

UNITED STATES BANKRUPTCY COURT

Eastern District of California

Honorable Ronald H. Sargis

Chief Bankruptcy Judge

Sacramento, California

Pursuant to District Court General Order 612, no persons are permitted to appear in court unless authorized by order of the court. All appearances of parties and attorneys shall be telephonic through CourtCall, which advises the court that it is waiving the fee for the use of its service by *pro se* (not represented by an attorney) parties through April 30, 2020. **The contact information for CourtCall to arrange for a phone appearance is: (866) 582-6878.**

MODESTO DIVISION CALENDAR

April 2, 2020 at 2:00 p.m.

1. 19-91111 -E-11	THE LIVING CENTERS OF FRESNO, INC.	CONTINUED STATUS CONFERENCE RE: VOLUNTARY PETITION 12-24-19 [1]
-----------------------------------	---------------------------------------	---

Debtor's Atty: David C. Johnston

Notes:

Continued from 2/6/20

Operating Reports filed: 2/18/20; 3/18/20

**The Status Conference is continued to 2:00 p.m. on ~~XXXXXXXXXX~~,
2020.**

APRIL 2, 2020 STATUS CONFERENCE

The Debtor in Possession has not filed an updated Status Report for the April 2, 2020 Conference. The Debtor in Possession has been timely filing Monthly Operating Reports, providing realtime financial information through February 2020. The Monthly Operating Report for February 2020 (filed March 18, 2020) provides the following information:

April 2, 2020 at 2:00 p.m.

- Page 1 of 12 -

- A. The Bankruptcy Estate had \$0 in cash receipts in February 2020 and has had \$0 in cash receipts since the commencement of this case on December 24, 2019.
- B. Debtor's Cash Disbursement for the month of February 2020 and since the commencement of this case total (\$1,738).

Dckt. 34.

At the Status Conference, counsel for the Debtor in Possession reported **XXXXXXXXXX**

FEBRUARY 6, 2020 STATUS CONFERENCE

This is the second recent Chapter 11 case filed by this Debtor. The prior case, 17-90981, was dismissed on September 2, 2019. No proposed Chapter 11 plan or proposed disclosure statement was filed by the Debtor in Possession in the prior case. The dismissal was made pursuant to the motion of the Debtor in Possession, with the court finding that based on the evidence presented by the Debtor in Possession that there was no likelihood of there being a successful reorganization in Chapter 11. 17-90981; Civil Minutes, Dckt. 128.

Debtor in Possession Status Report (Filed February 3, 2020; Dckt. 26)

In the Status Report, the Debtor in Possession states it is operating two locations, providing a 6 bed "in patient" behavior modification program in Fresno and a small "out-patient" support group in Turlock, California.

The Debtor in Possession reports that this bankruptcy case filing was precipitated by the Internal Revenue Service levies on the Debtor's bank accounts and insurance company payments.

With respect to property of the bankruptcy estate, Debtor in Possession reports, "There are so few assets that the Debtor in Possession does not anticipate any disputes concerning value of assets." Status report, p. 3:1-2; Dckt. 26.

The Debtor in Possession anticipates a Chapter 11 plan that provides for a payment plan for the Internal Revenue Service debt.

At the Status Conference, Counsel for the Debtor in Possession stated that they are now down to one location in Fresno and an out patient Turlock location, there is a license issue, insurance companies are not paying, and the principals are looking at dissolution.

Counsel for the Fresno landlord stated that the three day notice was served on November 6, 2019. Lease expires on May 28, 2020, if not already terminated.

Debtor's Atty: David C. Johnston

Notes:

Continued from 2/27/20. Counsel for the Debtor stating that the status of the Debtor would be unsuspended by the time of this continued status conference.

Operating Report filed: 3/21/20

The Status Conference is ~~XXXXXXX~~.

APRIL 2, 2020 STATUS CONFERENCE

On March 2, 2020, the court issued an Order to Show Cause why a Chapter 11 trustee should not be appointed in light of the Debtor's powers as a limited liability company ("LLC Powers") having been suspended by the State of California. OSC, Dckt. 24, *see also* discussion below from the February 27, 2020 Status Conference. The Order to Show Cause required that Responsive Pleadings be filed and served on or before March 19, 2020, and Replies, if any, on or before March 26, 2020.

The U.S. Trustee filed a Response on March 16, 2020. Dckt. 29. The U.S. Trustee supports the appointment of a Chapter 11 trustee in light of the Debtor having its LLC Powers suspended.

No Response to the Order to Show Cause was filed by the Debtor, nor a Reply to the U.S. Trustee request that a Chapter 11 trustee be appointed.

However, on March 23, 2020, the California Franchise Tax Board filed a document titled "California Franchise Tax Board's Limited Purpose Revivor." Dckt. 34. This Limited Purpose Revivor states:

PLEASE TAKE NOTICE that, pursuant to California Revenue and Taxation Code § 23305b, California Franchise Tax Board ("FTB") hereby **revives Sun-One LLC to good standing until the earlier of the following occurs: (1) this case is dismissed, or (2) this case is closed.** FTB reserves the right to revoke tJ's Limited Purpose Revivor by filing a revocation in this case in which this Limited Purpose Revivor will have no further force or effect.

Id. (emphasis added).

With this Revivor the issue of the ability to the Debtor to exercise its LLC Powers and serve as the debtor in possession has been resolved.

Prosecution of the Case and a Chapter 11 Plan

At the Status Conference, counsel for the Debtor in Possession explained, **XXXXXXXXXX**

FEBRUARY 27, 2020 STATUS CONFERENCE

This voluntary Chapter 11 case was filed by the Debtor on January 21, 2020, with the Debtor in Possession now serving as the fiduciary of the bankruptcy estate. The Managing Member executing the bankruptcy Petition is Kathryn Machado.

On Schedule A/B the Debtor lists owning one asset, real property described as 141 acres, Sims Road, Chinese Camp, Tuolumne County, California, stated to have a value of \$4,390,000. Dckt. 1 at 5. Debtor lists owning no personal property. Id. at 4-5.

Ms. Machado's name and the property appeared familiar to the court, and reviewing the court's files appears to tie this property and Ms. Machado to the Chapter 7 case (converted from Chapter 11) filed by Richard Sinclair, who was identified as Ms. Machado's brother. 14-91565. The real property is property that Richard Sinclair asserted had been gifted to Golden Hills Chinese Camp, LLC. Id., Motion to Abandon, Dckt. 554.

On Schedule D, Debtor lists two creditors. The first is Superior Loan Servicing (which does not appear to be the actual creditor but a loan servicer for the actual creditor), with a claim of (\$662,500.00). Dckt. 13 at 8. The Debtor also lists the Tuolumne County Tax Collector as having a secured claim for (\$2,200.00) Id.

For priority unsecured claims, Debtor states on Schedule E/F owing (\$2,000.00) for the "annual franchise tax." Id. at 10. No creditors with general unsecured claims are listed.

On the Statement of Financial Affairs for income in 2020, Debtor lists \$0.00. For income in 2019, Debtor lists \$0.00. For income in 2018, Debtor lists \$0.00. Id. at 14. Debtor further reports that Sun-One, LLC has been in real estate development since July 21, 2013. FN. 1.

FN. 1. The California Secretary of State reports that Sun-One, LLC's status is "FTB Suspended." The Secretary of State reports that Golden Hills Chinese Camp, LLC is also a suspended entity. The managing member of that entity is also Kathryn Machado, with the same address as the Kathryn Machado in this case. The original Articles of Organization were filed April 29, 2003, with Richard Sinclair identified as the agent for service of process and organizer of that entity.

On February 15, 2020, the Debtor in Possession filed an initial Status Report. Dckt. 20. Counsel for the Debtor in Possession states that the property is to be developed, but the tentative entitlements have expired. However, the Debtor in Possession believes that the development can be revived "once working capital is available." *Id.*, Dckt. p. 1:27 -2:1.

The Debtor in Possession further reports that in March 2018, the Debtor obtained a high interest rate, high fees loan of \$600,000. The interest only payments on this loan are stated to be \$6,250.00 a month, which indicates an interest rate of 12.5% for a grossly oversecured (by the Debtor's estimate of value) loan. Being unable to make the interest payments, the creditor proceeded with foreclosure, and this bankruptcy case was filed to stop the foreclosure (a valid use of bankruptcy – so long as it is done with the intention to prosecute the bankruptcy case and possible plan in good faith).

The Debtor in Possession states that the Debtor in Possession plans on filing a plan of reorganization (not liquidation) by April 20, 2020.

The U.S. Trustee's report of the First Meeting of Creditors states that counsel for the Debtor in Possession appeared, but no responsible representative appeared for the Debtor or Debtor in Possession. U.S. Trustee February 19, 2020 Docket Entry Report. The first meeting was continued to February 27, 2020.

At the Status Conference counsel for the Debtor stated that the status of the Debtor would be unsuspended by the time of the continued status conference.

Final Ruling: No appearance at the April 2, 2020 hearing is required.

The Order to Show Cause was served by the Clerk of the Court on Debtor, Debtor's Attorney, Chapter 11 Trustee, and the Office of the United States Trustee as stated on the Certificate of Service on March 5, 2020. The court computes that 28 days' notice has been provided.

The Order to Show Cause is discharged.

**REVIEW OF ORDER TO SHOW CAUSE
WHY CHAPTER 11 TRUSTEE SHOULD NOT BE APPOINTED**

Sun-One, LLC, a California registered limited liability company commenced this voluntary Chapter 11 case on January 21, 2020. No Chapter 11 Trustee has been appointed in this case. As discussed by the court in the Civil Minutes from the February 27, 2020 Status Conference, the only asset that the Debtor had as of the filing of this bankruptcy case was real property described as 141 acres, Sims Road, Chinese Camp, Tuolumne County, California, stated to have a value of \$4,390,000.00. The Debtor had no personal property, no monies, no bank accounts, and nothing else with which to do business.

In reviewing the California Secretary of State on-line records, it is reported that the Debtor's status in the State of California is "FTB Suspended." FN.1. At the hearing, counsel for the Debtor (there being no order entered authorizing the employment of counsel by the debtor in possession) who filed the bankruptcy case confirmed that the Debtor's status was suspended. As reported on the Schedules and stated by Debtor's counsel, this is because of the failure of Debtor, and the principals of Debtor, to make a \$2,000.00 minimum annual registration payment for the limited liability company to the State of California. No good answer was provided as to why this Debtor, who purports to own property worth more than \$4,000,000.00 and the principals of this limited liability company that asserts to own property worth more than \$4,000,000.00 have failed to make such *de minimis* payment to the State of California.

In the Status Report filed by counsel for the Debtor (Dckt. 20), it is stated that in this bankruptcy case the "debtor in possession" will commence making payments on the (\$600,000.00) claim secured by the more than \$4,000,000.00 valued real property or have a plan filed within 90 days of the commencement of this case. No explanation is provided as to how the "debtor in possession" will have monies to make such payments. No explanation is provided as to how the Debtor, whose powers are suspended, can operate as a debtor in possession to do such. At the Status Conference, it was stated that the plan was to develop the property.

Suspended Status of Limited Liability Company

California Revenue and Taxation Code § 23301 provides for the suspension of the corporate/limited liability company powers, rights and privileges of a domestic taxpayer. For purposes of this provision, the term “taxpayer” means:

(a) “**Taxpayer**” means either:

(1) A corporation subject to tax under this chapter.

(2) **A business entity organized under a statute or law**, under a state or a federally recognized Indian tribe, under another jurisdiction, if the statute or law describes or refers to the entity **as a limited liability company** or if regulations of the Franchise Tax Board identify a business entity organized under the laws of a foreign country as a limited liability company.

(b) With regard to a limited liability company:

(1) “Articles of incorporation” shall include a limited liability company’s articles of organization.

(2) “Tax” shall include the tax and fee imposed by Sections 17941 and 17942, or former Sections 23091 and 23092, respectively.

Cal. Rev. & Tax § 23305.5 (emphasis added).

FN.1. <https://businesssearch.sos.ca.gov/CBS/Detail>.

When suspended, the business entity loses the ability to engage in a number of activities, including prosecuting or defending legal actions. The California Court of Appeal recently described the effect of such suspension as follows:

A corporation that has had its powers suspended “lacks the legal capacity to prosecute or defend a civil action during its suspension.” (*Sade Shoe Co. v. Oschin & Snyder* (1990) 217 Cal.App.3d 1509, 1512 (*Sade*)). “The ‘corporate powers, rights and privileges’ of any domestic corporate taxpayer may be suspended for failure to pay certain taxes and penalties. (Rev. & Tax. Code, § 23301.) This means the suspended corporation cannot sell, transfer or exchange real property in California, and contracts entered into during the time of suspension are voidable ... through legal action. [Citation.] ... Nor, during the period of suspension, may the corporation prosecute or defend an action, seek a writ of mandate, appeal from an adverse judgment, or renew a judgment obtained before suspension.” (*Center for Self-Improvement & Community Development v. Lennar Corp.* (2009) 173 Cal.App.4th 1543, 1552 (*Center for Self-Improvement*)).

City of San Diego v. San Diegans for Open Government, 3 Cal.App. 5th 568, 577-578 (2016).

Though the Debtor could, in the extremis of suspension, commence the bankruptcy case to prevent dismemberment of its asset, the Debtor lacks the ability to serve as the debtor in possession, the fiduciary of the bankruptcy estate that was created upon the filing of this case. 11 U.S.C. § 541, § 1107. To serve in that fiduciary capacity, a debtor in possession must commence or defend all of the federal judicial proceedings, contested matters, motions, objections, applications, plan and disclosure statement filings, and prosecution or defense of such actions and proceeds as would a Chapter 11 trustee. The suspended corporation cannot do that.

REINSTATEMENT OF POWERS

On March 23, 2020, the California Franchise Tax Board filed a “Limited Purpose Revivor.” Dckt. 34. Pursuant to California Revenue and Taxation Code § 23305b, the California Franchise Tax Board as revived Debtor Sun-One, LLC to good standing until the earlier of the following (1) the instant case is dismissed, or (2) the instant case is closed. The California Franchise Tax board reserves the right to revoke this Limited Purpose Revivor by filing a revocation in this case in which this Limited Purpose Revivor will have no further effect.

The Revivor filed by the California Franchise Tax Board addressing the court’s concerns on whether a Chapter 11 trustee should not be appointed due to Debtor’s suspension, the Order to Show Cause is discharged.

The Order to Show Cause is Discharged and the Debtor may proceed to exercise the powers of, and fulfill the fiduciary duties of, a debtor in possession.

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 Order to Show Cause Why a Chapter 11 Trustee Should Not Be Appointed 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 Order to Show Cause is discharged, with no action ordered pursuant thereto.

Debtor's Atty: David C. Johnston

Notes:

Continued from 2/6/20

The Status Conference is XXXXXXX.

APRIL 2, 2020 STATUS CONFERENCE

The Debtor in Possession has not provided the court with an updated status report. During the seven months that the Bankruptcy Estate has been operating the Debtor's business, the Estate has seen a net increase of \$35,790 from such operations.

At the February 6, 2020 Status Conference, counsel for the Debtor in Possession reported that the exclusivity period in this small business case did not expire until February 23, 2020, and the Debtor in Possession was intending to get a plan on file by that time.

Counsel for the Debtor in Possession reported, XXXXXXXXXX

FEBRUARY 6, 2020 STATUS CONFERENCE

On February 3, 2020, the Debtor in Possession filed an Updated Status Report. Dckt. 38. This bankruptcy case was filed on August 27, 2019, and was designated by the Debtor as a "small business debtor" as denied in 11 U.S.C. § 101(61D). One hundred and sixty-three (163) days have passed since this case was commenced by the Debtor.

The Debtor in Possession reports that it was originally going to file a plan on or before December 25, 2019, but has determined that in a small business case the exclusivity period will not end until February 23, 2020, so the Debtor in Possession elected to not file and start prosecuting a plan by December 25, 2019 as earlier represented.

Looking at the Docket, there appears that little is being done by the Debtor in Possession to prosecute this case. Other than Monthly Operating Reports being filed, no motions or other contested matters are being prosecuted by the Debtor in Possession.

The Internal Revenue Service has filed Proof of Claim No. 2 in the amount of (\$147,365.34), of which (\$21,043.00) is secured by a statutory lien and (\$126,322.34), of which (\$110,899.29) is asserted as

a priority claim. Though the Internal Revenue Service asserts a secured claim in all of the Debtor's property as of the commencement of this case, the court does not see either a stipulation to use cash collateral or an order authorizing the use of cash collateral.

At the Status Conference, counsel for the Debtor in Possession reported that this is a "tax case." Counsel has been working with the IRS concerning the claim.

FINAL RULINGS

5. [17-90577](#)-E-7 WILSON SARHAD

[17-9019](#)
GARCIA V. SARHAD

CONTINUED PRE-TRIAL
CONFERENCE
RE: COMPLAINT TO (1) DETERMINE
DISCHARGEABILITY OF
PARTICULAR
DEBT; AND (2) DETERMINE
DISCHARGEABILITY OF ALL DEBTS
11-6-17 [\[1\]](#)

Final Ruling: No appearance at the April 2, 2020 Pre-Trial Conference is required.

Plaintiff's Atty: Michael R. Dennis
Defendant's Atty: David C. Johnston

Adv. Filed: 11/6/17
Answer: 12/3/17
Nature of Action:
Dischargeability - willful and malicious injury
Objection/revocation of discharge

The Pre-Trial Conference has been continued to 2:00 p.m. on May 14, 2020, pursuant to prior order of the court. The Parties requested by the continuance by joint motion, stating that this matter has now been settled.

Notes:
Continued from 1/23/20 to allow the Parties to consummate the reported settlement.

[DCJ-3] Order granting motion to dismiss the second claim for relief (objection to discharge) filed by Leonani Garcia filed 1/30/20 [Dckt 58]

[DCJ-3] Amended order continuing hearing on Motion for Authorization of Dismissal of Second Claim for Relief in Adversary Complaint filed 1/30/20 [Dckt 59]

April 2, 2020 at 2:00 p.m.
- Page 12 of 12 -