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UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

CIVIL MINUTES - GENERAL

Case No.	SACV 15-1640 AG, consolidated with SACV 15-2065 AG	Date	May 31, 2016
Title	IN RE LAWRENCE KEITH DODGE		

Present: The Honorable	ANDREW J. GUILFORD	
Lisa Bredahl	Not Present	
Deputy Clerk	Court Reporter / Recorder	Tape No.

Attorneys Present for Plaintiffs: Attorneys Present for Defendants:

Proceedings: [IN CHAMBERS] ORDERING AFFIRMING BANKRUPTCY COURT'S RULINGS RE SETTLEMENT

This matter arises from appeals of two Bankruptcy Court orders in a Chapter 11 bankruptcy case. This Court consolidated the appeals. This Court has jurisdiction over the appeals under 28 U.S.C. § 1334. This matter is appropriate for disposition without a hearing. After considering all of the filings and applicable authority, the Court AFFIRMS the Bankruptcy Court's rulings.

1. PRELIMINARY MATTERS

Before diving into the merits of the appeals, some housekeeping is in store. Debtor and Appellant Kansas City Art Institute ("KCAI") objects to the Supplemental Excerpts of Record ("SER") of Appellee Federal Deposit Insurance Company, as Receiver ("FDIC-R"). The SER includes entries on the docket in the underlying bankruptcy court proceedings. FDIC-R correctly notes that these objections are untimely, as FDIC-R designated these items to be included on appeal over four months ago and KCAI never objected to the designations. Further, the Court is not persuaded by the merits of KCAI's objections.

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Specifically, KCAI objects to the SER as irrelevant to this appeal, while simultaneously requesting the Court "take judicial notice of the bankruptcy docket." (Reply at 2 n.2.) These conflicting requests expose the incoherence of KCAI's objection. Further, it is axiomatic that the Court can consider documents on the Bankruptcy Court's docket that were properly designated for appeal. As such, KCAI's objections are OVERRULED.

KCAI also requests that the Court "disregard" FDIC-R's statement of the case in its responsive brief. KCAI's request essentially reiterates its objections to the SER. As those objections are overruled, the Court DENIES KCAI's request to not consider FDIC-R's statement of the case.

Before moving on, the Court must address KCAI's statement in its Reply that there is no "evidence to show that KCAI ever knew about the judgment" entered in FDIC-R's adversary proceeding against Dodge. (Reply at 3 n.3.) In a responsive brief, FDIC-R said it was "compelled to advise the Court that KCAI's representation is false," as KCAI was served with copies of the judgment on October 19, 2015. (Dkt. No. 19, Ex. 1 (Proof of Service).) At best, KCAI's statement was an inadvertent mistake. At worst, it was a knowingly false statement to the Court. Even assuming the best, though, the Court expects counsel to exercise diligence in ensuring its representations of law and fact are correct. At stake are credibility, ethics, and persuasiveness.

2. BACKGROUND

Next, some brief background about the appeals. Debtor and Appellee Lawrence Keith Dodge is the majority shareholder of American Sterling Corporation ("ASC"), which wholly owned American Sterling Bank ("ASB") and American Sterling Insurance Company ("ASIC"). (SER at 88.) At various points in time, Dodge served as ASB's CEO, director, and member of its Directors Loan Committee. (SER89.)

In April 2009, ASB failed due to insolvency. (SER88.) FDIC-R was appointed as the bank's

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receiver. (SER88.) In February 2013, Dodge filed for bankruptcy under Chapter 11. (SER1.)

In August 2013, the Bankruptcy Court appointed a Chapter 11 Trustee to oversee the case. (SER183.)

This appeal focuses on a claim submitted in that bankruptcy case by FDIC-R, who was also a creditor of Dodge. Specifically, on May 24, 2013, FDIC-R asserted a claim for $10 million based on Dodge's alleged breaches of his fiduciary duties to ASB. (Appellant's Excerpt of Record ("ER") at 102–107.) FDIC-R also filed an adversary case against Dodge seeking to have the claim deemed non-dischargeable. (ER23–40.)

In August 2015, after two years of negotiation, the Trustee and the FDIC-R agreed to settle FDIC-R's claim and its adversary action against Dodge for $10 million. Dodge filed a motion to approve the settlement. (ER7–59.) In support, the Chapter 11 Trustee declared that the settlement was in the best interest of the bankruptcy estate. (ER60–62.)

On the sidelines to the settlement was Appellant KCAI, who was also a creditor of Dodge with a judgment against him for $3.3 million. KCAI made two attempts to stop FDIC-R's settlement with Dodge. First, KCAI filed an objection to the settlement. (ER67–74.) Second, KCAI filed a motion to disallow FDIC-R's claim. (ER93–98.) Both the objection and the disallowance motion argued that the settlement wasn't fair and equitable because there was insufficient evidentiary support for the settlement. (ER69 (Objection); ER95 (Disallowance Motion).)

The Bankruptcy Court rejected both attempts to stop the settlement, overruling KCAI's objection to the settlement and denying the disallowance motion. (ER125–126; ER288–291.) KCAI appealed both rulings. (ER127–132; ER295–297.) This Court consolidated the two appeals. This Order addresses the merits of those appeals.

3. STANDARD OF REVIEW

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On appeal, a district court reviews a bankruptcy court's findings of fact under a clearly erroneous standard, its conclusions of law de novo, and its discretionary standards for abuse of discretion. *In re Int'l Fibercom, Inc.*, 503 F.3d 933, 940 (9th Cir. 2007); *In re Hatcher*, 208 B.R. 959, 963 (B.A.P. 10th Cir. 1997).

A bankruptcy court's decision to approve a settlement is a discretionary decision. As such, it is reviewed for abuse of discretion. *See In re Mickey Thompson Entm't Grp., Inc.*, 292 B.R. 415, 420 (B.A.P. 9th Cir. 2003) ("The bankruptcy court's decision to approve a compromise is reviewed for abuse of discretion."). Under this standard, a court should not overturn a bankruptcy court's decision unless it committed "clear error of judgment upon weighing of the relevant factors." *Id.*

4. ANALYSIS

Whether characterized as an "objection" to the settlement or a "motion for disallowance," both appeals relate to the central question of whether the Bankruptcy Court properly denied KCAI's attempts to stop the settlement between Dodge and FDIC-R. Accordingly, the Court addresses whether the Bankruptcy Court erred by analyzing KCAI's substantive arguments as they relate to both orders.

4.1 A Rubber Stamp?

First, KCAI argues that the Bankruptcy Court abused its discretion by not engaging in a meaningful evaluation of FDIC-R's claim, but instead relying on the Trustee's judgment to "rubber stamp" the settlement.

Under Rule 9019 of the Federal Rules of Bankruptcy Procedure, "[o]n motion by the trustee and after notice and a hearing, the court may approve a compromise or settlement." "[W]hile a court generally gives deference to a trustee's business judgment in deciding whether to settle a matter, the trustee 'has the burden of persuading the bankruptcy court that the

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compromise is fair and equitable and should be approved.'" *In re Mickey Thompson Entm't Grp., Inc.*, 292 B.R. at 420 (citing *In re A&C Properties*, 784 F.2d 1377, 1381 (9th Cir. 1986)). *In re Churchfield*, 277 B.R. 769, 773 (Bankr. E.D. Cal. 2002) ("While the opinion of the Trustee is entitled to great weight, the bankruptcy court has a duty to make an informed, independent judgment as to the reasonableness of the proposed compromise."). In other words, the Bankruptcy Court can't "rubber stamp" the settlement.

To assess whether a proposed settlement is fair and equitable, a bankruptcy court must consider the following factors — dubbed "the *A&C* factors."

> (a) The probability of success in the litigation; (b) the difficulties, if any to be encountered in the matter of collection; (c) the complexity of the litigation involved, and the expense, inconvenience and delay necessarily attending it; and (d) the paramount interest of the creditors and a proper deference to their reasonable views in the premise.

In re A&C Properties, 784 F.2d at 1381 (internal alterations omitted).

KCAI argues that the Bankruptcy Court didn't sufficiently analyze the *A&C* factors before approving the settlement. Relatedly, KCAI argues that the settlement provided no benefit to the estate and that the Bankruptcy Court didn't make the requisite inquiry into the proposed reorganization plan.

The record shows otherwise. On September 10, 2015, the Bankruptcy Court issued two tentative rulings. First, the court tentatively granted the motion to approve the settlement "for the reasons and based on the analysis set forth in the Motion and Replies, which the court incorporates by reference." Second, the court tentatively overruled KCAI's objection as "unpersuasive" and based on the arguments in the Replies. (ER256.)

In its motion to approve the settlement and its reply, FDIC-R specifically described how the *A&C* factors applied to the settlement. (ER14–16; ER84.) FDIC-R emphasized that the

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adversary action was complex and would be expensive for Dodge to defend. (ER15.) FDIC-R also emphasized that Dodge's success in the adversary proceeding was "far from certain." (ER15.) And even if Dodge successfully defended against the adversary action, FDIC-R may still have a claim against Dodge's estate. (ER16.) Finally, FDIC-R noted that the settlement was fair and equitable to the creditors, who could consider and vote on the proposed reorganization plan. (ER16.) FDIC-R therefore adequately addressed the *A&C* factors in its motion. And the Bankruptcy Court expressly incorporated those arguments in its order approving the settlement.

The Bankruptcy Court did not "rubber stamp" the settlement simply because the court used a short-cut in its order by incorporating FDIC-R's arguments by reference. Indeed, at the hearing on the motion to approve and KCAI's objection, the Bankruptcy Court dispelled any notion that it was thoughtlessly approving the settlement. The Court said:

> In this case, although the tentative ruling was really short — I mean I didn't go into a lot of detail other than to basically adopt the analysis and the arguments set forth in the motion and in the replies — it doesn't mean that I did not read them. And I did read them in detail, and I do take objections very seriously.

(ER00315.) The Court also stated that the motion was "well documented" and the benefit to the estate was "well articulated." (ER317.) Those statements support that the Bankruptcy Court didn't simply rely on the Trustee's judgment and rubber stamp the settlement. Instead, it shows that the Bankruptcy Court used its own informed, independent judgment to find that the proposed settlement was reasonable. *In re Churchfield*, 277 B.R. at 773.

Nor does KCAI provide any authority that the Bankruptcy Court was required to independently prepare anything before approving the settlement. Indeed, "when assessing a compromise, courts need not rule on disputed facts and questions of law, but only canvas the issues." *In re Zarate*, No. BAPEC 14-1371 FDJU, 2015 WL 8482887, at *5 (B.A.P. 9th Cir. Dec. 9, 2015). The record here shows the Bankruptcy Court did not just "canvas" the settlement, but instead engaged in a "detailed" reading of the motion to approve the

settlement and KCAI's accompanying objection. Thus, the Bankruptcy Court did not improperly "rubber stamp" the settlement without independently analyzing the *A&C* factors.

4.2 Whose Burden?

KCAI also argues that the Bankruptcy Court "shifted the burden of persuasion to KCAI" when it approved the settlement. As noted, the Trustee "has the burden of persuading the bankruptcy court that the compromise is fair and equitable and should be approved." *In re Mickey Thompson Entm't Grp., Inc.*, 292 B.R. at 420. The heart of KCAI's argument is whether the Bankruptcy Court improperly presumed the claim was valid.

"A proof of claim executed and filed in accordance with these rules shall constitute prima facie evidence of the validity and amount of the claim." Fed. R. Bankr. P. 3001(f); *see also* 11 U.S.C. § 502(a) (finding a claim "is deemed allowed" unless a party in interest objects). "Although the creditor bears the ultimate burden of persuasion, the debtor must come forward with evidence to rebut the presumption of validity." *In re S. Cal. Plastics, Inc.*, 165 F.3d 1243, 1248 (9th Cir. 1999).

In the Bankruptcy Court proceedings and now on appeal, KCAI argues that the $10 million claim was not entitled to presumptive validity because it did not comply with Rule 3001(c)(1) of the Federal Rules of Bankruptcy Procedure. (ER308–09.) That rule requires a claim based on a writing to attach a copy of the writing. The Bankruptcy Court confirmed that KCAI's only argument as to why the settlement should be rejected was the failure to attach the proper documentation to the claim. (ER00311.)

In rejecting that argument, the Bankruptcy Court did not improperly shift the burden of proof to KCAI. To start, Rule 3001(c)(1) is inapplicable to FDIC-R's claim. Specifically, the claim and adversary action alleged that Dodge breached its fiduciary duties to ASB. Those

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duties were not imposed by "a writing," but by statute. *See* Cal. Corp. Code § 309 (requiring a director to perform their duties "in good faith" and "in a manner such director believes to be in the best interests of the corporation"). When a claim is based on a statute, not a writing, a creditor is "not required to attach documentation to its proof of claim." *In re Los Angeles Int'l Airport Hotel Assocs.*, 106 F.3d 1479, 1480 (9th Cir. 1997). The Bankruptcy Court was therefore correct to acknowledge that "this really isn't a claim that is based on a writing that could be attached." (ER316.)

Accordingly, the Bankruptcy Court was correct to give the claim presumptive validity under Rule 3001(f). Because it was presumptively valid, KCAI was required to "come forward with evidence to rebut the presumption of validity." *In re S. Cal. Plastics, Inc.*, 165 F.3d at 1248. Case law thus makes clear that the Bankruptcy Court did not improperly shift the burden of persuasion to KCAI. *See In re Zarate*, 2015 WL 8482887, at *6 (finding that the bankruptcy judge did not improperly shift the burdens of persuasion and production to the objector by crediting the Trustee and requiring the objecting party to "come forth with evidence to support facts that demonstrate that there is more merit to his contentions.").

Instead of improperly shifting the burden of persuasion or production to KCAI, the Bankruptcy Court was simply unpersuaded by KCAI's attempt to rebut the presumptive validity of the claim. At the hearing on the motion to approve the settlement, the Bankruptcy Court stated:

> I was a little confused by your — part of your opposition. Basically you say that the claim was not proven, and I don't understand that because you haven't come forward with any factual information to dispute that. You don't seem to deal with the fact that as a proof of claim that is filed, there's a presumed validity until an actual objection is filed. You seem to ignore that completely as if — and any party filing a proof of claim then has to come forward and prove it.
>
> So I'm a little baffled. You've made the general statement that you don't think the claim

> is legitimate or you don't think it's valid, but you haven't come forward with anything that would suggest otherwise. And there seems to be a sufficient analysis on the other side with respect to the claim, at least an explanation for why there has not been an objection to this claim

(ER00304–05). The Court also stated "I think that the objecting creditor has got to do more than say 'Well, they didn't attach something to the document.'" (ER316.) Those statements show the Bankruptcy Court was simply unpersuaded by KCAI's attempt to rebut the claim's presumptive validity because KCAI hadn't provided any evidence to dispute the amount or validity of FDIC-R's claim.

The Bankruptcy Court therefore did not improperly shift the burden of persuasion or production to KCAI in overruling KCAI's objection and denying KCAI's disallowance motion.

4.3 $10 Million Sum

KCAI also disputes that the $10 million sum is supported by the evidence. Specifically, KCAI argues that the Bankruptcy Court only relied on Exhibit 2 to the complaint, which KCAI argues only supports losses totaling $8,969,256, not $10 million.

As the claim was presumptively valid under Rule 3001(f), the Court is not persuaded that FDIC-R needed to file any evidence to support the $10 million sum. Despite the claim's presumptive validity, FDIC-R nonetheless provided sufficient evidence to support the $10 million sum. In a declaration supporting the opposition to the disallowance motion, counsel for FDIC-R declared that "[i]n the process of providing the Trustee with information and documentation supporting the FDIC-R Claim, the FDIC-R presented information demonstrating losses in excess of $10 million." (ER196.) The Bankruptcy Court acknowledged that this declaration supported the $10 million sum. (ER323.) The court stated: "[T]hat declaration stands on its own. There was no evidentiary objection to that

declaration that that is what constitutes the claim. So that's what I'm looking at." (ER323.) Thus, the Bankruptcy Court was not merely relying on "Exhibit 2," but also on an undisputed declaration supporting the $10 million sum.

That undisputed declaration, along with the detailed exhibits attached to the complaint listing out each loan and amount of loss, adequately supported the Bankruptcy Court's approval of the $10 million settlement sum. The Bankruptcy Court was not required to "conduct an exhaustive investigation nor a mini-trial on the validity or merits of the claims sought to be compromised." *In re Dharmasuriya*, No. 2:09 BK 28606 PC, 2014 WL 845991, at *3 (Bankr. C.D. Cal. Mar. 4, 2014).

Accordingly, the Bankruptcy Court did not err in overruling KCAI's objection to the settlement and denying KCAI's disallowance motion. This Court therefore declines to vacate and remand the order for further findings, as KCAI suggests.

5. DISPOSITION

The Court AFFIRMS the Bankruptcy Court's rulings overruling KCAI's objection to the settlement and denying KCAI's Motion to disallow the settlement.

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