the Plan.

9 In 2015, Wells Fargo assigned 1332 Broadway Note, LLC, its  
10 note and deed of trust, hence its secured and unsecured claims.

11 Although the 84 monthly payments on account of the Wells  
12 Fargo secured claim appear to have been made, the \$951,214.63  
13 balloon payment due on September 1, 2018, was not made.<sup>11</sup>

14 No payment ever was made to Class V unsecured creditors  
15 during the 84-month term of the Plan. The failure to have made  
16 any payment on unsecured claims precipitated the instant motion  
17 to dismiss or convert on account of Plan default on the premise  
18 that there must have been at least some disposable income.

19  
20 B. Income

21 The Debtors' defense to this motion to dismiss or convert is  
22 that there never was "disposable income" available to make  
23 payments to the unsecured class.

24 \_\_\_\_\_  
25 to the extent specified in 11 U.S.C. § 1141. However, any  
26 liability imposed by the Plan will not be discharged.

27 Plan, ¶ IV-A.

28 <sup>11</sup>Umesh Patel has instituted separate litigation seeking to  
forestall attempts to foreclose on account of the failure to have  
made the balloon payment.

The seven 120-day Plan reports that were made each reported no disposable income during the relevant periods and that no problems were anticipated in plan performance.<sup>12</sup> No 120-day Plan report was made for any period after September 30, 2013.

The twelve Quarterly Post-confirmation Status Reports to the United States trustee that were filed by the Revested Debtors show receipts and disbursements. Nine of those reports appended more detailed profit and loss statements for motel operations.

<u>Dkt</u>	<u>End Date</u>	<u>Received</u>	<u>Disbursed</u>	<u>Net</u>	<u>Profit/(Loss)</u>
184	12/31/11	\$58,580	\$82,938	\$ (24,358)	none provided
186	3/31/12	93,904	74,229	19,675	none provided
195	6/30/12	61,782	72,226	(10,444)	none provided
214	9/30/12	99,535	110,376	(10,841)	\$ (20,841)
223	12/31/12	74,538	109,877	(35,339)	(35,338)
228	3/31/13	31,439	61,298	(29,859)	(29,805)
231	6/30/13	96,904	89,936	6,968	7,002
234	9/30/13	82,581	73,668	8,913	8,916
235	12/31/13	82,032	106,145	(24,113)	(24,111)
236	3/31/14	67,320	60,649	6,671	6,930*
237	6/30/14	89,394	74,886	14,508	14,507
240	9/30/14	<u>138,762</u>	<u>74,034</u>	<u>64,728</u>	<u>64,728</u>

<sup>12</sup>Each report includes the following statements:

No payments have accrued at this time for the benefit of the class of Unsecured Creditors, since Revested Debtors have received no "Disposable Income" from which that class is entitled to be paid.

Revested Debtors remain in a cash positive position due to savings accumulated prior to the commencement of payments under the Plan and do not anticipate any problems with performance of the Plan.

Revested Debtors' Status Report, p.2. Dkt. 185 (1/17/2012); Dkt. 187 (4/19/2013); Dkt. 194 (7/20/2012); Dkt. 224 (2/1/13); Dkt. 227 (4/17/2013); Dkt. 230 (7/15/2013); Dkt. 233 (10/19/2013).

The first status report also notes: "To conserve cash, Revested Debtors have only received \$1,500 during this quarter against the manager's salary of \$2,500 per month called for under the Plan, Revested Debtors are accruing that obligation to be paid when cash flow permits." Id., p.2. Dkt. 185 (1/17/2012).

1 Totals: \$976,771 \$990,262 \$(13,491) \$(8,512)\*  
2 \*(3/31/14 Profit/Loss omits \$32,500 in receipts)

3 Between April 1, 2013, and September 30, 2014, receipts  
4 exceeded disbursements by \$77,675. Profits were \$77,972. No  
5 quarterly Plan Class V disbursements were made.

6 Motel operations for 2015, 2016, and 2017 yielded net  
7 profits of \$286,333, exclusive of depreciation, or, if adjusting  
8 for depreciation, \$98,121, evidence of which is derived from  
9 Umesh Patel's federal tax returns.<sup>13</sup> No quarterly Plan Class V  
10 disbursements were made.

11 Those tax returns also reveal income from sources other than  
12 motel operations, including ordinary dividend income of \$5,056 in  
13 2015 and \$4,721 in 2017.

14 Umesh Patel managed to fund a \$50,000 Roth IRA account  
15 between 2012 and 2018.

16 And, he was trading in financial markets. Umesh Patel  
17 opened Scottrade brokerage account No. XXXXX995 in 2012. In the  
18 "Options Application & Agreement," dated March 12, 2012, he  
19 stated: annual income, \$80,000; net worth \$150,000; and liquid  
20 assets \$50,000. He had an unreported Scottrade account in 2010,  
21  
22

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23 <sup>13</sup>Umesh Patel's Federal Tax Forms 1040, Schedule D (Profit  
24 or Loss from Business - Sole Proprietorship) show:

25 2015 - net profit \$8,083 (gross receipts \$317,611, gross  
26 income \$269,390, and total expenses \$261,307, including  
27 depreciation \$60,767);

28 2016 - net profit \$15,217 (gross receipts \$311,512, gross  
income \$291,312, and total expenses \$276,095, including  
depreciation \$60,316);

2017 - net profit \$74,821 (gross receipts \$432,526, gross  
income \$386,474, and total expenses \$311,653, including  
depreciation \$67,129).



1 when he was a debtor in possession.<sup>14</sup>

2 Scottrade account No. XXXXX995 statement for January 2014  
3 shows credits of \$112,206.05 and debits of \$66,551.43.

4 During the Plan period, Umesh Patel opened Ameritrade  
5 brokerage account No. XXX-XXX331, to purchase stocks on margin.

6 The Ameritrade statement for August 2018 shows year-to-date:  
7 securities purchases \$2,627,970.74; sales \$2,912,589.66;  
8 dividends \$3,958.39; and margin interest \$3,589.81.

9 Investment activity is reflected on the Umesh Patel federal  
10 tax Forms 1040, Schedule D, for 2015, 2016, and 2017.<sup>15</sup>

11 Umesh Patel admits that between 2011 and 2018 he lost at  
12 least \$339,000 in the stock market. His expert, Norman Johnson  
13 says losses were \$372,800.

14 No investment account was disclosed to the class of  
15 unsecured creditors by Umesh Patel during the 84-month Plan.

16  
17 C. Developments Regarding Debtors

18 Umesh and Lee Patel divorced in an action filed June 22,  
19 2012, in El Dorado County Superior Court as No. PFL 20120518.  
20 The 120-day Plan reports filed in 2012 noted the existence of the

21  
22 <sup>14</sup>In the 2013 divorce of Umesh and Dipti Patel, Umesh  
23 reported a Scottrade deposit account acquired in 2010 with  
24 \$21,000 and a Scottrade Roth IRA of \$23,000 acquired in 2014.  
Petitioner's Schedule of Assets and Debts, Umesh Patel v. Dipti  
Patel, No. PFL20130940, El Dorado County Superior Court.

25 <sup>15</sup>The returns in evidence show: 2015 - short-term capital  
26 loss \$63,430 (proceeds \$500,244, cost \$563,674), plus a \$4,377  
27 loss carryforward from 2014; 2016 - short-term capital gain \$240  
(proceeds \$840, cost \$600), plus long-term capital loss \$5,781  
(proceeds \$32,431, cost \$38,212); 2017 - short-term capital loss  
28 \$59,738 (proceeds \$102,449, cost \$162,187), plus long-term  
capital loss \$80,549 (proceeds \$176, cost \$80,549).

1 divorce and that Lee Patel intended to quitclaim to Umesh Patel  
2 her interest in the motel. She then disappears from the case.<sup>16</sup>

3 Umesh Patel soon remarried. In 2013, he was Petitioner in  
4 the marital dissolution action, Umesh Patel v. Dipti Patel, No.  
5 PFL 20130940, in El Dorado County Superior Court.

6 Umesh Patel next married Sukhwinder K. Randhawa Patel in  
7 2017. In the ensuing marital dissolution action, Umesh claimed  
8 that when she left in November 2017, she stole from him gold and  
9 diamond jewelry that he valued at \$60,000.<sup>17</sup> If the schedules  
10 filed at the inception of the case are truthful, then this  
11 \$60,000 is property acquired after commencement of the case.<sup>18</sup>

12  
13 <sup>16</sup>The post-divorce status of Lee Patel as joint debtor and a  
14 Revested Debtor can be resolved after conversion to chapter 7.

15 <sup>17</sup>Umesh Patel's declaration testimony in state court was:

16 While most of the receipts are by credit card, I do  
17 receive cash payments on occasion. My routine is to keep  
18 cash in pouch along with an itemized statement of the cash  
19 receipts. On November 27, 2017, I discovered that the cash  
20 pouch was missing. I asked the Respondent if she had seen  
21 it, but she denied seeing it. I believe the pouch had  
22 \$13,000 or so in it at that time.

23 About the same time, I inspected a box kept in a  
24 dresser in my room that contained gold jewelry and diamond  
25 watches and bracelets that were my separate property  
26 obtained long before this marriage of eight months. This  
27 jewelry is worth about \$60,000.

28 Attachment 10 to Declaration of Umesh Patel, Responsive  
Declaration to Request for Order, Umesh Patel v. Sukhwinder K.  
Randhawa Patel, No. PFL20170902, El Dorado County CA. Super. Ct.,  
March 6, 2018 ("Umesh Patel Declaration Attachment 10").

<sup>18</sup>No such property appears in Schedule B(Personal Property):

Item 5 - ... art objects; ... or collectibles: "none"

Item 7 - Furs and jewelry: "none"

Item 35 - Other personal property of any kind not already  
listed: "none."

1 On October 10, 2018, Umesh Patel purchased a 2018 Tesla  
2 Model 3 for \$71,049.50, making a down payment of \$11,023.50.

3  
4 Procedure

5 1332 Broadway Note, LLC, as holder of the assigned Wells  
6 Fargo \$430,061 unsecured claim, invoked the Plan's default  
7 provision to prosecute this motion to convert or dismiss under  
8 § 1112(b) on the theory that it was a default never to have made  
9 a payment to the unsecured class.

10 At trial, this court listened carefully to the testimony of  
11 Umesh Patel defending his financial transactions and did not find  
12 it credible. Nor was his expert helpful.

13  
14 Jurisdiction

15 Jurisdiction is founded upon 28 U.S.C. § 1334(a). A motion  
16 under 11 U.S.C. § 1112(b) to convert or dismiss a chapter 11 case  
17 is a core proceeding that a bankruptcy judge may hear and  
18 determine. 28 U.S.C. §§ 157(b) (2) (A) & (L).

19  
20 Analysis

21 Analysis begins with rules of construction and applicable  
22 law before venturing into the shifting sands of burdens.

23  
24 I

25 Confirmed chapter 11 plans are construed as contracts in the  
26 manner of consent decrees, which have elements of both judgment  
27  
28

1 and contract. Hillis Motors, Inc. v. Haw. Auto. Dealers' Ass'n,  
2 997 F.2d 581, 588 (9th Cir. 1993); Pioneer Liquidating Corp. v.  
3 United States Tr. (In re Consol. Pioneer Mortg. Entities), 248  
4 B.R. 368, 375 (9th Cir. BAP 2000), aff'd, 264 F.3d 803 (9th Cir.  
5 2001) ("Consolidated Pioneer"); Dragnea v. Dragnea (In re  
6 Dragnea), 609 B.R. 239, 250-51 (Bankr. E.D. Cal. 2019).

7  
8 A

9 The federal rule of decision for construing contract terms  
10 in chapter 11 plans is to rely on state law where, as here, there  
11 is no need for a uniform federal rule on the question. Hillis  
12 Motors, 997 F.2d at 588; Dragnea, 609 B.R. at 250-51.

13 California law controls this Plan. The Plan is silent about  
14 choice of law. The Debtors reside in California, all property is  
15 located in California, and venue of the case is in California.

16  
17 B

18 California contract law is governed by its Civil Code, not  
19 common law. CAL. CIV. CODE §§ 1635-63; Dragnea, 609 B.R. at 247.

20 Civil Code provisions relevant here relate to ambiguous or  
21 uncertain terms. The promisor's belief of what the promisee  
22 understood at the time of contracting controls. CAL. CIV. CODE  
23 § 1649.<sup>19</sup> If uncertainty persists, language shall be interpreted

24  
25 <sup>19</sup>The provision is:

26 § 1649. If the terms of a promise are in any respect  
27 ambiguous or uncertain, it must be interpreted in the sense  
28 in which the promisor believed, at the time of making it,  
that the promisee understood it.

1 "most strongly" against the party who caused the uncertainty.  
2 CAL. CIV. CODE § 1654.<sup>20</sup> In essence, the California Civil Code is  
3 consistent with the familiar common-law rule.<sup>21</sup>

4 As the Plan was drafted and proposed by the Debtors,  
5 ambiguities and uncertainties are construed against them.

7 II

8 Multiple points of uncertainty emanate from the Plan promise  
9 to pay unsecured creditors: "100% of the Debtors' disposable  
10 income as defined in 11 U.S.C. § 1129(a)(15)(B) (the "Disposable  
11 Income"), by using revenue from Debtors' continued operation of  
12 the Motel as a going concern." Plan, Introduction & ¶ II-C-3.

13 What is certain is that, as a matter of law, a "disposable  
14 income" plan payment based on § 1129(a)(15)(B) means actual  
15 disposable income, even though the plan confirmation standard at  
16 § 1129(a)(15)(B) focuses on projected disposable income. That

17 \_\_\_\_\_  
18 CAL. CIV. CODE § 1649.

19 <sup>20</sup>The provision is:

20 § 1654. In cases of uncertainty not removed by the preceding  
21 rules, the language of a contract should be interpreted most  
22 strongly against the party who caused the uncertainty to  
exist.

23 CAL. CIV. CODE § 1654.

24 <sup>21</sup>The Restatement (Second) of Contracts provides:

25 § 206. Interpretation Against the Draftsman

26 In choosing among the reasonable meanings of a promise or  
27 agreement or a term thereof, that meaning is generally  
preferred which operates against the party who supplies the  
words or from whom a writing otherwise proceeds.

28 Restatement (Second) of Contracts § 206 (1981).

1 conclusion follows from aligning § 1129(a)(15)(B), with  
2 § 1325(b)(2), and § 101(10A)(ii).<sup>22</sup>

3  
4 <sup>22</sup>The exercise is: § 1129(a)(15)(B) adopts the definition of  
5 "projected disposable income" at § 1325(b)(2), which in turn  
6 incorporates "current monthly income" from § 101(10A).

7 The relevant portion of the chapter 11 confirmation standard is:

8 (15) [If an unsecured creditor objects to confirmation] –

9     ...  
10     (B) the value of the property to be distributed under  
11     the plan is not less than the projected disposable income of  
12     the debtor (as defined in section 1325(b)(2)) to be received  
13     during the 5-year period beginning on the date that the  
14     first payment is due under the plan, or during the period  
15     for which the plan provides payments, whichever is longer.

16 11 U.S.C. § 1129(a)(15)(B) (emphasis supplied).

17 The § 1325(b)(2) "disposable income" definition as of the time of  
18 confirmation was:

19 (2) For purposes of this subsection, the term  
20 "disposable income" means current monthly income received by  
21 the debtor [other than child-related payments] less amounts  
22 reasonably necessary to be expended –

23 (A)(i) for the [family] maintenance or support ...  
24 that first becomes payable after ... petition is filed; and

25 (ii) for charitable contributions [up to 15  
26 percent of annual gross income]; and

27 (B) if the debtor is engaged in business, for the  
28 payment of expenditures necessary for the continuation,  
preservation, and operation of such business.

11 U.S.C. § 1325(b)(2) (2012).

As § 101(10A) existed at the time the Plan was confirmed:

(10A) The term "current monthly income"--

(A) means the average monthly income from all sources  
that the debtor receives (or in a joint case the debtor and  
the debtor's spouse receive) without regard to whether such  
income is taxable income, derived during the 6-month period  
ending on –

(i) [not applicable here]

(ii) the date on which current income is determined  
by the court for purposes of this title if the debtor does  
not file the schedule of current income required by section

A

The first point of uncertainty is whether the reference to continued operations of the motel is a limitation on the Plan term "Disposable Income" or merely an expression of the then-existing business plan for performing the Plan terms.

Actual "disposable income" under the statutory definition used in the Plan includes, as a matter of law, "income from all sources." But, the Plan and Disclosure Statement could be read to limit "disposable income" to motel revenues.

In their Disclosure Statement, the Debtors said that the motel is their only source of income and that "the cash flow of revenues obtained by the Debtors in excess of operating expenses" would fund the Plan. Disclosure Statement, ¶¶ II-A & III-D-1.

In the Plan Introduction, the Debtors stated they would pay unsecured creditors "100% of the Debtors' disposable income as defined in 11 U.S.C. § 1129(a)(15)(B) of the Bankruptcy Code ("Disposable Income"), by using revenue from Debtors' continued operation" of the motel. The Plan treatment of Class V unsecured claims is "100% of Disposable Income." Plan, ¶ II-C-3. The Means of Performing the Plan are: "Revenues from operations of the Motel will be the source of funding of this Plan, after payment of day to day operating expenses." Plan, ¶ II-D-1.

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521(a)(1)(B)(ii); and

(B) includes any amount paid by any entity other than the debtor ... on a regular basis for the household expenses of the debtor ... but excludes benefits received under the Social Security Act [and war crime/terrorism compensation].

11 U.S.C. § 101(10A) (2012) (emphasis supplied).

1 Despite emphasizing revenues from motel operations, they  
2 expressly incorporated in the Plan the Bankruptcy Code definition  
3 of "disposable income," which means income from all sources, net  
4 of certain exclusions and deductions.

5 This court finds as fact that, at the time of promising, the  
6 promisor Debtors believed that the promisee unsecured creditors  
7 would understand the term to mean what the promisors actually  
8 said: "100% of the Debtors' disposable income as defined in 11  
9 U.S.C. § 1129(a)(15)(B)," that is, revenue from all sources.

10 Repeated references to motel revenue in the Plan are to be  
11 understood not as a limitation on source of payment, but as a  
12 representation regarding the then-existing business plan.

13 It follows that the Plan promise of 100% of the Debtors'  
14 disposable income is construed to mean revenue from all sources.  
15 CAL. CIV. CODE § 1649.

16 The Debtors proposed the Plan. Lest any uncertainty remain  
17 about whether disposable income in the Plan means disposable  
18 income from all sources or income only from motel operations, the  
19 Plan is construed "most strongly" against the Debtors. CAL. CIV.  
20 CODE § 1654. Hence, disposable income in the Plan includes  
21 income from all sources.

22  
23 B

24 The next uncertainty relates to the absence of prescribed  
25 accounting rules for determining disposable income. Are loss  
26 carryforwards permitted allowing gains in one period to be offset  
27 against losses incurred in a prior period? Is depreciation  
28 permitted? The Plan and the Disclosure Statement are silent.



Loss carryforwards make a difference in assessing whether any Class V payments were required from the first three Plan years. Operating losses of \$91,166 were incurred during the first six quarters, which were nearly offset by operating profits of \$77,675 in the next six quarters ending September 30, 2014.

Depreciation makes a difference for 2015 through 2017 where tax returns provide the evidence of motel operations. Profits for those years were \$286,333, exclusive of depreciation, or \$98,121 after depreciation.

No direct evidence is probative of what the promisor plan proponents thought the promisee Class V creditors believed about loss carryforwards and depreciation at the time of contracting.

The California contract rule requiring construing the Plan "most strongly" against the Revested Debtors casts doubt on loss carryforwards and depreciation. CAL. CIV. CODE § 1654.

## III

As to accounting for Plan payments, the crucial provision is: "Debtors shall act as disbursing agent for the purpose of making all distributions under the Plan." Plan, ¶ II-D-3.

The undertaking to act as disbursing agent necessarily implies a correlative duty to account to creditors entitled to distributions under the Plan.

There are two alternative ways of viewing the duties of a revested debtor who assumes the role of disbursing agent under a plan of reorganization: fiduciary duties and contractual duties. Either way, it adds up to a duty to account.

1 A

2 The Debtors acted as fiduciaries in control of the estate  
3 during the period they were debtors in possession. The filing of  
4 the chapter 11 case created an estate consisting of all of their  
5 legal or equitable interests in property. 11 U.S.C. § 541(a).  
6 As debtors in possession, they performed most of the functions  
7 and duties of a chapter 11 trustee. 11 U.S.C. § 1107(a). One of  
8 those duties is to be accountable for all property received. 28  
9 U.S.C. § 704(a)(2), as incorporated by § 1106(a)(1).

10  
11 1

12 Thus, it commonly is said that a debtor in possession  
13 administers the estate as a fiduciary for the estate's creditors.  
14 E.g., Baker Botts L.L.P. v. ASARCO LLC, 135 S.Ct. 2158, 2163  
15 (2015). Although details, facets, parameters, beneficiaries, and  
16 consequences of debtor-in-possession fiduciary status are subject  
17 to debate, at a minimum a debtor in possession is "accountable  
18 for all property received" as provided by § 704(a)(2).

19 Hence, the Debtors were fiduciaries accountable to their  
20 creditors for all property so long as they functioned as debtors  
21 in possession. Upon confirmation of the Plan, property of the  
22 estate revested in the Debtors. Plan ¶ IV-B.

23  
24 2

25 Ordinarily, termination of debtor in possession status ends  
26 fiduciary responsibilities to creditors. But a chapter 11 plan  
27 may provide otherwise. And, this one did so provide.

The Plan tasked the Debtors with the duty of acting as disbursing agent for distributions to creditors during the Plan's 84-month duration. There being no separate policing mechanism prescribed by Plan, the disbursing agent role entailed determining on a "trust me" basis the amounts of the actual disposable income to be distributed quarterly to the Class V unsecured creditors.

Moreover, property-of-the-estate status lingered in the Plan default provision: “if the Court orders the case converted to Chapter 7 after the Plan is confirmed, then all property that had been property of the Chapter 11 estate, and that has not been disbursed pursuant to the Plan, will revert in the Chapter 7 estate, and the automatic stay will be reimposed.” Plan ¶ IV-F.

This “trust me” disbursing agent role of the Revested Debtors in control of a business not subject to independent accounting verification supervision and combined with a prospect of property revesting in a chapter 7 estate has the structural attributes of a trust.

3

Viewed through the prism of trusts, the Plan's disbursing agent structure places the Revested Debtors in the position of settlor and trustee. The trust corpus is the motel business. The Class V unsecured creditors are beneficiaries. The trust terminates either by disbursement to the beneficiaries according to the 84-month term of the Plan or by Conversion to chapter 7. See *Consolidated Pioneer*, 264 F.3d at 808 (California law).

1 Because the trust is for the primary purpose of paying  
2 debts, it is excluded from the formal definition of "trust" for  
3 purposes of California law. CAL. PROBATE CODE § 82(b)(13).

4 Nevertheless, the principles and procedures of California  
5 trust law, California Probate Code §§ 15000-19530, may be applied  
6 to an entity or relationship that is excluded from the Probate  
7 Code § 82 definition of "trust" when such application of  
8 principles and procedures is pursuant to statute, common law,  
9 court order or rule, or contract. CAL. PROBATE CODE § 15003(c).<sup>23</sup>

10 As already noted the confirmed Plan is a hybrid court order  
11 and contract governed by California law.

12 In contrast to California contract law governed by its Civil  
13 Code rather than common law, California trust law applies common  
14 law except to the extent modified by statute. CAL. PROBATE CODE  
15 § 15002;<sup>24</sup> see generally Otto v. Niles (In re Niles), 106 F.3d  
16 1456, 1461 n.4 (9th Cir. 1997) (common law fiduciary duties).

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18 <sup>23</sup>Section 15003(c) provides:

19 15003(c). Nothing in this division or in Section 82 is  
20 intended to prevent the application of all or part of the  
21 principles or procedures of this division to an entity or  
22 relationship that is excluded from the definition of "trust"  
23 provided by Section 82 where these principles or procedures  
are applied pursuant to statutory or common law principles,  
by court order or rule, or by contract.

24 CAL. PROBATE CODE § 15003(c).

25 <sup>24</sup>Section 15002 provides:

26 15002. Except to the extent that the common law rules  
27 governing trusts are modified by statute, the common law as  
to trusts is the law of this state.

28 CAL. PROBATE CODE § 15002.

1 California trustees must account to each beneficiary at  
2 least annually. CAL. PROBATE CODE § 16062(a). They also must keep  
3 beneficiaries reasonably informed of the trust and its  
4 administration. CAL. PROBATE CODE § 16060, accord RESTATEMENT (THIRD)  
5 OF TRUSTS § 83 (2007); RESTATEMENT (SECOND) OF TRUSTS § 172 (1959).

6 The reporting requirement of the Plan comports with these  
7 duties. Regular reports to unsecured creditors are required  
8 every 120 days. Plan, ¶ IV-D. Disbursements are to be made  
9 quarterly, beginning January 1, 2012, and ending September 1,  
10 2018. Plan, ¶ II-C-3.

11 The absence in the Plan of the word "trust" is not  
12 dispositive. The Revested Debtors as Disbursing Agent were  
13 required to calculate and disburse actual disposable income,  
14 which was dedicated to the exclusive benefit of the Class V  
15 unsecured creditors up to the amounts of their claims. As was  
16 the case in Consolidated Pioneer, it follows the these duties  
17 were fiduciary in nature. Consolidated Pioneer, 264 F.3d at 808  
18 (applying California Law).

19 It follows that the terms of this Plan saddled the Revested  
20 Debtors with the trust-law duty of a fiduciary to account to the  
21 Plan Class V beneficiaries for actual disposable income.

22  
23 B

24 In the alternative, if the Revested Debtor is not deemed to  
25 be subject to a fiduciary duty to account to the Plan Class V  
26 unsecured creditors, he nevertheless has a contractual duty to  
27 account that follows from the role as disbursing agent for actual  
28 disposable income owing to the Class V creditors.

1 C

2 It is not material that the requisite frequency of reports  
3 is uncertain. Regardless of whether the duty to report is a  
4 fiduciary or contractual duty, it is either quarterly to match  
5 the prescribed Class V disbursement interval or 120 days to match  
6 the 120-Plan Report requirement. Either way, no report was made  
7 during the final 48 months of the Plan.

8  
9 IV

10 The Revested Debtors' defense relies on the fallacious  
11 premise that the movant Class V unsecured creditor has the burden  
12 of persuasion in all respects. In the end, however, the Revested  
13 Debtors have the determinative burden of persuasion.<sup>25</sup>

14  
15 A

16 Basic principles of fiduciary law allocate the burden to  
17 render an accounting on the fiduciary once it is shown that funds  
18 have been entrusted to the fiduciary and not paid over or  
19 otherwise accounted for. Niles, 106 F.3d at 1462.

20 The Revested Debtors know what funds they received and how  
21 they applied them. The Class V creditors have no independent  
22 knowledge of those facts and would have to pry the necessary  
23 information out of the Revested Debtors in order to determine  
24 actual disposable income. It is appropriate to allocate the

25  
26  
27 <sup>25</sup>Fed. R. Evid. 301; 21B CHARLES ALAN WRIGHT, ARTHUR R. MILLER, &  
28 KENNETH W. GRAHAM, JR., FEDERAL PRACTICE AND PROCEDURE: EVIDENCE § 5122 (2d  
ed. 2020) (burdens of production, persuasion, and proof).

1 burden to the Revested Debtors as being better positioned to  
2 produce the requisite proof. Niles, 106 F.3d at 1462.

3 Similarly, substantive policies behind both fiduciary law  
4 and agency law favor requiring fiduciaries and agents to perform  
5 their obligations faithfully and with care. Niles, 106 F.3d at  
6 1462, citing RESTATEMENT (SECOND) OF TRUSTS § 172 (duty to render  
7 accounts) and RESTATEMENT (SECOND) OF AGENCY § 382 (same).

8 The movant Class V creditor has satisfied its burden of  
9 production by establishing that the Revested Debtors are in a  
10 fiduciary position. The burden then shifted to the Revested  
11 Debtors to persuade the trier of fact that they complied with  
12 their fiduciary duties to account. The correlative risk of  
13 nonpersuasion reposes on the Revested Debtors. This trier of  
14 fact is not persuaded.

15  
16 B

17 The contract analysis is complicated by related reciprocal  
18 burdens.

19  
20 1

21 As a matter of conventional contract law, the movant Class V  
22 creditor, as the party seeking conversion or dismissal of the  
23 chapter 11 case on a theory of material default with respect to  
24 the confirmed Plan under § 1112(b)(4)(N), ordinarily has the  
25 burden to demonstrate that it was a Plan default never to  
26 disburse promised actual disposable income to Class V creditors.

27 Once a prima facie case has been made, the burden of  
28 production then shifts to the Revested Debtors to come forward

1 with evidence to the contrary. If they do so, then the movant  
2 ordinarily bears the ultimate burden of persuasion of material  
3 default and the correlative risk of nonpersuasion.

4  
5 2

6 But, when the chapter 11 debtor is an individual, the  
7 picture is clouded by the debtor's reciprocal obligation to prove  
8 completion of all payments under the plan as a condition of  
9 receiving a discharge.

10 The Plan provides that there will be no discharge for debts  
11 incurred before confirmation until completion of all payments  
12 under the Plan. Plan, ¶ IV-A.

13 That Plan provision comports with the general rule of  
14 Bankruptcy Code § 1141(d) (5) that an individual debtor does not  
15 receive a discharge until completion of all payments under the  
16 Plan unless the court orders otherwise for cause. 11 U.S.C.  
17 § 1141(d) (5) (A) .

18  
19 a

20 Therein lies the rub. In order to obtain a discharge, the  
21 Revested Debtors have the § 1141(d) (5) (A) burden to demonstrate  
22 completion of all payments under the Plan. That burden requires  
23 them to prove (i.e. persuade) that there never was actual  
24 disposable income during the 84 months of the Plan.

25 At this stage of a chapter 11 case, one cannot ignore the  
26 discharge question. No discharge would mean that all original  
27 debts remain owed with interest and that the Plan operated as an  
28 84-month shield against collections that could now be resumed.



When, not if, a discharge is requested, the Revested Debtors will have the burden of persuasion on the question whether they have completed all payments under the Plan. Fulfilling that burden requires them to make an accounting essentially identical to that which is required of a fiduciary.

Hence, the question of material default on a theory of nonpayment presented by the movant Class V creditor and the question of completion of payments under the Plan for purposes of discharge are reciprocal and inextricably intertwined issues.

b

A ruling in the creditor's action that the Revested Debtors are in material default for not having made required plan payments likely would be issue preclusive of the Debtors' entitlement to discharge on which they have the burden of proof.

The Revested Debtors' defense in this case is that they made all required Plan payments to Class V, to wit, none – because there never was disposable income. And, in a request for entry of discharge, that is what they would have the affirmative burden to prove by way of an accounting.

This situation, then, is more than a shifting burden of production. The creditor's showing of prima facie case on the question of nonpayment could be fatally issue preclusive to the Debtors' ability to obtain a discharge and shifts the ultimate burden of persuasion to the Debtors to show that there never was actual disposable income during the 84-month period of the Plan.

3

Regardless of whether the Revested Debtors saddled themselves with fiduciary duties to account when they assumed the role of disbursing agent for plan payments, they certainly have a contractual duty to account for their income from all sources during the 84 months of the Plan.

V

The evidence adduced at trial does not favor the position of the Revested Debtors that there never was "disposable income" and that the duties under the Plan were otherwise performed.

This trier of fact did not believe the testimony of Umesh Patel attempting to explain his finances during the 84-month Plan period. His testimony that he received loans from Kirki Patel and James Macko is unsubstantiated and not believed. Nor is the analysis by his expert, Norman Johnson, persuasive. In contrast, movant's expert J. Michael Issa was more helpful.

Under any view of the evidence and under any construction of the Plan, motel operations in 2015, 2016, and 2017 yielded, at a minimum, profits of \$98,121 that qualified as actual disposable income required to be disbursed to Class V unsecured creditors. The failure to disburse was a Plan default.

The Revested Debtors had a continuing duty to account for the full 84 months of the Plan, but provided neither accounting nor report for any of the final 48 months of the Plan. This was a Plan default.

The Revested Debtors had income from sources other than motel operations but did not account for such income during any

1 month of the Plan, even though the definition of "disposable  
2 income" that they prescribed in the Plan includes income from  
3 "all sources." This was a Plan default.

4 The Revested Debtors departed from the announced business  
5 plan to branch out into trading in securities options and margin  
6 accounts without notifying or accounting to the Class V  
7 creditors. The magnitude of this activity is material. Evidence  
8 of one account in Plan month 28 (January 2014) shows credits of  
9 \$112,206.05 and debits of \$66,551.43. Another account in Plan  
10 month 83 (August 2018) reflects year-to-date securities purchases  
11 of \$2,627,970.74 and sales of \$2,912,589.66. Umesh Patel and his  
12 expert concede that stock market losses between 2011 and 2018  
13 were between \$339,000 and \$372,800.

14 In order to engage in such trading, the source funds must  
15 have either been derived from the motel operations that Umesh  
16 Patel said was his sole source of income or from undisclosed  
17 sources of income, which nevertheless were required to be counted  
18 in the "disposable income" calculation. Diverting funds that  
19 should have been considered for disbursement to Class V  
20 creditors, without notice to those creditors, in order to gamble  
21 in the casino games of stock options and stock investments on  
22 margin is a Plan default.

23 The funding by Umesh Patel of \$50,000 in a Roth IRA came  
24 from funds that constituted disposable income.

25 The \$60,000 of gold and diamond jewelry that Umesh Patel  
26 claimed was stolen from him by Sukhwinder Patel in 2017 has no  
27 identifiable source in the record. Two plausible alternative  
28 explanations are that this personal property was acquired with

1 disposable income by way of a Plan default or that Umesh Patel  
2 perjured himself at the outset of the case.

3 The fact that Umesh Patel had the financial wherewithal to  
4 make a \$11,023.50 down payment on the purchase a new \$71,049.50  
5 Tesla automobile ten days after the nominal expiration of the 84-  
6 month plan, warrants the inference that the source of that  
7 \$11,023.50 payment was from income attributable to a time during  
8 the 84-month plan period. Not disbursing such funds to Class V  
9 unsecured creditors was a Plan default.

10  
11 VI

12 Each of the identified Plan defaults is a material default  
13 with respect to a confirmed plan that provides cause within the  
14 meaning of § 1112(b) (4) (N) to convert or dismiss the case. 11  
15 U.S.C. § 1112(b) (4) (N).<sup>26</sup>

16 The requisite standard is "whichever is in the best  
17 interests of creditors and the estate." 11 U.S.C. § 1112(b) (1).

18 The movant creditor contends that conversion, rather than  
19 dismissal is in the best interest of creditors and the estate.

20 This court agrees that conversion is in the interest of  
21 creditors and the estate.

22  
23  
24 <sup>26</sup>In making this determination, the court has ignored the  
25 failure to pay the \$951,214.63 balloon Plan payment due to 1332  
26 Broadway Note, LLC, on September 1, 2018. There is a pending  
27 adversary proceeding by Umesh Patel against 1332 Broadway Note,  
28 LLC, contending that it sabotaged Patel's efforts to refinance  
the motel. That cause of action, as to the merits of which this  
court expresses no view, is property of the estate that the  
Chapter 7 trustee will be able to assess.

1 Dismissal would place all parties in interest back to the  
2 2009 status quo in 2020. Too much water has gone over the dam  
3 since then to perpetuate the case in chapter 11.

4 The Plan specifically contemplates the possibility of  
5 conversion to chapter 7 for default and clarifies what will  
6 constitute property of the estate following conversion and the  
7 status of the automatic stay.

8 While the interests of the Debtors are not directly included  
9 in the § 1112(b) standard, which focuses on interests of  
10 creditors and the estate, it is noted that after conversion the  
11 Debtors, in principle, could salvage a chapter 7 discharge.

12 The court is mindful that it has discretion to determine  
13 that appointment under § 1104(a) of a trustee or examiner is in  
14 the best interests of creditors and the estate. 11 U.S.C.  
15 § 1112(b)(1). That alternative would not be efficacious in view  
16 of the history of this case.<sup>27</sup>

17 Successful liquidation in this case may involve selling the  
18 motel as a going concern. To facilitate that possibility without  
19 harming employees, it is appropriate for this court to exercise  
20 its discretion under § 721 to authorize the chapter 7 trustee to  
21 operate the business for 90 days after conversion if, in the  
22 business judgment of the trustee, such operation is in the best  
23 interest of the estate and consistent with orderly liquidation of  
24 the estate. 11 U.S.C. § 721.

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25  
26 <sup>27</sup>Rule 1019 governs conversion from chapter 11 to chapter 7  
27 at any stage of the case, including after plan confirmation.  
28 Fed. R. Bankr. P. 1019. The conversion order will provide that  
any request for this court to exercise its Rule 1019 authority to  
order or direct "otherwise" shall be by separate motion.

Conclusion

There being multiple material defaults in the confirmed plan and the best interests of creditors and the estate favoring conversion to chapter 7, the case will be ordered converted to chapter 7 pursuant to 11 U.S.C. §§ 1112(b)(1) and (b)(4)(N).

An appropriate order will issue.

Dated: October 15, 2020



United States Bankruptcy Judge