UNITED STATES BANKRUPTCY COURT
Eastern District of California

Honorable Ronald H. Sargis
Chief Bankruptcy Judge
Sacramento, California

June 14, 2018, at 10:30 a.m.

1.	**18-21107-E-11** **UST-1**	**LAURELS MEDICAL SERVICES** **Stephan Brown**	**MOTION TO CONVERT CASE TO CHAPTER 7 AND/OR MOTION TO DISMISS CASE** **4-24-18 [60]**

No Tentative Ruling: Oral argument may be presented by the parties at the scheduled hearing, where the parties shall address the issues identified in this tentative ruling and such other issues as are necessary and appropriate to the court's resolution of the matter.

Local Rule 9014-1(f)(1) Motion—Hearing Required.

Sufficient Notice Provided. The Proof of Service states that the Motion and supporting pleadings were served on Debtor in Possession, Debtor in Possession's Attorney, and creditors on April 24, 2018. By the court's calculation, 51 days' notice was provided. 35 days' notice is required. FED. R. BANKR. P. 2002(a)(4) (requiring twenty-one-days' notice); LOCAL BANKR. R. 9014-1(f)(1)(B) (requiring fourteen-days' notice for written opposition).

The Motion to Convert has been set for hearing on the notice required by Local Bankruptcy Rule 9014-1(f)(1). Failure of the respondent and other parties in interest to file written opposition at least fourteen days prior to the hearing as required by Local Bankruptcy Rule 9014-1(f)(1)(B) is considered to be the equivalent of a statement of nonopposition. *Cf. Ghazali v. Moran*, 46 F.3d 52, 53 (9th Cir. 1995) (upholding a court ruling based upon a local rule construing a party's failure to file opposition as consent to grant a motion). The defaults of the non-responding parties and other parties in interest are entered.

The Motion to Convert the Chapter 11 Bankruptcy Case to a Case under Chapter 7 is xxxxxxxxxxxxxxxxxxxxx.

This Motion to Convert the Chapter 11 bankruptcy case of Laurels Medical Services ("Debtor in Possession") has been filed by Tracy Hope Davis ("Movant"), the U.S. Trustee. Movant asserts that the case should be dismissed or converted based on the following grounds:

A. Debtor in Possession's estate is diminished and there is no reasonable likelihood of Debtor in Possession's rehabilitation.

B. The Estate has been grossly mismanaged.

C. Debtor in Possession has used cash collateral that was not authorized to be used.

D. A conversion would be in the best interest of the creditors.

DEBTOR IN POSSESSION'S OPPOSITION

Debtor in Possession filed an Opposition on May 31, 2018. Dckt.91. Debtor in Possession states that there is no cause to convert or dismiss. Debtor in Possession asserts that it reasonably believed that it had consent to use cash collateral based on verbal consent obtained from the Internal Revenue Service ("IRS") prior to payments using cash collateral. Debtor in Possession relies on Motion to use cash collateral through May 31, 2018 which was granted. Dckt. 31.

Debtor in Possession argues that there is a reasonable likelihood of rehabilitation through ongoing operations and the resolution of the Portland VA lawsuit. Dckt. 91. Debtor in Possession asserts that the likelihood of the Chapter 7 Trustee pursuing resolution of the lawsuit is unknown.

Debtor in Possession asserts that a conversion is not in the best interests of the creditors. Debtor in Possession states that if the case continues in Chapter 11, the ongoing operations will provide funding to pay priority claim of the IRS and that a concurrent Motion to Approve Stipulation for the use of cash collateral was filed on May 31, 2018. Dckt. 85, 91. Debtor in Possession asserts that the Stipulation negotiated with the IRS allows for use of cash collateral to pay ongoing operating expenses, which will in turn generate additional income for the estate and the proposed Chapter 11 plan. Dckt. 85. Debtor in Possession again states that the ability to pursue the resolution of the Portland VA lawsuit is in the best interest of creditors.

MOVANT'S REPLY

Movant filed a Reply on June 5, 2018. Dckt. 95. Movant asserts that Debtor in Possession never sought court approval of the $297,099 payment from IRS's cash collateral to prepetition creditor Mygoride. Debtor submits an unsigned Draft Stipulation that states that "Debtor and IRS agree that the contractor is a critical vendor that must continue operating in order for Debtor to stay in business and pay the IRS as agreed. Therefore, IRS agrees to allow contractor to be paid its pre-petition claim, subject to approval from the bankruptcy court." Exhibit A, Dckt. 93. However, Movant stresses that Debtor in Possession never sought approval from the court of the payment.

Movant also asserts that Debtor in Possession has not provided sufficient evidence to suggest reasonable reliance on the Draft Stipulation or its prior versions. While the Draft Stipulation proposed a monthly $4,000 adequate protection payment to IRS, Debtor's Motion to Use Cash Collateral, filed March 8, 2018 (Dckt. 20), did not propose that amount. Furthermore, the Signed Stipulation (Dckt. 89) removes the "critical vendor" paragraph listed in the Draft Stipulation.

Movant argues that Debtor in Possession's ongoing operations do not support a reasonable likelihood of rehabilitation. The Signed Stipulation calls for a $3,000 adequate protection payment to IRS and leaves only $585 in net monthly proceeds. Even if Debtor could contribute the full $3,585 each month to pay down the IRS's $434,858 secured claim, it would take over 121 months to pay the claim before reaching administrative claims and unsecured claims, which goes well beyond the forty-eight months remaining on the San Francisco VA Medical Center contract.

Movant notes how Debtor in Possession states that the resolution of the Portland VA lawsuit supports its rehabilitation, but Debtor in Possession has not provided any evidence to prove the viability of the lawsuit. For Movant, Debtor in Possession has provided no docket, no documents to assess the lawsuit, and no employment of counsel to proceed with the lawsuit. To the contrary, Schedule E/F lists $469,679 as disputedly owed to the Portland VA Medical Center under the contract for services. Dckt. 24.

APPLICABLE LAW

Questions of conversion or dismissal must be dealt with a thorough, two-step analysis: "[f]irst, it must be determined that there is 'cause' to act[;] [s]econd, once a determination of 'cause' has been made, a choice must be made between conversion and dismissal based on the 'best interests of the creditors and the estate.'" *Nelson v. Meyer (In re Nelson)*, 343 B.R. 671, 675 (B.A.P. 9th Cir. 2006) (citing *Ho v. Dowell (In re Ho)*, 274 B.R. 867, 877 (B.A.P. 9th Cir. 2002)).

The Bankruptcy Code Provides:

> [O]n 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 sections 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).

DISCUSSION

Review of Points and Authorities

The court has reviewed the Memorandum of Points and Authorities provided by Movant in support of converting this case to one under Chapter 7, or dismissing it. *See* Dckt. 63.

The Memorandum argues that Debtor in Possession's estate is diminished substantially after Debtor in Possession made an unauthorized $297,099 payment to a prepetition creditor, Mygoride Inc. "[S]ubstantial or continuing loss to or diminution of the estate and the absence of a reasonable likelihood of rehabilitation" is enumerated as cause to convert or dismiss a case at 11 U.S.C. § 1112(b)(4)(A). The Estate's ability to pay its other creditors in their proper priority is substantially diminished according to Movant.

Movant argues that there is no reasonable likelihood of Debtor in Possession's rehabilitation. Debtor in Possession has no business assets, other than $2,500 in office equipment and cell phones in a mini storage, from which to reorganize or rehabilitate. Additionally, Debtor in Possession admits that the IRS has a lien on the San Francisco VA contract ("Contract")) for its $434,858 secured claim. The Contract only provides net income before most administrative expenses of $7,600 monthly. Even if Debtor in Possession could contribute the full $7,600 each month to pay down the IRS secured claim, it would take over fifty-seven months to pay the claim off, nine months longer than the remainder of the Contract. The continuation of the $7,600 net income is questionable because it relies on a month-to-month subcontract to service a forty-eight-month contract.

Movant believes that the Estate has been grossly mismanaged. Management determined to pay Mygoride $297,099 from IRS's cash collateral without court authorization and knowing that, it was not seeking anything more than monthly payments to Mygoride in the future. Additionally to Movant, management does not appear to take Debtor in Possession's duties seriously because it signed declarations that contained serious accounting false statements.

Debtor in Possession has used cash collateral that was not authorized to be used. "[U]nauthorized use of cash collateral substantially harmful to 1 or more creditors" is enumerated as cause to convert or dismiss a case at 11 U.S.C. § 1112(b)(4)(D). Debtor in Possession paid Mygoride $297,099 from IRS's cash collateral, while knowing Debtor in Possession's Motion to Use Cash Collateral was pending and knowing that even if granted, it was not seeking anything more than monthly payments to Mygoride in the future. It would take a substantial amount of time, if ever, to recover the $297,099 for the IRS.

Under 11 U.S.C. § 1112(b), the court may convert a case to Chapter 7, or dismiss the case, as long as the action is not contrary to the best interests of the creditors and there is not a reasonable likelihood that the plan will be confirmed within an established or reasonable period of time—noting also that there can be additional causes for conversion, such as bad faith by the debtor. *In re AmeriCERT, Inc.*, 360 B.R. 398, 401 (Bankr. D.N.H. 2007). Movant argues that Debtor in Possession's estate may continue to diminish through ongoing operations and use of cash collateral, which is not in the best interest of the creditors.

Additionally, under 11 U.S.C. § 1112(b)(4)(B), the gross mismanagement of the estate is sufficient cause to convert or dismiss a case. Movant argues that the unauthorized use of cash collateral to pay a pre-petition creditor is evidence of Debtor in Possession's failure to appropriately manage the estate.

Movant asserts that there is 'cause' to convert based on the aforementioned issues, and the discussion must now shift to whether it is in the best interests of creditors to convert or dismiss the case. *In re Nelson*, 343 B.R. 671, 675 (B.A.P. 9th Cir. 2006). Movant states that conversion may be in the best interests of creditors to allow a Chapter 7 trustee to assess the unauthorized use of cash collateral and the valuation of a potential lawsuit against the Portland VA.

Filing of and Hearings on Related Motions

The court has held two hearings on Debtor in Possession's motion to authorize the use of cash collateral. *See* Dckt. 31, 83. At the second hearing, the court noted that Debtor in Possession's budget has

become considerably tighter, but the court afforded Debtor in Possession an opportunity to use cash collateral and to demonstrate that the budget could work in this case. Dckt. 83. The continued hearing for supplemental authority to use cash collateral is set for 10:30 a.m. on July 19, 2018. Dckt. 84.

On May 31, 2018 (after Movant identified the problem), Debtor in Possession filed a motion for the court to approve a stipulation with the IRS about the use of cash collateral in this case. *See* Dckt. 85. The motion does not discuss the terms of the stipulation or why Debtor in Possession is seeking approval apparently after already using fund without court authorization—according to Movant. *See id.*

Conduct of Debtor in Possession, the Fiduciary to the Bankruptcy Estate in Lieu of a Chapter 11 Trustee Having Been Appointed

This bankruptcy case was filed on February 27, 2018. Movant asserts that on March 15, 2018, $316,963 was deposited into Debtor in Possession's bank account to hold property of the bankruptcy estate. Then, on March 16, 2018, Debtor in Possession withdrew $297,099, asserting that Debtor in Possession's principal testified that this money was then passed on to the subcontractor.

It is asserted that the $316,963 is cash collateral securing the claim of the IRS and that Debtor in Possession was not authorized to use such cash collateral (either by stipulation or order of the court).

Monthly Operating Reports

The Monthly Operating Report for April 2018 reports that in the period since the February 27, 2018 commencement of this case, Debtor in Possession has received $534,963 from "sales." MOR, Dckt. 78 at 4. That is for two full months of post-petition operation. For the Month of April 2018, Debtor in Possession reports receiving only $109,000, leaving $425,963 as having come in the two days in February or in the month of March 2018.

The March 2018 Monthly Operating Report states that the full $425,963 was received in March 2018. Dckt. 53 at 4. Not surprisingly, $109,000 plus the $316,963 in cash collateral monies released to Debtor in Possession total $425,963. Debtor in Possession states on the March 2018 Monthly Operating Report that $297,099 was disbursed to MYGORIDE, Inc. (as "subcontractor" disbursement) in March. *Id.*

Proceeding to the April 2018 Monthly Operating Report, Debtor in Possession states that MYGORIDE, Inc. ("subcontractor" disbursement) totals $400,599 for the first two months of this case. Dckt. 78 at 4. The April Monthly Operating Report shows $2,990 for "payroll" (salary for principal of Debtor in Possession), with $4,485 having been disbursed for payroll since the February 27, 2018 filing of this case.

A review of the March 2018 bank statements attached to the March Monthly Operating Report shows the $316,962.69 and $109,000.00 deposits into Account 0290. Dckt. 53 at 7. For withdrawals and debits from Account 0290, there are three transfers to the estate checking account(6657): $50.00, $1,000.00, and $4,000.00. The bank statement for checking account 6657 shows there being one withdrawal for ($75.00) and a check order fee of ($175.00). No other disbursements from checking account 6657 are shown.

Account 2090 also shows two "Customer Withdrawal Images" in the amounts of ($198,066.14) and ($99,033.07). Those two "Withdrawal Images" total $297,099.21, the MYGORIDE, Inc. reported subcontractor disbursement amount. However, no copies of checks, cashier's checks, or other "images" of such purported transfers are attached.

Requested Assumption of Executor Contract

The purported pre-petition contract with MYGORIDE, Inc. (the entity receiving the $297,099 of cash collateral) was denied without prejudice by the court (dated April 23, 2018). Dckt. 59. Debtor in Possession did not include a copy of the pre-petition contract. Rather, the Motion merely stated:

> 2. On the Petition Date, debtor Laurels Medical Services ("Debtor") had two executory contracts outstanding:
>
> > a. A contract with the San Francisco Veteran's Affairs hospital, requiring Debtor **to provide transportation services to medical employees** in exchange for $112,000 per month ("San Francisco VA Contract"); and
> >
> > b. A sub-contract with MYGORIDE, Inc., a California corporation licensed **to transport medical employees**, for $100,000 per month ("Sub-Contract"). (collectively "Executory Contracts"). Mir Decl. ¶ 3.[1]
>
> . . .
>
> 8. **Debtor has 4 months of prepetition payments in default, estimated at $396,000.** Mir Decl. ¶ 4. **Debtor is current on postpetition payments for Sub-Contract, and has received Court permission to make post-petition payments** March 22, 2018 through May 31, 2018. Dckt. 33; Mir Decl. ¶ 6.
>
> 9. Debtor's prepetition defaults were due in large part to the IRS's collection efforts through the Federal Offset Levy program, which levied the proceeds of Debtor's sole contract with a VA hospital in San Francisco. Because of this offset levy, Debtor in Possession was unable to pay the Sub-Contract and fell behind. Mir Decl. ¶ 5.
>
> . . .
>
> 12. **Debtor in Possession proposes to pay up to $200,000 to MYGORIDE**, Inc. from the Debtor in Possession bank account **within 30 days of entry of the order granting assumption of the Executory Contracts**, curing approximately 2 months of prepetition payments. Debtor in Possession also proposes to promptly cure the remainder of the deficiency through a confirmed Chapter 11 plan as an administrative claim pursuant to 11 U.S.C. § 503(b)(1)(A).

Motion to Assume Executory Contract, Dckt. 44 (emphasis added).

Taken on face value, and subject to the certifications of Federal Rule of Bankruptcy Procedure 9011, Debtor in Possession states:

A. The services are merely to transport medical employees (apparently not patients).

B. The MYGORIDE, Inc. contract is merely to provide subcontractor services to transport medical employees.

C. All post-petition payments to MYGORIDE, Inc. are current.

D. Debtor in Possession has not made any payments on the pre-petition arrearage.

E. Debtor in Possession will not make any payments on the pre-petition arrearage until the court issues an order granting the motion to assume the contract with MYGORIDE, Inc.

The Motion to Assume was filed on April 4, 2018. At that time, there had been only one post-petition month for post-petition payments to be made to MYGORIDE, Inc. However, the March 2018 Monthly Operating Report discloses that $297,099.00 was disbursed by Debtor in Possession to MYGORIDE, Inc. in March 2018. Dckt. 53 at 4. This is well in excess of the $100,000 per month that Debtor in Possession states in the Motion to Assume that MYGORIDE, Inc. is to be paid under the sub-contract for which assumption is sought (and payment being made for post-petition services).

Notwithstanding expressly stating that there would not be any payment of pre-petition amounts without court approval, Debtor in Possession either affirmatively made such misstatement in the Motion, or Mr. Mir (below) affirmatively misstated that there was a pre-petition default of $396,00.00 as of his April 4, 2018 Declaration, in light of the $297,099.00 disbursement shown in the March 2018 Monthly Operating Report. Alternatively, the $297,099.00 in March 2018 was for the $99,033.07 for March 2018 post-petition services under the not-yet-assumed sub-contract and a $200,000 "gift" (unauthorized post-petition transfer) not related to the unassumed sub-contract.

In his Declaration, Shiraz Mir, the Responsible Officer for Debtor in Possession, testifies that under the contract with MYGORIDE, Inc. the monthly payment is $100,000.00, and the services are to "transport medical employees." Declaration ¶ 3, Dckt. 46. He further testifies that at the time of filing Debtor was in default for four months pre-petition payments that totaled $396,000.00. *Id.*, ¶ 4.

In the April 2018 Monthly Operating Report, Debtor in Possession states that an additional $103,500 was paid to MYGORIDE, Inc. ("subcontractor" disbursement), with the total two month post-petition payments being $400,599—more than four times the amount stated in the Motion to Assume.

Debtor in Possession elected not to provide the court with a copy of the contract with MYGORIDE, Inc. for which assumption was sought. However, the U.S. Trustee provided a copy with its Opposition to the Motion to Assume. That Document (Exhibit A, Dckt. 50) includes the following information:

A. It is titled "VASF Employee Shuttle Service Subcontract."

B. MYGORIDE, Inc. is to be paid at a fixed monthly cost. ¶ 2.b.

C. MYGORIDE, Inc. will be paid the following amounts:

1. Route 1.....$55,371.92
   Pass Through SMFTA Fees.....$ 4,902.57

2. Route 2.....$10,416.50
3. Route 3.....$28,342.08

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Total MYGORIDE, Inc. Monthly Payment.....$99,033.07

Therefore, for the post-petition months of March and April 2018, Debtor in Possession should have paid no more than $198,066.14 to MYGORIDE, Inc.

The denial, as discussed by the court in the Civil Minutes for the hearing on the Motion, included:

> The court has issued an order authorizing the use of cash collateral from the post-petition operation of the business that is property of the bankruptcy estate. Order, Dckt. 33. Under that Order, of the $112,000 per month being generated on the Veteran's Affairs Contract, $100,000 will be paid to MYGORIDE, Inc. for its post-petition services in performing the Contract, $4,000 to the principal of Debtor for serving as the responsible representative, and $400 for payroll taxes. The bankruptcy estate will net only $7,600.00 per month.
>
> The Internal Revenue Service is asserting a $449,539.16 secured claim in this case. Proof of Claim 7-1. The lien is claimed in all property of Debtor, which appears to include the accounts receivable if such is intended to be used to cure the arrearage. The Internal Revenue Service asserts in Proof of Claim 7-1 that its claim exceeds the value of Debtor's assets.
>
> There is currently no motion filed for the court to authorize the use of cash collateral to make the $200,000 payment, which is approximately one-half of the total $396,000 pre-petition arrearage. Debtor in Possession asserts that this arrearage arose because the Internal Revenue Service levied pre-petition on the monies due on the contract, resulting in the pre-petition defaults to the sub-contractor.
>
> At the hearing, Debtor in Possession stated on the record that the motion should be dismissed without prejudice. It was represented that addressing this issue will be part of a larger agreement being reached in this case.

Civil Minutes, Dckt. 58 at 3. The court, as stated in the tentative ruling, was skeptical as to the legal foundation upon which Debtor in Possession's request was based.

Cash Collateral Stipulation

On May 31, 2018—forty-two days after the hearing at which the court announced the ruling to deny the Motion to Assume Executory Contract without prejudice—Debtor in Possession filed a Motion to Approve a purported cash collateral stipulation with the IRS.

The Declaration in support of the Motion to Approve Cash Collateral Stipulation is provided by counsel for Debtor in Possession—not the responsible representative. Dckt. 88. Counsel testified:

A. He believes that this is best compromise possible for Debtor in Possession.

B. Debtor in Possession will avoid having to litigate the use of cash collateral.

C. The Settlement Agreement provided as Exhibit A "reflects the verbal consent obtained from the IRS prior to any payments being made by the Debtor in Possession."

The Stipulation provided as Exhibit A (Dckt. 89) has a signature page on which there is the signature of Jeffrey Lodge, Esq., Attorney for the Internal Revenue Service. This Stipulation presented to the court provides for the use of the following monthly uses of cash collateral:

Cash Collateral Income.....$112,000

Medical Services, Sub-Contractor.....(103,500)

IRS Cash Collateral Payment.....($ 3,000)

Salary of Officer.....($ 1,800)

US Trustee Fee
(payable quarterly).....($ 1 ,625)

GSA Fee.....($1 ,000)

Internet/fax/phone .....($ 210)

Payroll taxes.....($ 180)

Payroll Processing.....($ 50)

Software.....($ 50)

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Projected Monthly Net Proceeds.....$585

The court cannot identify any provisions in the Stipulation for a lump sum payment of $297,099 to MYGORIDE, Inc.

It appears that Debtor in Possession continues to treat the property of the estate as the personal money of the principals of Debtor, using it however they choose—without regard to the fiduciary duties of Debtor in Possession and Responsible Representative. Debtor in Possession and the Responsible Representative have now made it clear that they intend to use the property of the estate however Debtor and the Responsible Representative personally desire, without regard to their duties and the Bankruptcy Code. This may well be a clear sign of the court's earlier concerns that there appears to be no business here and no benefit for the bankruptcy estate in operating the "business" of channeling all of the revenues to MYGORIDE, Inc. and Mr. Mir, as the Responsible Representative.

This Chapter 11 case could appear to be fairly straight-forward—the bankruptcy estate having no operating business, outsourcing all of its operations, and its only asset of value to creditors and the estate being the claims for the alleged breach of the Oregon Veterans Administration contract. Such claims could include the destruction of Debtor's business. Unfortunately, the fiduciary Debtor in Possession has been challenged in the prosecution of this case. It began with Debtor not being able to accurately complete the original schedules. Then, the only asset of significant value to the bankruptcy estate is the litigation over the Oregon Veterans Administration contract. However, Debtor in Possession has not sought authorization to employ counsel to prosecute that litigation. Either Debtor in Possession has abandoned that asset or the attorney has elected to provide *pro bono* legal services, choosing not to have his or her employment authorized pursuant to 11 U.S.C. § 327.

Debtor in Possession, represented by counsel, has failed to prosecute this case as permitted under the Bankruptcy Code. Debtor in Possession uses cash collateral, being "bothered" by complying with the Bankruptcy Code only after money is spent and the misconduct is brought to the court's attention.

The bankruptcy estate appears to exist solely to prosecute the rights against the Veterans Administration for the benefit of the bankruptcy estate. The operation of it by Debtor in Possession appears to exist so as to allow MYGORIDE, Inc. to generate income in the place of any business run by the bankruptcy estate.

At the hearing, Debtor in Possession explained **xxxxxxxxxxxxxxxxxxxxxxxxxxxxxxx**.

~~Cause exists/does not exist, the Motion is granted/denied without prejudice and the case is **xxxxxxxxxxxxxxxxxxxx.**~~

The court shall issue a minute order substantially in the following form holding that:

> Findings of Fact and Conclusions of Law are stated in the Civil Minutes for the hearing.

The Motion to Convert the Chapter 11 case filed by Tracy Hope Davis ("the U.S. Trustee") having been presented to the court, and upon review of the pleadings, evidence, arguments of counsel, and good cause appearing,

IT IS ORDERED that the Motion to Convert is **xxxxxxxxxxxx**.

2. **17-25221-E-13 PGM-3** | **TOMMIE RICHARDSON** **Peter Macaluso** | **SCHEDULING CONFERENCE RE: OBJECTION TO CLAIM OF SENECA LEANDRO VIEW LLC, CLAIM NUMBER 7** **4-13-18 [87]**

Tentative Ruling: Oral argument may be presented by the parties at the scheduled hearing, where the parties shall address the issues identified in this tentative ruling and such other issues as are necessary and appropriate to the court's resolution of the matter.

Local Rule 3007-1 Objection to Claim—Hearing Required.

Sufficient Notice Provided. The Proof of Service states that the Objection to Claim and supporting pleadings were served on Creditor, Debtor, Chapter 13 Trustee, parties requesting special notice, and Office of the United States Trustee on April 13, 2018. By the court's calculation, 53 days' notice was provided. 44 days' notice is required. FED. R. BANKR. P. 3007(a) (requiring thirty days' notice); LOCAL BANKR. R. 3007-1(b)(1) (requiring fourteen days' notice for written opposition).

The Objection to Claim has been set for hearing on the notice required by Local Bankruptcy Rule 3007-1(b)(1). Failure of the respondent and other parties in interest to file written opposition at least fourteen days prior to the hearing as required by Local Bankruptcy Rule 9014-1(f)(1)(B) is considered to be the equivalent of a statement of nonopposition. *Cf. Ghazali v. Moran*, 46 F.3d 52, 53 (9th Cir. 1995) (upholding a court ruling based upon a local rule construing a party's failure to file opposition as consent to grant a motion). The defaults of the non-responding parties and other parties in interest are entered.

The Scheduling Conference on the Objection to Proof of Claim Number 7 has been continued to 1:30 p.m. on June 26, 2018, by prior Order of the court (Dckt. 121).

Tommie Richardson, Chapter 13 Debtor, ("Objector") requests that the court disallow the claim of Seneca Leandro View LLC ("Creditor"), Proof of Claim No. 7 ("Claim"), Official Registry of Claims in this case. The Claim is asserted to be unsecured in the amount of $195,000.00. Objector asserts that there is no evidence to support the claim, especially not for Objector being liable for a property being foreclosed upon while also in escrow. Objector admits to receiving $15,000 from Creditor, but Objector asserts that there is no basis for liability for any higher amount.

The Objection itself states with particularity the following grounds upon which it is based and why the claim should not be allowed:

A. No documentation for a security interest is included with the Proof of Claim.

B. There is no "Declaration" providing testimony to authenticate the exhibits attached to the Proof of Claim. FN.1.

FN. 1. This is a curious "grounds," in that proofs of claim are not pleadings for which declarations, points and authorities, and briefs are filed in support. Everyday documentation underlying the claim, such as notes and deeds of trust, are filed with proofs of claim, without "declarations" or other supporting pleadings. Objector has not provided a points and authorities in support of the Objection for the legal proposition that attachments to proofs of claim must be authenticated as provided in Federal Rule of Evidence 901 et seq.

C. There is no recorded lien attached to the Proof of Claim.

D. There is no "evidence" of the amount asserted to be owed by Debtor. FN.2.

FN. 2. *See* FN.1.

E. There are no equitable liens on the funds held by the foreclosure trustee.

F. The first objection is that "admissible evidence" is not attached to Proof of Claim No. 7.

G. The second objection is that Creditor has not presented admissible evidence to support Proof of Claim No. 7. FN.3.

FN. 3. Debtor directs the court to *Atwood v. Chase Manhattan Mortgage, Co. (In re Atwood)*, 293 B.R. 277, 233 (B.A.P. 9th Cir. 2003), for the proposition that Creditor cannot rely on the prima facie presumption of validity of the claim when the objecting debtor has presented evidence countering the prima facie effect. However, in making this argument, Objector asserts that since evidence is not authenticated with the Proof of Claim, the Proof of Claim must fail. This ignores the well-established law in this case and appears to cut out the burden that "[o]bjector is then called upon to produce evidence and show facts tending to defeat the claim by probative force equal to that of the allegations of the proofs of claim themselves." *Wright v. Holm (In re Holm)*, 931 F.2d 620, 623 (9th Cir. 1991) (quoting 3 L. King, Collier on Bankruptcy § 502.02, at 502–22 (15th ed. 1991)). The presumptive validity of the claim may be overcome by the objecting party only if it offers evidence of equally probative value in rebutting that offered by the proof of claim. *Id.* at 623; *In re Allegheny International, Inc.*, 954 F.2d 167, 173–74 (3d Cir. 1992). Here, Objector cannot merely argue "I don't agree so you lose" in countering the *prima facie* presumption.

H. Objector argues that the prima facie presumption is dependent upon Creditor first presenting evidence of reasonableness, without any evidence offered by Objector to rebut the presumption.

Objector has provided his Declaration in Opposition. Dckt. 89. In it, Objector testifies that with respect to the Proof of Claim:

A. In December 2016, Objected entered into the Purchase and Sale Agreement with Creditor.

B. He identifies the "Liaison" between Creditor and Objector, and several people were "responsible" for the escrow. Objector does not provide testimony as to what the "Liaison" and people "responsible" for the escrow were supposed to do in connection with the Purchase and Sale Agreement.

C. Objector testifies that he was told by one of the "responsible" persons that another person "would be handling the paperwork" for the sale. No declaration by such "responsible" person to whom the statement is attributed is provided.

D. Objector testifies that some of the liens being reported on the property were "questionable." He does not state why he believed they were "questionable." Objector further testifies that he investigated and told the person handling the "paperwork" what liens should be paid.

E. On January 26, 2017, escrow was opened. On February 24, 2017, Creditor advanced $15,000 for payment through escrow for the sale of the property.

F. On March 7, 2017, a notice of default and election to sell was filed.

G. Objector concludes that "I did everything said by escrow, and do not owe anything to the creditor as the failure to complete escrow was not my fault, but that of First American Title Company, ..."

The above is the sum total of the evidence presented to rebut the prima facie effect of the Proof of Claim.

CREDITOR'S RESPONSE

Creditor filed a Response on May 22, 2018. Dckt. 103. Creditor argues that it and Objector entered into a purchase agreement for real property on December 27, 2016. Creditor argues that Objector did not disclose being in default on a second deed of trust on the property, leading to a Notice of Default being issued on March 2, 2017, which was also not disclosed to Creditor. Creditor states that it was not informed of a Notice of Trustee's Sale recorded on June 9, 2017, before the property was sold on July 6, 2017.

Creditor argues that escrow had not closed on its purchase agreement because Objector had not required one tenant on the property to vacate the premises. That tenant is identified as Objector's sister.

Creditor argues that it was ready to purchase at any time while the sale was pending and would have waived the requirement for the tenant to be removed if it had known about the pending foreclosure.

With respect to damages, Creditor first asserts that this property was listed on Debtor's Schedule A under penalty of perjury as having a value of $1,000,000 by Objector. Further, the property had been appraised (Creditor's appraiser) to have a value of $940,000 as of July 6, 2017. Using the $940,000 value and the $760,000 contract price, Creditor computes the damages to be $195,000 (which includes the $15,000 advanced by Creditor through escrow). Creditor argues that Objector breached the purchase agreement and now owes Creditor at least $195,000.00, as reflected in Proof of Claim 7-3 filed as an unsecured claim.

As legal grounds, Creditor asserts that its breach of contract claim against Objector is determined by California law, and Creditor points to California Civil Code §§ 3300 and 3306 to determine how contract breach damages are calculated.

JUNE 5, 2018 HEARING

At the hearing, the court announced that it was setting a Scheduling Conference for this matter to be heard at 10:30 a.m. on June 14, 2018. Dckt. 118. The court ordered Objector and Creditor to file and serve on each other's counsel their Scheduling Conference Reports on or before 12:00 p.m. on June 11, 2018. The parties were ordered to identify the applicable California laws upon which they rely and the witnesses and documentary evidence in support of their positions.

DISCUSSION

Section 502(a) provides that a claim supported by a Proof of Claim is allowed unless a party in interest objects. Once an objection has been filed, the court may determine the amount of the claim after a noticed hearing. 11 U.S.C. § 502(b). It is settled law in the Ninth Circuit that the party objecting to a proof of claim has the burden of presenting substantial factual basis to overcome the prima facie validity of a proof of claim, and the evidence must be of probative force equal to that of the creditor's proof of claim. *Wright v. Holm (In re Holm)*, 931 F.2d 620, 623 (9th Cir. 1991); *see also United Student Funds, Inc. v. Wylie (In re Wylie)*, 349 B.R. 204, 210 (B.A.P. 9th Cir. 2006).

Unless otherwise covered by the Bankruptcy Code, state law applies to determine the existence and validity of a claim. *Cossu v. Jefferson Pilot Securities Corp. (In re Cossu)*, 410 F.3d 591, 595 (9th Cir. 2005) ("The validity of a creditor's claim is determined by the rules of state law . . . ."). Furthermore, if all of the events for a breach of contract claim occurred pre-petition, even though liability has not yet been affixed, then the claim is not contingent upon a future determination of liability. *In re Keenan*, 201 B.R. 263 (Bankr. S.D. Cal. 1996).

The court has reviewed the purchase agreement that Creditor attached as Exhibit 1. Dckt. 107. Creditor directs the court to Paragraphs 9(G) & 10. Dckt. 103 at 2. Paragraph 9(G) states in its entirety:

> SELLER REPRESENTATION: Seller represents that Seller has no actual knowledge: (I) of any current pending lawsuit(s), investigation(s), inquiry(ies), action(s), or other proceeding(s) affecting the Property or the right to use and occupy it; (ii) of any unsatisfied mechanic's or materialman lien(s) affecting the Property; and (iii) that any tenant of the Property is the subject of a bankruptcy. If Seller receives any such notice prior to Close Of Escrow, Seller shall immediately notify Buyer.

Exhibit 1, Dckt. 107 at 6.

Paragraph 10 states in its entirety:

> SUBSEQUENT DISCLOSURES: In the event Seller, prior to Close Of Escrow, becomes aware of adverse conditions materially affecting the Property, or any material inaccuracy in disclosures, information or representations previously provided to Buyer, Seller shall promptly Deliver a subsequent or amended disclosure of notice, in writing, covering those items. However, a subsequent or amended disclosure shall not be required for conditions and material inaccuracies of which Buyer is otherwise aware, or which are disclosed in reports provided to or obtained by Buyer or ordered and paid for by Buyer.

Id.

The Purchase Agreement defines "Buyer" as Seneca Leandro View, LLC, and "Seller" as Tommie Richardson. "Close Of Escrow" is stated to mean "2/28/17 or sooner." *Id.* at 3. The original Purchase Agreement was signed by Creditor/Buyer on November 29, 2016, and by Objector/Seller on December 27, 2016. *Id.* at 11.

No declaration is provided by Creditor or Creditor's Managing Member responsible and with personal knowledge of this transaction. No testimony is provided as to Creditor having the money in place to perform the contract, the cost of such money (points, fees), or the ability to complete the purchase.

A declaration is provided by Steven Geller, the appraiser providing his testimony as to value of the Property as of July 6, 2017. Dckt. 104. His appraisal report is stated to be provided as Exhibit 2 to the Declaration. Dckt. 105.

Setting Scheduling Conference

Creditor has provided the court with a brief citation to California Civil Code §§ 3300 and 3306 as the legal authorities for the court to determine what the contract between the parties was, if the contract existed who breached it, and the damages to the breaching party. Creditor asserts that it is per se the aggrieved party and its damages are the difference between the gross value of the property as set by its appraiser and the liens.

Creditor has not provided the court with any evidence of its efforts to perform the contract, that it could perform the contract, or what it did in connection with reviewing the title report and acting with respect to the reported liens against the property. This contract is purported to have arisen in December 2016 when it was signed by Objector. Creditor offers no explanation of what it was doing to perform its part of the contract in:

January 2017,

February 2017,

March 2017,

April 2017,

May 2017,

June 2017, and

July 2017,

to assert its alleged rights under the Purchase and Sale Agreement. The Agreement states that it was to close on or before February 28, 2017. Exhibit 1, Dckt. 107 at 3. Though February 28, 2017, came and went, there is no evidence of Creditor doing anything for the rights it now so stridently demands should be enforced.

Objector's pleading (Dckt. 87) does not provide any California law or treatise materials as to how this court makes a determination as to what the contract was, how to determine if it was breached, and how to correctly compute damages. The "legal basis" for the contention that only $15,000 could be owed as damages is—Objector says so.

Though the court could research the law, develop the arguments that it believes the respective parties could present, organize the legal analysis, and prosecute this Contested Matter for the respective parties, the court declines such assignment of work. It is clear that the court needs to set a scheduling conference and from there a discovery schedule for this Contested Matter. The parties need to assemble their evidence, which supports their state law legal arguments for whether there is an enforceable contract, and if so, what damages may flow therefrom.

On June 11, 2018, the court entered an order resetting the matter for 1:30 p.m. on June 26, 2018. Dckt. 121.