

FILED  
December 06, 2011  
CLERK, U.S. BANKRUPTCY COURT  
EASTERN DISTRICT OF CALIFORNIA  
  
0003942474

1 8  
2 **JASON BLUMBERG, NY State Bar No. 4055257**  
3 Trial Attorney  
4 ANTONIA G. DARLING, State Bar No. 76190  
5 Assistant United States Trustee  
6 **UNITED STATES DEPARTMENT OF JUSTICE**  
7 Office of the United States Trustee  
8 501 "I" Street, Suite 7-500  
9 Sacramento, CA 95814-2322  
10 (916) 930-2100 / Fax (916) 930-2099  
11  
12 Attorneys for Acting United States Trustee,  
13 Region 17, August B. Landis

8  
9 **UNITED STATES BANKRUPTCY COURT**  
10 **EASTERN DISTRICT OF CALIFORNIA**

11 In re: Case No. 10-39240-B-11  
12 DC No.: UST-1  
13 **COUNCIL FOR REFRACTIVE**  
14 **SURGERY QUALITY ASSURANCE,**  
15 Date: December 13, 2011  
16 Time: 9:32 a.m.  
17 Dept.: B  
18 Courtroom: 32  
19 Debtor. /

17 **UNITED STATES TRUSTEE'S REPLY IN SUPPORT OF HIS MOTION**  
18 **FOR DISMISSAL OR CONVERSION OF CHAPTER 11 CASE**

19 TO THE HONORABLE THOMAS C. HOLMAN, U.S. BANKRUPTCY JUDGE:

20 The Acting United States Trustee for the Eastern District of California (the "**United**  
21 **States Trustee**") hereby submits this reply in support of his motion (docket no. 168) (the  
22 "**Motion**") to dismiss or convert this Chapter 11 case, and in response to the Debtor's opposition  
23 to the Motion (docket no. 174) (the "**Opposition**"):

24 The Court recently denied confirmation of the Debtor's plan. And, because the Debtor is  
25 a "small business debtor" and this case is more than 300 days old, the Debtor is statutorily  
26 precluded from filing a new plan. See 11 U.S.C. § 1121(e)(2); In re Roots Rents, Inc., 420 B.R.  
27 28, 35 (Bankr. D. Idaho 2009) ("The small business debtor has an outside bar of 300 days from  
28

1 the order for relief ... within which it must file a disclosure statement and a plan.”) (emphasis  
2 added).

3 To escape the 300 day deadline, the Debtor now claims that it is not a “small business  
4 debtor.” Nevertheless, as set forth Section A and Section B below, the Debtor still qualifies as a  
5 “small business debtor” or, alternatively, should be judicially estopped from claiming otherwise.

6 Even assuming the Debtor is not a “small business debtor,” it lacks the ability to confirm  
7 a plan for another reason. Hostile creditors hold an overwhelming amount of the claims against  
8 this estate. Thus, as set forth in Section C below, the Debtor will not be able muster the assent of  
9 an impaired class for a new plan. See 11 U.S.C. § 1129(a)(10).

10 In short, the Debtor cannot effectuate a plan. While this is not one of the specifically  
11 enumerated “causes” in Section 1112(b)(4), it is nonetheless a sufficient basis to dismiss this  
12 case. See In re Babayoff, 2011 WL 611659, at \*8-\*9 (Bankr. E.D.N.Y. Feb. 16, 2011) (“[The  
13 “causes” listed in Section 1112(b)(4)] are ‘illustrative, not exhaustive’ .... Courts recognize that  
14 cause under Section 1112(b) may be established where the record shows that the Debtor cannot  
15 effectuate a plan.”).<sup>1</sup>

16 **A. The Debtor is a “Small Business Debtor.”**

17 The Debtor claims that it is no longer a “small business debtor” as defined in 11 U.S.C. §  
18 101(51D). The reason being that Brent Hanson has filed a proof of claim for \$2.5 million, and  
19 Lauranell Burch has filed a proof of claim for \$125,000. And thus, according to the Debtor, the  
20 debt limits set forth in 11 U.S.C. § 101(51D) have been exceeded. See Opposition, at p.2;  
21 Debtor’s Amended Petition (docket no. 177).

22 However, the debt limits in the statute expressly apply only to “noncontingent” and  
23 “liquidated” debts. See 11 U.S.C. § 101(51D)(A).

---

26 <sup>1</sup> The Debtor’s failure to obtain confirmation of its original plan within the 45-day  
27 period prescribed in 11 U.S.C. § 1129(e) may itself be an expressly enumerated “cause” to  
28 dismiss or convert this case. See In re Roots Rents, Inc., 420 B.R. at 37 (dismissing case for  
“cause” under Sections 1121(b)(4)(J), where small business debtor failed to obtain confirmation  
of its plan within 45 days of the plan’s filing, as required by Section 1129(e)).

1 The Debtor has scheduled both Mr. Hanson's claim and Ms. Burch's claim as  
 2 "contingent" and "unliquidated." See Debtor's Amended Schedule F (docket no 54). In fact, in  
 3 the Opposition, the Debtor asserts that these claims are "grossly inflated, unsubstantiated, and do  
 4 not accurately reflect damages, if any, for which the Debtor is liable." See Opposition, at p. 2.

5 Thus, under the plain terms of the statute, both Mr. Hanson's claim and Ms. Burch's  
 6 claim must be excluded from the analysis. Those claims aside, the Debtors noncontingent and  
 7 liquidated claims total less than **\$5,000**. See Debtor's Amended Schedules E and F (docket no  
 8 54). This amount is well within the statutory debt limit.<sup>2</sup>

9 **B. The Debtor should be Judicially Estopped from now Claiming it is not a "Small**  
 10 **Business Debtor."**

11 The Debtor should be judicially estopped from now claiming it is not a "small business  
 12 debtor."

13 Debtors may typically amend court-filings "as a matter of course at any time before the  
 14 case is closed." See Fed. R. Bankr. P. 1009(a). But, under the equitable doctrine of judicial  
 15 estoppel, courts can prevent amendments where "intentional self-contradiction is being used as  
 16 a means of obtaining an unfair advantage." See In re Save Our Springs (S.O.S.) Alliance, Inc.,  
 17 632 F.3d 168, 175 (5<sup>th</sup> Cir. 2011) (holding that debtor was judicially estopped from claiming it  
 18 was not a "small business debtor" in order to belatedly gain time to file a plan after the 300 day  
 19 deadline).

20 In determining whether to apply the judicial estoppel doctrine, courts consider the  
 21 following factors:

- 22 (1) whether the party's later position is "clearly inconsistent" with its earlier  
 23 position;

---

24  
 25 <sup>2</sup> The Court recently overruled the Debtor's objection to Mr. Hanson's proof of  
 26 claim. The grounds for the objection were limited to whether Mr. Hanson (i) had Article III  
 27 standing and (ii) had failed to properly support his claim with evidence and documentation. See  
 28 docket nos. 160 and 161. Based on the Debtor's statements in the Opposition, it appears that the  
 Debtor intends to file additional objections to Mr. Hanson's claim. In fact, as set forth in Section  
C below, unless the Debtor succeeds with those objections, it will not be able to confirm a plan  
 (even if it could file one).

1 (2) whether the party has “successfully persuaded” the court of the earlier  
2 position; and

3 (3) whether allowing the inconsistent position would allow the party to “derive an  
4 unfair advantage or impose an unfair detriment on the opposing party.”

5 See United States v. Ibrahim, 522 F.3d 1003, 1009 (9<sup>th</sup> Cir. 2008). All three elements are present  
6 here.

7 First, the Debtor’s assertion that it is not a “small business debtor” is “clearly  
8 inconsistent” with the designation on the original Petition. See Save Our Springs, 632 F.3d at  
9 175-76 (“S.O.S.’s new assertion that it is not a small business debtor is clearly inconsistent with  
10 its original designation”).

11 Second, the Court accepted the Debtor’s original designation and treated the Debtor as a  
12 “small business debtor.” See Save Our Springs, 632 F.3d at 176 (holding that the second  
13 element of judicial estoppel was satisfied where, among other things, the court permitted the  
14 debtor to file a plan without a separate disclosure statement, as permitted in small business  
15 cases).

16 For instance, the Court ordered the Debtor to file a combined plan and disclosure  
17 statement pursuant to Rule 3016(b) of the Federal Rules of Bankruptcy Procedure. The Court  
18 also ordered the Debtor to use the procedure for “conditional approval” of its disclosure  
19 statement, as outlined in 11 U.S.C. § 1125(f)(3) and Rule 3017.1 of the Federal Rules of  
20 Bankruptcy Procedure. See Order after Status Conference (docket no. 74).

21 Third, as noted above, the Debtor has already enjoyed the streamlining benefits of being  
22 a “small business debtor.” If it were permitted to change its designation now, it would gain the  
23 “unfair advantage” of escaping of the attendant burdens (e.g., the 300 day plan filing deadline).

24 Moreover, the Debtor has known of the potentially inflated claims of Mr. Hansen and  
25 Ms. Burch since at least January 4, 2011. See Amended Schedules (docket no. 54). Yet, the  
26 Debtor did not change its designation until after the United States Trustee filed the Motion. The  
27 delay suggests opportunistic behavior. See Save Our Springs, 632 F.3d at 176 (finding that the  
28

1 debtor acted “opportunistic[ally]” where it was aware that its “small business” designation might  
2 be incorrect for approximately 9 months).<sup>3</sup>

3 The Fifth Circuit’s decision in the Save Our Springs case is directly on point. Like the  
4 Debtor in this case, the debtor in Save Our Springs was a non-profit entity that designated itself  
5 as a “small business debtor.” See Save Our Springs, 632 F.3d at 170-71. Like the Debtor in this  
6 case, the debtor in Save Our Springs filed a plan within the 300 day deadline and availed itself of  
7 several of the benefits of being a “small business debtor” (e.g., it filed a plan without a disclosure  
8 statement). See id. at 171, 175-76. And, like the Debtor in this case, the debtor in Save Our  
9 Springs impermissibly sought to gerrymander an accepting impaired class for its plan by  
10 separately classifying a hostile creditor. See id. at 174-75.

11 After the lower court in the Save Our Springs case denied confirmation of the plan, a  
12 creditor filed a motion to dismiss the case, citing the now-passed 300 day deadline. See id. at  
13 171-72. It was only then, in response to the motion to dismiss, that the debtor asserted it was not  
14 a “small business debtor.” See id. at 172, 176.

15 Under these facts, the Fifth Circuit<sup>3</sup> concluded that the debtor was judicially estopped  
16 from claiming it was not a “small business debtor, and it thus affirmed the dismissal of the case.  
17 See id. at 175-76.

18 **C. Even Assuming the Debtor is *not* a “Small Business Debtor,” it Still Cannot**  
19 **Effectuate a Plan.**

20 In their plan, the Debtor proposed to deal with the claims of Mr. Hanson and Ms. Burch  
21 by classifying them separately from the other unsecured claims. See Debtor’s Plan of  
22 Reorganization (docket no. 108), at p.3. As noted above, other unsecured claims total less than  
23 \$5,000.

24 This was an obvious attempt to impermissibly gerrymander an accepting class. Perhaps  
25 as a result, the Court denied confirmation of the Debtor’s plan under 11 U.S.C. § 1129(a)(10).  
26 See docket no. 156.

---

27 <sup>3</sup> As noted above, while the Debtor’s objection to Mr Hansen’s claim was  
28 overruled, the Debtor gives every indication in its Opposition that it intends to file a new  
objection. See Opposition, at p.2

1 Contrary to the Debtor's assertion, the Debtor's failure to obtain the assent of at least one  
2 of the impaired classes is no mere "technical error." A plan simply may not be confirmed in this  
3 case unless an impaired class accepts it. See In re Figter Ltd., 118 F.3d 635, 637 (9<sup>th</sup> Cir. 1997)  
4 ("Figter's plan is unconfirmable because it is unable to meet the requirements of 11 U.S.C. §  
5 1129(a)(10); there will not be an impaired, consenting class of claims. That will preclude a 'cram  
6 down' of Teachers' secured claim under 11 U.S.C. § 1129(b).").

7 Given the size of Mr. Hansen's and Ms. Burch's claims, it is difficult to conceive of how  
8 the Debtor will be able to comply with this requirement. The Debtor certainly gives no  
9 indication of its strategy in the Opposition.

10 **D. Section 1112(b)(2) is Not Applicable to this Case.**

11 If there is "cause" to do so, a Chapter 11 case must ordinarily be converted to one under  
12 Chapter 7 or dismissed, unless Section 1112(b)(2) applies. See 11 U.S.C. § 1112(b)(1); see also  
13 In re Gateway Access Solutions, Inc., 374 B.R. 556, 560 (Bankr. M.D. Pa. 2007) (as amended by  
14 BAPCPA, "§ 1112 limits the Court's discretion to refuse to dismiss or convert a Chapter 11 case  
15 upon a finding of cause").

16 Section 1112(b)(2) of the Bankruptcy Code is an exception to the general framework  
17 established by Section 1112(b)(1). It provides that, even if there is "cause" to do so, a court may  
18 not convert or dismiss a case if:

19 (i) the court specifically identifies "unusual circumstances" that establish that  
20 dismissal or conversion is not in the "best interests of creditors";

21 (ii) there is a reasonable likelihood that a plan will be confirmed within the time-  
22 frames established in Sections 1121(e) and 1129(e) or (if such sections do not  
23 apply) within a reasonable period of time;

24 (iii) the grounds for conversion or dismissal include an act or omission for which  
25 there exists a reasonable justification; and

26 (iv) the act or omission in question will be cured within a reasonable period of  
27 time.

28 See 11 U.S.C. § 1112(b)(2) (as amended by the Bankruptcy Technical Corrections Act of 2010,  
Pub. L. No. 111-327 (Dec. 22, 2010)).

1 All of these elements must be satisfied in order for a debtor to avoid dismissal or  
2 conversion. See In re Om Shivai, Inc., 447 B.R. 459, 465 (Bankr. D.S.C. 2011). In this case,  
3 however, at least two of the elements are not present.

4 As to the first element, there are no “unusual circumstances.” “Unusual circumstances”  
5 are not defined in the Bankruptcy Code. Nevertheless, the term “clearly contemplates conditions  
6 that are not common in most chapter 11 cases.” 7 Collier on Bankruptcy § 1112.04[3] (15<sup>th</sup> ed.  
7 2009).

8 Aside from the extraordinary level of acrimony between the Debtor, on the one hand, and  
9 Mr. Hanson and Ms. Burch, on the other, there does not appear to be anything unusual about this  
10 case. In fact, the only “unusual circumstance” that the Debtor has identified is that Mr. Hansen’s  
11 claim exceeds the statutory debt limit for “small business debtors.” See Opposition, at p. 4.  
12 That issue has been addressed in Section A and Section B above.

13 Moreover, it is not at all clear that keeping this case in Chapter 11 is in the best interests  
14 of creditors. Mr. Hanson, the estate’s largest creditor by far, supports the Motion. See docket  
15 no. 179. Presumably, Ms. Burch, the next largest creditor, shares this view.

16 As to the second element, the Debtor is precluded from filing a new plan in this case.  
17 See 11 U.S.C. § 1121(e)(2). Even if that were not the case, the issues under Section 1129(a)(10)  
18 appear to be nearly insurmountable. See Section C, supra.

19  
20 ///

21  
22 ///

23  
24 ///

