No. 09-55573

United States Court of Appeals
for the
Ninth Circuit

In re: J. HOWARD MARSHALL, III and ILENE O. MARSHALL, Debtors.

ELAINE T. MARSHALL, as Successor Trustee of the Bettye B. Marshall Living Trust, Successor Trustee of the J. Howard Marshall, II Marital Trust Number Two, and Successor Trustee of the E. Pierce Marshall Family Trust Created Under the Bettye B. Marshall Living Trust Indenture Dated October 30, 1990,
Appellant

- against -

J. HOWARD MARSHALL, III, and ILENE O. MARSHALL,
Appellees

APPEAL FROM THE FINAL DECISION OF THE UNITED STATES DISTRICT COURT FOR THE CENTRAL DISTRICT OF CALIFORNIA IN NO. 8:03-CV-01354-DOC (HONORABLE DAVID O. CARTER, JUDGE)

APPELLANT'S OPENING BRIEF

G. Eric Brunstad, Jr.
Counsel of Record
Collin O'Connor Udell
Matthew J. Delude
Kate O'Keeffe
Dechert, LLP
90 State House Square
Hartford, CT 06103
(860) 524-3999

Attorneys for Appellant

TABLE OF CONTENTS

Page

TABLE OF CONTENTS
(continued)

Page

TABLE OF CONTENTS
(continued)

Page

TABLE OF AUTHORITIES

Page

CASES

TABLE OF AUTHORITIES
(continued)

Page

TABLE OF AUTHORITIES
(continued)

Page

TABLE OF AUTHORITIES
(continued)

Page

TABLE OF AUTHORITIES
(continued)

Page

U.S. CONSTITUTION, STATUTES, RULES AND GENERAL ORDERS

TABLE OF AUTHORITIES
(continued)

Page

STATEMENT IN SUPPORT OF ORAL ARGUMENT

Appellant respectfully requests oral argument and represents that oral argument is warranted and will aid the Court's decisional process. This case involves four independent bases for reversal of the decisions below and an extensive record. Appellant submits that oral argument will assist the Court in addressing the issues presented.

PRELIMINARY STATEMENT

This appeal arises out of the Chapter 11 bankruptcy case of appellees J. Howard Marshall, III ("Howard") and Ilene O. Marshall (collectively, the "Debtors"). Appellant is Elaine T. Marshall ("Elaine"), as Successor Trustee of the Bettye B. Marshall Living Trust, Successor Trustee of the J. Howard Marshall, II Marital Trust Number Two, and Successor Trustee of the E. Pierce Marshall Family Trust Created Under the Bettye B. Marshall Living Trust Indenture Dated October 30, 1990 (the "Trusts").[1] Elaine's deceased husband, E. Pierce Marshall ("Pierce"), was the prior trustee of the Trusts. The Trusts hold an $11 million fraud judgment against Howard (the "Fraud Judgment").

The Debtors are wealthy, solvent individuals (i.e., the value of their assets exceeds their liabilities by many millions of dollars) who filed for bankruptcy to avoid paying the Fraud Judgment. As part of their effort to avoid paying the judgment, the Debtors endeavored to steer their bankruptcy case to a particular bankruptcy judge (the "Judge") who, in a prior case involving the late Vickie Lynn Marshall, a/k/a Anna Nicole Smith ("Vickie"), demonstrated a profound (and unjustified) hostility towards Pierce, *Marshall v. Marshall (In re Marshall)*, No. 96-01838 (Bankr. C.D. Cal.) (the "Vickie Case"). Although the Debtors conceded below that their bankruptcy case was not "related to" the Vickie case under the

[1] Elaine T. Marshall appears solely in her successor trustee capacity.

relevant rules of procedure, they nonetheless attached an improper "addendum" to their bankruptcy petition (the "Addendum") indentifying purported similarities between the two cases. As a result of the improper Addendum, the Debtors' bankruptcy case was pulled from random assignment and given to the Judge. Pierce, as trustee of the Trusts, objected to the nonrandom assignment and moved for reassignment and recusal, which motions the Judge denied.

The Debtors then proposed, and the Judge ultimately confirmed, a chapter 11 plan (the "Plan") providing for the full payment of all of the Debtors' debts *except* the Fraud Judgment, which they proposed to discharge without payment of any kind. Pierce moved to dismiss the Debtors' bankruptcy case for lack of good faith, which motion the Judge denied. Pierce also objected to the plan, which objection the Judge overruled. This appeal presents four questions of law: whether the Judge erred in denying (1) random reassignment of the Debtors' case; (2) recusal; (3) dismissal of the case on grounds of bad faith; and (4) the Trusts' challenge to the Plan.

JURISDICTION

The bankruptcy court asserted jurisdiction under 28 U.S.C. §§ 1334 and 157. On appeal, the district court asserted jurisdiction under 28 U.S.C. § 158(a). This Court has jurisdiction of the district court's affirmance of the bankruptcy court's orders under 28 U.S.C. § 158(d). The district court's order is dated March 18,

2009. ER1. Appellant appealed the order on April 16, 2009. ER118. The appeal is timely pursuant to Fed. R. App. P. 4(a)(1)(A).

STATEMENT OF ISSUES

Whether the district court erred in affirming the bankruptcy court's decisions denying recusal or reassignment; denying the motion to dismiss; and confirming the Plan. Relevant statutory provisions have been reproduced in the attached statutory appendix.

STATEMENT OF THE CASE

A. The Fraud Judgment.

Pierce and Howard are the sons of the late J. Howard Marshall, II ("J. Howard"). ER3640, 3741-42. J. Howard married Vickie in June 1994. ER3668. After J. Howard died, ER3026, both Vickie and Howard challenged J. Howard's estate plan in the Texas probate court (the "Probate Court"), ER3026-28, 3035-48, 3107-27, 3068-76; *see In the Estate of J. Howard Marshall, II Deceased*, No. 276,815-402 (the "Probate Case"). The Trusts counterclaimed against Howard, asserting that Howard had engaged in fraud. ER2666-718.

After a lengthy trial, the jury found that Howard had committed fraud, ER2811-16, and the Probate Court entered the Fraud Judgment against him. ER2592-98. The Fraud Judgment exceeds $11,000,000. ER2604.

B. Howard's Attempts to Avoid the Fraud Judgment.

Following entry of the Fraud Judgment, Howard moved unsuccessfully in the Probate Court to overturn it, ER1807-70, 1716, 1922-37, 1953-68, 1995 ¶ 3.41, 2000-16, and on February 21, 2002, he appealed it, ER2017-19. In addition, Howard sought to block discovery aimed at enforcing the judgment. ER1938-52. On January 31, 2002, he filed a motion to stay execution of the judgment or reduce the security necessary to obtain a stay pending appeal (the "Stay Motion"), ER2020-30, together with a sworn affidavit (the "Probate Affidavit"), in which he claimed a "total net worth" of $22,413,220, ER2031-34. This sworn statement is highly significant because it is the most accurate statement of the Debtors' net worth that Howard offered, demonstrating that the value of the Debtors' assets well exceeds their liabilities (even taking into account the Fraud Judgment). Notably, in subsequent filings in the bankruptcy court (discussed below), the Debtors improperly claimed a far lower net worth that grossly undervalued certain of their assets and simply omitted others.

On February 11, 2002, the Trusts deposed Howard regarding his Probate Affidavit. ER2477 ¶ 8, 2481-2507. The deposition revealed several misrepresentations concerning his purported inability to obtain a bond. *Id.*[2] By

[2] Howard stated in his affidavit that "the only assets that banks are willing to accept as collateral are my bonds and cash." ER2032 ¶ 6. The deposition revealed, however, that Howard knew that he could also borrow against his publicly held

agreement, the parties temporarily stayed execution of the Fraud Judgment numerous times while they negotiated the manner in which Howard could secure the Fraud Judgment. ER2478 ¶ 9, 2043-64. On March 4, 2002, the parties reached an agreement in principle that Howard would post as security (1) a $10.4 million bond; (2) a lien on his Lake Arrowhead property; and (3) a lien on his interest in a $6 million debenture (the "Debenture"). ER2478 ¶ 10, 2508-11, 2067.[3] Thereafter, Howard reneged, proposed an entirely different deal, and simultaneously threatened bankruptcy. ER2478 ¶ 11, 2512-13, 2067-68.

On March 21, 2002, the Trusts moved to enforce the Fraud Judgment (the "Enforcement Motion"), citing Howard's misrepresentations and seeking to have Howard either turn over securities to satisfy the Fraud Judgment or post a bond. ER2478 ¶ 12, 2065-72. Howard indicated that he would post security consistent with the parties' prior agreement, but then announced that the bank designated to post the bond refused to do so. ER2478 ¶ 13, 2076. The Trusts later amended the Enforcement Motion to seek either the turnover of Howard's securities or the

---

stock holdings, valued at $7,764,322 in his affidavit. ER2488. He also admitted that he had no personal knowledge of the truth of this sworn statement when he made it and had merely repeated what his attorney told him. ER2484-87.

[3] Howard is the beneficiary of the Eleanor P. Stevens Irrevocable Gift Trust Number One, which had as its *res* the $6 million Debenture, accruing interest at a rate of 10% per annum. ER2329. The Debenture reached maturity on July 1, 2009, and the Trust terminated on January 1, 2010, ER2329, whereupon Howard received the $6 million in principal.

liquidation of sufficient of his securities to obtain a cash bond for the entire amount of the Fraud Judgment. ER2478 ¶ 13, 2073-84.

On July 15, 2002, the Trusts filed a supplemental brief in support of the Enforcement Motion. ER2478-79 ¶ 15, 2090-2131. At a July 18, 2002 hearing, the Probate Court asked Howard to consider voluntarily moving some of his assets to Texas for enforcement of the Fraud Judgment. ER2479 ¶ 16. The court set another hearing for July 25, 2002 to consider whether it would order Howard to transfer assets to Texas. ER2479 ¶ 17.

The July 18 hearing set in motion a rapid series of events that culminated in the Debtors' filing their bankruptcy petition (the "Petition") in the bankruptcy court on July 23, 2002 (the "Petition Date") – two days before the Probate Court's scheduled hearing on enforcement. ER2141-42. The precise sequence of events is as follows:

Thursday, July 18	Probate Court indicates it might enforce the Fraud Judgment by requiring Howard to transfer assets to Texas. ER1504-05.
Friday, July 19	Debtors draw down entire $300,000 from Mellon line of credit, which previously had a zero balance. ER1498.
Monday, July 22	Debtors pay $200,000 of drawn funds as retainer to their bankruptcy counsel, ER1499, and use remainder to pay off certain unsecured debts. ER1500.
Tuesday, July 23	Debtors file for bankruptcy. ER2141.

Wednesday, July 24	Debtors file Notice of Bankruptcy with the Probate Court. ER2142-62.
Thursday, July 25	Probate Court hearing cannot proceed.

Howard's submissions and his counsel's statements confirm that the motive for the bankruptcy filing was to evade enforcement of the Fraud Judgment, stating that the Debtors had "made a decision that the best way to try to resolve the claims pending against them was through the Chapter 11 process." ER2167-68, 1242-43.

C. Howard Engineers Assignment of the Debtors' Case to the Judge.

Pursuant to Local Rule 1015-2 of the bankruptcy court, the Debtors were required to file with their Petition a statement responding to questions testing whether their case was "related to" another bankruptcy case. ER2563-64. While their answers plainly demonstrated that their case was *not* related to the Vickie Case under the rule's criteria, ER2563, a point the Debtors conceded, ER2564, the Debtors nonetheless filed the Addendum to their Petition, contending that their bankruptcy case "may have many of the same principal parties" as the Vickie Case, ER2564. Of course, the only overlapping party involved in both cases was Pierce. The Debtors' representation caused their case to be pulled from random distribution and assigned to the Judge. ER2526.

The intake clerk for the bankruptcy court informed Pierce's counsel informally of the nonrandom assignment. ER2526. Pierce objected to the nonrandom assignment and likewise filed a motion requesting that the Judge

recuse himself from hearing the Debtors' case. In conjunction with these motions, Pierce submitted the information he had received from the clerk and suggested that the court either conduct its own inquiry, permit Pierce to depose the clerk, or permit Pierce to call the clerk as a witness. ER2526-27, 2535. The Judge refused each suggestion. ER2535.

D. Proceedings in the Vickie Case.

Some detailed discussion of the proceedings in the Vickie Case is necessary to explain the essential foundations for Pierce's motion to seek reassignment or recusal – e.g., the Judge's profound (and unjustified) antipathy towards Pierce.

Vickie commenced her bankruptcy case on January 25, 1996, ER3624, and the Vickie Case was assigned to the Judge. Pierce filed a proof of claim in the Vickie Case asserting that he held a claim against her for defamation, and Pierce also sought a determination that his claim was not subject to her bankruptcy discharge. ER3049-53. In response, Vickie asserted a "counterclaim" against Pierce alleging, among other things, that Pierce had interfered with her expectancy of a gift from J. Howard. ER3055-56. Vickie's "counterclaim" was virtually identical to the claim she asserted against Pierce in the Probate Court. *Compare* ER3055-56 *with* ER3600-02. The Judge summarily dismissed Pierce's proof of claim against Vickie, ER3591-93, and then undertook to finally adjudicate Vickie's counterclaim against Pierce (which, as the U.S. Supreme Court ultimately

concluded, he had no constitutional authority to do, *Stern v. Marshall*, 131 S. Ct. 2594 (2011)).

In contrast to the Probate Court's five-and-a-half-month jury trial, the Judge held just five days of hearings on Vickie's counterclaim, beginning October 27, 1999. *Compare* ER3624 *with* ER3600-02. At the outset of the hearings, the Judge held a press conference at which he invited the press to ask questions in open court, answered questions posed by a reporter, and discussed the relationship between the Vickie Case and the then-pending Probate Case. ER3575-77. During the hearings, the Judge refused to allow Pierce to call witnesses and severely circumscribed his ability to present testimony and evidence. ER2851-54, 3628. Rather than permit Pierce to try the issues, the Judge deemed that Vickie had established her claim as a discovery sanction against Pierce, which Pierce strenuously disputed as unjustified. ER2851-54, 3625 n.5, 3628. The discovery sanction, together with the reasons why it was unjustified, are addressed in detail below.

On September 27, 2000, the Judge issued a decision that Vickie had an expectancy of an inheritance based on a theory of a "widow's election" right against J. Howard's estate, ER3617, a theory that Vickie never argued, and awarded Vickie the breathtaking sum of $449,754,134 in damages, ER3622. On October 6, 2000, the Judge *sua sponte* entered a revised opinion abandoning his "widow's election" theory that Vickie never argued, finding instead that Vickie

"had an expectancy to receive a substantial portion of [J. Howard's] wealth." ER3629. The Judge then awarded Vickie the same damages he had awarded under his initial opinion, concluding on the basis of presumed facts deemed true as a discovery sanction that Pierce had interfered with this expectancy. ER3625 n.5, 3631. On November 21, 2000, the Judge assessed an additional $25 million in punitive damages against Pierce, again based on presumed facts, ER3635-38, and on December 29, 2000, entered judgment for Vickie in the total amount of approximately $474 million (the "Vickie Judgment"), ER3644. In contrast, following the five-and-a-half-month jury trial noted above, the Probate Court entered a final judgment concluding that Vickie had no claim against Pierce or any other party, which judgment this Court ultimately concluded was binding on preclusion grounds. *Marshall v. Stern*, 600 F.3d 1106 (9th Cir. 2010).

1. The Judge's Sanctions Against Pierce in the Vickie Case.

The Judge entered his initial sanctions order against Pierce on February 2, 1999 (the "Initial Sanctions Order"), deeming various critical factual matters to be established, including that J. Howard had intended to leave Vickie a substantial inheritance and that Pierce had tortiously interfered with her inheritance rights. ER3500-03. Pierce appealed the Initial Sanctions Order to the district court. The district court vacated the order as lacking evidentiary support and remanded. ER3516-20. On remand, the Judge simply reimposed the same order (the "Final

Sanctions Order") in a form virtually identical to the vacated order (with footnotes added), and as a result, Pierce was not allowed to put on his case or challenge the presumed findings at trial. ER3527-30. On January 18, 2000, the Judge *sua sponte* withdrew the Final Sanctions Order, ER3613-14, but adhered to his original presumed findings and based his opinion and judgment against Pierce on them. ER3500-03, 3527-30.

The Judge never conducted an evidentiary hearing concerning Pierce's alleged discovery abuses, nor did any witness ever testify to them. He simply accepted as true the unsubstantiated and contested accusations of Vickie's counsel and based his sanctions on the following categories of alleged discovery abuse that Pierce vigorously disputed.

a. Alleged Document Destruction.

The Judge found that "Pierce destroyed a substantial quantity of documents that were subject to a pending discovery request." ER3626. This was unjustified. The *only* evidence of "document destruction" is Pierce's testimony in the Probate Case that, as a member of the board of directors of Koch Industries ("Koch"), he routinely received copies (not originals) of certain minutes of Koch board meetings, board meeting agenda, and confidential board information that he, like all board members, destroyed in the ordinary course of business. ER3103-06, 3710-11. Pierce testified he did *not* destroy any communications with J. Howard, any

memoranda or letters written by J. Howard, or any communications between J. Howard and his attorneys. ER3103-04, 3711. He also reconstructed and produced copies of the destroyed Koch materials. ER3455, 3711-12. There is no evidence that any of these documents, which were readily available from other sources, including Koch, were the subject of any pending discovery request in the Vickie Case, or that they were relevant to Vickie's claim.[4] Nevertheless, Vickie relentlessly and falsely accused Pierce of destroying pertinent documents, *e.g.*, ER3428-29, and the Judge improperly credited these untrue statements without any evidentiary support.

b. Alleged Failure to Serve Discovery Responses.

The Judge found, unjustifiably, that Pierce "failed to serve a written response within 30 days after the service of the request" and did not serve any response "within any reasonable time thereafter." ER3626 & n.14. Vickie submitted her first set of 91 document requests on November 8, 1996, ER3840-67, seeking documents that she had already obtained in the Probate Case. On December 12, 1996, Pierce responded to the requests, objecting to many of them. ER3842. Vickie moved to compel as to some requests to which Pierce objected. ER3138.

[4] None of the discarded Koch documents were responsive to document request 85, ER3864-65, the only request relating to Koch documents the Judge required Pierce to respond to.

Although Pierce had already produced over 300 documents, ER3149-50, Vickie's counsel stated falsely at a February 26, 1997 status conference that "not one scrap of paper [has] been served on [Vickie] since they [*sic*] day they were supposed to respond on the document production" and that the only thing that had been produced was a "pile of newspaper clippings." ER3135-36. At a March 12, 1997 hearing on Pierce's objections to Vickie's requests and Vickie's motion to compel, the Judge significantly modified and narrowed many of the requests. ER3140-46. Recognizing that each party had prevailed in part, he stated that "an award of sanctions [had] to recognize that neither side won an undivided victory on [the] motion," ER3150-51, yet he imposed a $5,000 sanction against Pierce and nothing against Vickie. ER3153. On March 24, 1997, the Judge issued an order requiring Pierce to produce certain documents, ER3155. In compliance, Pierce produced 25 boxes of documents in April 1997. ER3317 ¶ 4.

On February 27, 1998, Vickie served a second set of document requests, ER3248-85, repetitive of the first set, ER3840-67. Pierce responded on May 1, 1998. ER3341-92. On July 30, 1999, Vickie served a third set of requests, seeking almost entirely privileged documents, ER3543-72. Pierce responded on September 2, 1999. ER3543-72.

c. Alleged Failure to Produce a Privilege Log and Documents *in Camera*.

The Judge found, incorrectly, that Pierce failed to produce a privilege log and documents *in camera.* ER3628. Pierce first produced a privilege log on May 2, 1997, ER3166-73, and supplemented it in November 1997, ER3304. Vickie did not complain of any insufficiency until February 1998, when she moved to strike Pierce's answer to her counterclaim. ER3183-3227.

On May 5, 1998, the Judge ordered Pierce to produce his privileged documents for *in camera* review, ER3404-07, which Pierce timely did on July 2, 1998, ER3877-78. Pierce amended his privilege log on June 15, 1998, ER3414, 3417-26, and provided a revised privilege log at the court's request, on November 20, 1998, ER3476, 3409-11.

d. The Hunter Documents.

The Judge also found that Pierce committed discovery abuse by failing to produce documents held by Edwin K. Hunter ("Hunter"), J. Howard's estate-planning lawyer. ER3626-27. The record demonstrates that Pierce made every effort to have these documents produced and that they were, in fact, produced. The record also demonstrates that these documents were not produced initially because Pierce did not have an attorney-client relationship with Hunter relative to these documents, and because Vickie failed to comply with the procedures required to obtain them and made false statements to the Judge about her efforts to do so.

The Judge's March 24, 1997 order directed Pierce to produce documents in Hunter's possession, including J. Howard's papers. ER2828-38. Upon Pierce's request that Hunter produce the documents, ER3440-41, Hunter stated that he could not do so voluntarily because: (1) Hunter did not represent Pierce and the requested documents belonged to persons other than Pierce, including J. Howard's estate, ER3439, 3442, and (2) many of the documents were covered by the attorney-client privilege held by persons other than Pierce, including Robert MacIntyre ("MacIntyre"), the court-appointed administrator of J. Howard's estate. ER3439-43.

On January 19, 1998, Vickie served Hunter with a subpoena duces tecum from the United States Bankruptcy Court for the Eastern District of Texas. ER3434. Although Hunter objected to the subpoena on February 2, 1998, he voluntarily produced over 70,000 pages and a privilege log, at Pierce's request. ER3435. Nevertheless, Vickie moved to strike Pierce's answer to her complaint on February 17, 1998, alleging he had failed to comply with discovery. ER3183-227. At a March 10, 1998 hearing, Vickie's counsel falsely stated that Vickie had not received any documents from Hunter, ER3340-3-4, 3340-6-8, when, at that very moment, Vickie's Texas counsel (who served the subpoena) was reviewing Hunter's production, ER3394-95. Pierce agreed at the conference to assist Vickie in obtaining non-privileged documents from third parties, including Hunter,

ER3332-40, 3394, and asked Hunter to provide the documents Vickie requested, ER3333-34, 3394-95.

Vickie argued at a May 5, 1998 hearing that she should not have to comply with procedures to compel production from Hunter, ER3400-03, and complained about Hunter's privilege log, ER3402-03. Although Hunter was not Pierce's lawyer, the Judge ordered Pierce to have Hunter annotate his privilege log more completely and to produce the privileged documents *in camera*. ER3404-07. After Pierce requested Hunter's cooperation, Hunter directed that his privilege log be annotated, ER3436, and prepared 26 boxes of privileged documents to be shipped to the court *in camera*, ER3440. Concerned about breaching his professional obligations to his clients (who had not waived their privileges) if he sent documents absent a court order, Hunter tried, unsuccessfully, to obtain permission to release the documents. ER3440. He told Pierce that he could not produce privileged documents absent a court order and Pierce asked him to reconsider. ER3440. On July 1, 1998, in response to Hunter's motion for a protective order clarifying his obligations, the Texas bankruptcy court held that it lacked jurisdiction *because Vickie never moved to compel* compliance with the subpoena. ER3437.

At an August 27, 1998 hearing, Vickie urged the Judge to sanction Pierce for Hunter's failure to produce documents, ignoring that Hunter was not Pierce's

attorney. ER3451-54. When the Judge asked Vickie's counsel about the status of the subpoena, he falsely stated that a motion to compel was pending in the Texas bankruptcy court in Beaumont. ER3449-50. In fact, no such motion was ever filed. ER3597-2. The Judge stated: "I think that [Vickie] should proceed with respect to the subpoena issued by the . . . Beaumont court for any documents that Mr. Hunter has not produced and that's the forum where that should be litigated." ER3456. At an October 29, 1998 hearing, Vickie's counsel falsely stated: "I don't have to hang around Beaumont to know I'm not going to get anything there, but we're going to take every step we can take." ER3475-4. In truth, Vickie took no further steps in Beaumont. In March 1999, MacIntyre agreed to waive the estate's privilege and Hunter produced 200 boxes of documents. ER3522, 3526.

e. The Townsend Documents.

Vickie also sought documents held by Jeff Townsend, one of J. Howard's attorneys. ER3190. Although Vickie never served him with a subpoena, Townsend produced non-privileged documents in his possession, and Vickie's counsel reviewed them on April 22 and 23, 1998. ER3395. More Townsend documents were produced on July 2, 1998. ER3877-79.

Townsend initially declined to produce certain documents because they did not belong to Pierce and MacIntyre would not waive the estate's privilege. ER3415, 3874. Vickie did not move to compel. On October 29, 1998, the Judge

ordered Pierce to produce the privileged Townsend documents *in camera*, stating that, if he failed to do so at the next hearing, his counsel should "bring your toothbrush." ER3475-3. On or before November 24, 1998, when the privileged documents were produced to the court, ER3484, the Judge advised that there would be no opportunity to argue whether any document was privileged, because "the opportunity to be heard has passed," ER3485. Neither Pierce nor any party was ever heard on the privilege issue.

On January 12, 1999, the Judge turned over to Vickie all documents that he deemed were not privileged, ER3489-91, and sanctioned Pierce's counsel $5,000 for Townsend's alleged bad faith claim of privilege, ER3493. Notwithstanding that Pierce's counsel had no authority or chance to review the documents before their submission to the court or to assert a privilege, ER3494-95, the Judge imposed the sanction, stating: "It doesn't matter." ER3495.

On January 22, 1999, the Judge sanctioned Pierce's counsel $15,000 for allegedly dumping the Townsend documents on the court *in camera* without properly reviewing them. ER3497-99. Pierce's counsel, however, was not responsible for the production and had no authority or chance to review these documents. ER3494. Nevertheless, the Judge improperly sanctioned Pierce and his counsel on the basis of Vickie's unsubstantiated allegations regarding the

alleged misconduct of others and never afforded Pierce any opportunity to pursue any claim of privilege.

2. Proceedings in the District Court in the Vickie Case.

In September 1998, Pierce moved to withdraw the case from the bankruptcy court to the district court in conjunction with his effort to obtain review of the Judge's various discovery determinations. ER3457-71. The district court withdrew the case on October 19, 1998. ER3472-74. Following the district court's withdrawal of the case from the bankruptcy court, the Judge stated on January 12, 1999 his intention to submit a secret memorandum to the district court (the "Secret Memo"), not available to Pierce, "to assist in [the district court's] review of the matter." ER3492. The contents of the Secret Memo have never been disclosed.

The district court stayed the Judge's various sanctions determinations on February 1, 1999, but the next day, the Judge declared the stay order ineffective and entered his Initial Sanctions Order deeming various factual issues to be established against Pierce. ER3500-06, 3509-11. As noted, the district court vacated the Initial Sanctions Order for lack of evidence on March 9, 1999. ER3517, 3519-20. Acknowledging receipt of the Secret Memo, ER3517-18, the district court then vacated the order withdrawing the case and sent it back to the Judge, ER3519. On May 20, 1999, the Judge entered the Final Sanctions Order

discussed above, deeming Vickie's allegations against Pierce to be established. ER3527-30, 3531-39. He subsequently entered the $474 million Vickie Judgment.

3. The Judge's Hearings and Ruling on Vickie's Claim.

As noted, the Judge's $474 million judgment against Pierce was "mainly based" on presumed facts that he determined to be true as "sanctions imposed on Pierce" for alleged discovery abuse. ER3624. With respect to the few witnesses he did hear, the Judge permitted a one-sided presentation. While Pierce's counsel raised approximately 88 evidentiary objections, of which approximately 14% were sustained, 79% of the approximately 35 evidentiary objections raised by Vickie's counsel were sustained.[5] The Judge summarily discredited the testimony of Pierce and his witnesses, stating that "insofar as the testimony of any witness conflicts with the findings herein (including findings imposed as discovery sanctions), the court finds that such testimony is not credible." ER3624.

The Judge ultimately concluded, without evidence, that Pierce fraudulently altered his father's estate plan; engaged in a "plot" to prevent Vickie from obtaining J. Howard's assets; adopted a "scorched earth approach" to the case; and did "his best to make it look like World War III." ER3624, 3626. He calculated damages based on his view of a recent increase in the price of oil, ER3625 n.7, which had no relevance to the case because J. Howard did not receive any

[5] These approximate numbers are derived from review of the transcripts.

significant income from oil production and there was no evidence that any increase in oil prices increased J. Howard's wealth.

4. Additional Disparaging Comments Regarding Pierce and His Counsel in the Vickie Case.

The Judge made numerous disparaging comments about Pierce and his counsel in open court in the Vickie Case. He called Pierce "a Defendant with extremely dirty hands." ER2939. He warned Pierce's attorney to bring certain documents to court or "bring your toothbrush," ER3475-3, and to bring his "checkbook" to a hearing, ER2907-08, 2913. When Vickie's counsel argued that Pierce owed numerous duties to various parties because of the many "hats" he wore in relation to certain trusts and corporations, the Judge stated: "Seems to think he has more hats than a hat store." ER2919. The Judge stated at another hearing that he had "substantial experience with the way your side has handled cases," and expressed ongoing skepticism regarding the accuracy of representations made by Pierce's counsel about case law. ER2926. As to Vickie's false accusation that Pierce destroyed relevant documents, he stated that "[Pierce] is going to have to face the music on that in due course in this litigation." ER2933.

5. The Judge's Invalidation of the Probate Court's Fee Award.

Following the jury's verdict in the Probate Court rejecting Vickie's claims to J. Howard's assets and validating J. Howard's estate plan, the Probate Court entered judgment against Vickie, concluding, *inter alia*, that J. Howard never

intended to give her any of his assets beyond what she had received during his lifetime and that she had no claim against Pierce. ER2599-604. The Probate Court also awarded Pierce $541,000 in attorneys' fees incurred at trial, stating that the award was based solely on events during trial and did not "arise from any conduct that occurred on or before March 8, 1999," the date of Vickie's bankruptcy discharge. ER2604 ¶¶ 3.39-3.40.

Following this determination, Vickie returned to the bankruptcy court, seeking to overturn the fee award on the ground that it violated her bankruptcy discharge. The Judge granted Vickie's request, ignoring the basis for the Probate Court's award (i.e., it occurred *after* her discharge in bankruptcy based on her post-discharge conduct and therefore was not covered by her discharge, which applied only to pre-discharge liabilities); opining that Vickie did not engage in any post-discharge conduct sufficient to support the award, ER3755-57; and concluding that Vickie's discharge rendered the award unenforceable. ER3759. In addition to the grounds for relief Vickie asserted, the Judge announced an alternative ground for his decision based on an argument that Vickie had not made, concluding that alleged statements by Pierce's counsel supplied sufficient grounds to overturn the fee award under the doctrine of judicial estoppel. ER3758-59. Pierce was given no opportunity to defend against this argument. This Court ultimately reversed the

bankruptcy court's improper order overturning the Probate Court's fee award. *Marshall v. Marshall (In re Marshall)*, 119 Fed. Appx. 136 (9th Cir. 2004).

6. Press Accounts Noting the Judge's Antagonism Towards Pierce.

The Vickie case received extensive press coverage, which noted the Judge's antagonism towards Pierce. For example, one article commented that the Judge "takes a less beneficent view" of Pierce than Vickie's view, ER2944, and that "one look at a May ruling by [the Judge] makes it clear that [Vickie] . . . approaches the trial date with a huge advantage," ER2943. Others concluded that the Vickie Judgment was not based upon the evidence, ER2947-50, and another reporter observed that the Judge "would not hear Pierce Marshall's side of the story," ER2948; *see also* ER2943. The Judge was aware of the press coverage. ER1538.

E. The Judge's Decision on Reassignment and Recusal.

After the Debtors in this case filed for bankruptcy and their case was assigned to the Judge, Pierce moved for random reassignment of the case and recusal of the Judge. Explaining the basis for his ruling on recusal at a hearing on Pierce's motions, the Judge remarked that the "[a]ppearance of impropriety is not a basis for recusal," and denied Pierce's motion on the record "in all respects." ER2546-47.

After the Judge denied the motion, however, he undertook his own investigation to see if there were additional grounds, not raised by the Debtors, for

denying the motion. Determining that Pierce had not filed a proof of claim in the Debtors' case, he issued an order to show cause requiring Pierce to litigate his standing to seek recusal. ER1567-71.

On March 10, 2003, the Judge issued a written decision again denying the motions. Regarding reassignment, the Judge held that "there is no doubt that this case is related to the Vickie Lynn Marshall case" based on the "complex relationship among the Marshalls, and the prior litigation in Vickie's case in this court," and commented that, were it not for that relationship and prior litigation, "the motion for recusal or reassignment would never have been made." ER113. The Judge held that, assuming the case was not randomly assigned to him "because it was related to the Vickie Lynn Marshall case, that assignment was entirely proper," noting that the facts "in these related cases are extremely complex." ER113-14. Notably, none of these reasons satisfy the criteria for relatedness under the relevant rules, and the two cases are not related under the rules' criteria – a point the Debtors conceded below, ER2563-64.

Regarding recusal, the Judge held that neither the adverse judgment against Pierce in the Vickie Case, the magnitude of the award, nor the inclusion of punitive damages warranted a different judge in the Debtors' case. ER115. The Judge discussed two remarks he had made in the Vickie case, stating that the characterization of Pierce as having "extremely dirty hands" was a finding of fact

that could not serve as a basis for recusal, and that his reference to Pierce making the litigation "look like World War III" was the Judge's repetition of a comment made first by Pierce's attorney. ER115. The Judge held further that "characterizations of newspaper articles and journalists are not grounds for recusal," and denied Pierce's motion "in all respects." ER116.

The Judge stated in his opinion denying recusal and reassignment that in the Vickie Case he "sanctioned Pierce for destroying records subject to pending requests, refusing to provide discovery and disobeying discovery orders." ER110. As explained above, however, Pierce did none of these things, and those unnecessary and untrue comments reveal an unjustified hostility towards Pierce.[6]

F. Misleading Filings in the Debtors' Bankruptcy Proceedings.

1. The Initial Schedules.

After successfully engineering assignment of their bankruptcy case to the Judge, on or about August 6, 2002, the Debtors filed their bankruptcy schedules listing their assets and "declar[ing] under penalty of perjury . . . that they [we]re true and correct to the best of [their] knowledge, information, and belief." ER2216. The Summary of Schedules stated that the Debtors' "Total Assets" amounted to

[6] Although the Judge stated that Pierce "does not deny that he refused to produce the documents that gave rise to [the court's prior] sanctions," ER115, Pierce always denied that he refused to produce documents or engaged in any misconduct, *see, e.g.*, ER2540.

$8,391,904. ER2195. Schedule B totaled the value of the Debtors' personal property at $6,084,922. ER2203. Those representations were intentionally false.

For example, the Debtors claimed in their initial schedules that the value of their stock holdings was "unknown" even though Howard's Probate Affidavit had valued them in the millions. ER2198. Howard received monthly statements from his investment advisor, including a June 30, 2002 statement[7] showing his stock holdings to be worth $5,891,141.65.[8] Howard also apparently had an independent valuation of his assets prepared a week before the Petition Date. ER2179. As Howard's counsel recognized, publicly traded stock is an asset that "anyone can check the value of on a publicly traded exchange and come up with a value." ER2180, 2184. The schedules contained numerous other discrepancies, omissions, and undervaluations, discussed below.

2. <u>The Amended Schedules and Continuing Misrepresentations</u>.

At the August 29, 2002 section 341(a) meeting of creditors, *see* 11 U.S.C. § 341(a), the Debtors were pressed on their failure to value certain assets and to explain inconsistencies between their bankruptcy schedules and Howard's Probate Affidavit listing his net worth at over $22 million. Only after being questioned

[7] This financial statement came to light only after a request by the Office of the United States Trustee. ER2271.

[8] Howard apparently used his June 30, 2002 financial statements to value his bonds, ER2176-79; *compare* ER2201 *with* ER2280-82, but not his stock holdings.

about their failure to disclose the value of millions of dollars in personal property did the Debtors sign amended schedules on September 4, 2002. But once again, they were evasive. They purported to value their common stock portfolio on a date prior to the Petition Date when the value was artificially and temporarily low, ER2326, and they still attributed no value to the Debenture that Howard told the Probate Court was worth $6,050,000 in calculating his "financial net worth," now claiming that the Debenture's value was "contingent," *compare* ER2034 *with* ER2329.

The amended schedules contained further unexplained irregularities. A brief summary of some of the major discrepancies between the Debtors' sworn disclosures to the bankruptcy court, Howard's sworn Probate Affidavit, and Howard's bank statements and other financial documents highlight the differences between what Howard told the Texas courts and the bankruptcy court about his assets and liabilities:

	January 31, 2002 Probate Affidavit	**August 6, 2002 Initial Schedules**	**September 4, 2002 Amended Schedules**
Value Attributed to Common Stock Holdings	$7,784,322	None	$4,746,407.38
Eleanor Stevens Gift Trust Debenture	$6,050,000	None	None

MDH Partnership Interest	$1,170,400[9]	$427,059	$427,059
Snow Summit Ski Corporation	$34,000	Not Listed	Not Listed
Stuff Technology Partners	$8,000	$100	$100
Aircraft LSG & FDNG Co. 11.00%	$25,000	$100	$100
Tri Star Financial Corp. 11.50%	$25,000	$100	$100
HJM Company	$60,000	Not Listed	Not Listed

In their initial schedules, the Debtors attributed no value to their publicly traded common stock holdings. In their amended schedules, they valued their portfolio "as of July 16, 2002" at $4,746,407.38. But even that delayed disclosure undervalued the stock holdings. ER2443-47.

Additionally, Howard attributed *no* value to the Debenture (which he had previously told the Probate Court was worth $6,050,000) in either his initial or amended schedules filed with the bankruptcy court, claiming that it "cannot be valued" at all because it is "contingent." *Compare* ER2034 *with* ER2329. This was also evasive. Under the terms of the Debenture, Howard was entitled to receive $600,000 each year in $50,000 monthly increments until the Debenture

[9] In his Probate Affidavit, Howard stated that stock in MDH was worth $18.858/share "based on reviewed financial statements of 31 December 2000, appraised real estate value on 29 January 1999, and discounted future earnings." In his bankruptcy schedules, Howard claimed it was valued at "$6.808/share; book value as of 31 May 2002." *Compare* ER2040 *with* ER2327.

matured and the Trust terminated, at which time Howard received the entire $6,000,000 in principal. ER2449. By attributing no value to the Debenture, Howard vastly understated his assets to create a false impression of insolvency.[10]

Using a market-driven approach consisting of reviewing financial statements, real estate appraisals, and discounted future earnings, Howard valued his interest in MDH at $18.58/share in his Probate Affidavit. ER2040. On his bankruptcy schedules, however, which ask for the current *market value,* Howard stated that his interest was worth $6.808/share at "book value," a standard that did not present a fair value of the asset. ER2440-43, 2327. With respect to his other partnership interests, valued by Howard in January 2002 at figures ranging from $8,000 to $25,000, each are inexplicably listed at "$100" on the Debtors' schedules. ER2200, 2327.

A thorough review of the Debtors' assets reveals that, as of the Petition Date, those assets had a value of *at least* $17,928,869, as opposed to the $13,138,311 listed in the Debtors' amended schedules. ER2453, 2457. This means that, as of

[10] Pierce presented expert evidence to the Judge that even conservatively calculated near the Petition Date, Howard's interest in cash flows from the Debenture, both interest and principal payments, had a fair market value of $3,583,375. ER2452 (conservatively calculating the value of Howard's interest in the Debenture by: (1) accounting for the probability that Howard will live to receive each interest payment and the distribution of the principal; (2) applying a discount to these cash flows to obtain a present value; and (3) applying a significant discount to the overall cash flow valuation to account for any lack of marketability). ER2449, 2470-72.

the Petition Date, the Debtors' assets exceeded their liabilities of $13,914,112 stated on their amended schedules by at least $4,000,000. ER2453, 2457.

G. The First Amended Plan.

The Debtors proposed an initial plan of reorganization, which they subsequently amended to provide for the full payment of all of their debts *except* the Fraud Judgment, which constitutes an unsecured claim against Howard. Under their Plan, the Debtors proposed to discharge the Fraud Judgment without any payment at all as a liability "incurred before confirmation of the Plan" that they do not propose to satisfy. ER1370.

The Fraud Judgment makes up approximately 82% of the Debtors' $13,914,112.39 scheduled liabilities and 88% of the total claims above real estate liens on the Debtors' several homes. ER2208-11. The balance of the unsecured debt appears to consist of smaller judgments against Howard and attorneys' fees. Absent are the general unsecured claims typical of a chapter 11 case, because the Debtors paid these claims before commencing their case. ER2336, 2339.

H. Rulings on Dismissal and Confirmation of the Plan.

Pierce moved to dismiss the Debtors' bankruptcy case for lack of good faith and also objected to the Plan. On August 26, 2003, the bankruptcy court issued an opinion denying dismissal of the case and confirming the Plan, concluding that "this bankruptcy case was filed and prosecuted in good faith and for a proper

purpose," and that "the plan [met] the requirements of good faith and the best interests of creditors," ER87, even though it proposed to pay nothing on the Fraud Judgment.

On the same day, the bankruptcy court issued a second opinion, rejecting Pierce's argument that permitting solvent debtors to discharge their debts under the Bankruptcy Code would exceed Congress' constitutional authority, and holding that "the exercise of federal jurisdiction under the Bankruptcy Clause of the United States Constitution does not require that a debtor be insolvent, and that the debtors in this case may constitutionally invoke remedies provided under the Bankruptcy Code." ER70. On September 3, 2003, the bankruptcy court amended its first decision. ER50. On October 9, 2003, the bankruptcy court amended its second decision. ER34.

The Judge's opinions on plan confirmation and dismissal also contain statements suggesting unjustified antipathy towards Pierce. For example, the Judge appeared to express disapproval that Pierce had inherited much of his father's wealth, ER87, and criticized Pierce's pursuit of the Fraud Judgment against Howard, stating that, despite his inheritance, "Pierce has not been deterred from pursuing the assets of his brother," ER94.

I. Appeal to the District Court.

The Trusts appealed to the district court, which affirmed each of the bankruptcy court's rulings. The court determined that, although the Debtors' case and the Vickie Case were not related as a technical matter, Pierce had no right to a particular assignment procedure. ER8-9. The court also refused to reverse "merely because the Bankruptcy Clerk failed to comply with a court-imposed administrative rule when assigning the case." ER9.

Regarding recusal, the court dispensed with each of the asserted grounds for bias, and determined that the Secret Memo was harmless. ER13-14. The court similarly found no ethical violation or suggestion of bias in the Judge's dealings with the press. ER14-16.

The court likewise affirmed confirmation of the Plan, ER25, as well as denial of Pierce's motion to dismiss, holding that the Judge did not commit clear error in concluding that the Debtors had acted in good faith, ER26, 32.

STANDARD OF REVIEW

In bankruptcy appeals, this Court reviews "a bankruptcy court decision independently and without deference to the district court's decision." *In re JTS Corp.*, 617 F.3d 1102, 1109 (9th Cir. 2010). A bankruptcy court's findings of fact are reviewed for clear error, and its conclusions of law are reviewed de novo. *Id.* Where a bankruptcy court's finding of fact is premised upon either an improper

legal standard "or a proper one improperly applied, that finding loses the insulation of the clearly erroneous rule." *Wilson v. Huffman (In re Missionary Baptist Found. of Am., Inc.)*, 712 F.2d 206, 209 (5th Cir. 1983); *see, e.g., General Elec. Capital Corp. v. Future Media Prods. Inc.*, 536 F.3d 969, 971 (9th Cir.), *amended on other grounds by* 547 F.3d 956 (9th Cir. 2008). Decisions involving "mixed questions of law and fact are reviewed de novo." *Beaupied v. Chang (In re Chang)*, 163 F.3d 1138, 1140 (9th Cir. 1998).

The following issues in this case are reviewable *de novo* as involving questions of law, mixed questions of law and fact, and/or an improper legal standard improperly applied: whether the Debtors' case should have been assigned randomly; whether the Debtors filed and pursued their case in bad faith; and whether their Plan should have been confirmed. Although recusal decisions are usually reviewed for abuse of discretion, *F.J. Hanshaw Enters., Inc. v. Emerald River Dev., Inc.*, 244 F.3d 1128, 1135 (9th Cir. 2001), *de novo* review applies where, as here, the decision rests on an incorrect view of the law. *Gorbach v. Reno*, 219 F.3d 1087, 1091 (9th Cir. 2000).[11] *De novo* review is also appropriate with respect to whether a judge's partiality violates the Due Process Clause. *See Reyes-Melendez v. INS*, 342 F.3d 1001, 1006 (9th Cir. 2003).

[11]Among other things, the Judge determined that "[a]ppearance of impropriety is not a basis for recusal," ER2546, which is contrary to well-settled law.

SUMMARY OF THE ARGUMENT

As the Supreme Court has explained repeatedly, bankruptcy law exists to provide relief to the honest but unfortunate debtor. The Debtors here have demonstrated that they do not fit this fundamental paradigm.

The record demonstrates that the Debtors filed their Petition in bad faith in an effort to gain a litigation advantage over the Trusts and defeat the Fraud Judgment. The Debtors improperly engineered the assignment of their case to the Judge, who had recently entered a nearly half-billion-dollar judgment against Pierce in the Vickie Case based on presumed facts and who had repeatedly demonstrated a profound (and unjustified) antipathy towards Pierce. When the Debtors filed their bankruptcy schedules, they misrepresented the value of their holdings, omitted assets, and otherwise obfuscated and evaded their obligation of candor. In doing so, the Debtors sought to appear insolvent when the record clearly demonstrates that their assets exceeded their liabilities by millions of dollars. Finally, the Debtors proposed (and confirmed) a Plan that sought to discharge the Fraud Judgment without any payment at all, thus allowing them to shelter their wealth in spite of Howard's fraud.

The decisions below should be reversed for any one of four alternative grounds. First, the bankruptcy court failed to follow the relevant law in permitting the Debtors' manipulation of the assignment of the case. Second, the decision

below should be reversed because the Judge failed to recuse himself where the record amply demonstrates that, under both 28 U.S.C. § 455 and the Due Process Clause, the Judge displayed the appearance of partiality, the absence of neutrality, and a deep-seated and unjustified hostility towards Pierce that made fair judgment impossible. Alternatively, the decision below should be reversed because the record demonstrates that the Debtors filed their Petition in bad faith. As a fourth basis for reversal, the decision below should be reversed because the proposed Plan unconstitutionally provided for the discharge of obligations of a solvent debtor and failed to satisfy the statutory "best interest of creditors" test.

ARGUMENT

I. The Case Assignment Was Improper.

Pursuant to 28 U.S.C. § 137, a case must be assigned among judges in accordance with local rules and general orders. By operation of U.S. District Court, C.D. Cal., General Order 224 § 1.2 (applicable in bankruptcy cases), the clerk of the bankruptcy court was directed to assign cases randomly. Notably, the clerk of the court had no power to alter this directive: "By statute, the power to divide the business of the court is vested only in the judges of th[e] court." *United States v. Phillips*, 59 F. Supp. 2d 1178, 1182-83 (D. Utah 1999); *see also* 28 U.S.C. § 137; DIST. C.D. CAL. GEN. ORDER 224 § 1.2 ("Neither the Clerk nor any Deputy Clerk shall have discretion in determining the judge to whom any civil case shall be

assigned. The action of the Clerk in the assignment of cases is ministerial only."). Rather, it is through the promulgation of local court rules or standing orders that the *judges* exercise this power. *See id.*; *see also United States ex rel. Kaimowitz v. Ansley*, No. 304CV1344J16HTS, 2006 WL 485109, at *1 (M.D. Fla. Feb. 23, 2006).

The practice of random assignment is based on "a policy of objectivity and fairness in the distribution of all matters . . . that . . . is important to the fair administration of justice." *Brown v. Baden (In re Yagman)*, 796 F.2d 1165, 1178 (9th Cir. 1986). Correspondingly, "[t]he suggestion that the case assignment process is being manipulated for motives other than the efficient administration of justice casts a very long shadow." *Cruz v. Abbate*, 812 F.2d 571, 574 (9th Cir. 1987). This Court has repeatedly "underscore[d] the concerns for avoiding the appearance of arbitrariness and unfairness" in the case assignment process and has charged lower courts to be "meticulously careful" to avoid "any improper appearance." *Yagman*, 796 F.2d at 1178; *see also Aetna Life Ins. Co. v. Lavoie*, 475 U.S. 813, 825 (1986) ("[in order] to perform its high function in the best way, justice must satisfy the appearance of 'justice.'") (citations and internal quotation marks omitted); *Phillips*, 59 F. Supp. 2d at 1180 ("attempts to manipulate the random case assignment process are subject to universal condemnation.") (citing cases). Accordingly, although it is true that a litigant "has no right to any

particular procedure for the selection of the judge . . . he *is* entitled to have that decision made in a manner *free from bias or the desire to influence the outcome of the proceedings*." *Cruz*, 812 F.2d at 574 (emphases added). Clearly, these directives were not complied with in this case.

By relevant rule, the only exception to the random assignment of bankruptcy cases was "[w]hen a 'Rule 1015-2 Statement' . . . discloses a Related Case (as defined in Local Bankruptcy Rule 1015-2(1))," in which event "the newly-filed case shall be assigned by the Clerk" to the judge supervising the prior case. BANKR. C.D. CAL. GEN. ORDER 99-02. The Debtors conceded below that their case is not "related to" the Vickie Case under any of the criteria stated in Local Bankruptcy Rule 1015-2. ER2563-64. Accordingly there was no basis for the assignment of their case other than through the random selection process.[12]

Moreover, even if the rules could be ignored here, there was no legitimate commonality between the Debtors' case and the Vickie Case. The issues and claims were different. Pierce's defamation claim against Vickie, Vickie's tortious

[12] Under the local rule, a related case is defined as one where the debtors "(1) [a]re the same; (2) [a]re spouses or ex-spouses; (3) [a]re 'affiliates,' as defined in 11 U.S.C. § 101(2), except that § 101(2)(B) shall not apply; (4) [a]re general partners in the same partnership; (5) [a]re a partnership and one or more of its general partners; (6) [a]re partnerships that share one or more common general partners; or (7) [h]ave, or within 180 days of the commencement of either of the related cases had, an interest in property that was or is included in the property of another estate under 11 U.S.C. § 541(a)." BANKR. C.D. CAL. R. 1015-2(a). The Debtors do not satisfy any of these criteria, as they conceded below.

interference counterclaim against Pierce, and the other issues in the Vickie Case had nothing to do with the Trusts' Fraud Judgment against Howard or the issues in the Debtors' case. The only commonality was Pierce, and the only reason the Debtors filed their Addendum was to influence the selection of the Judge, whom the Debtors knew held a profound (and unjustified) antipathy towards Pierce.

In denying random reassignment, the Judge deflected Pierce's concerns and, in the process, failed to adhere to the principle that case assignments be "free from bias or the desire to influence the outcome of the proceedings." *Cruz*, 812 F.2d at 574. In addition, by declining Pierce's suggestions concerning how to investigate and rectify the situation, the Judge failed to "take great pains to avoid any inference that the assignment[] [was] made for an improper purpose." *Id.*

The Debtors' conduct in this case is judge-shopping at its worst. The Court should vacate the Judge's decision declining to reassign the case, vacate the Judge's other rulings, and remand with instructions to have the case reassigned randomly. *See Jenkins v. Bellsouth Corp.*, No. Civ. A CV-02-1057-S, 2002 WL 32818728, at *3 (N.D. Ala. 2002).[13]

II. The Bankruptcy Judge Should Have Recused Himself.

Statutory recusal for bias is governed by 28 U.S.C. § 455. Section 455(b) requires recusal in certain enumerated instances, including cases involving actual

[13] Because the Judge has retired from the bench, there is no chance that, in the random reassignment process, the case would be assigned to him.

bias, such as whether a judge "has a personal bias or prejudice concerning a party." *Id.* § 455(b). Section 455(a) more broadly requires recusal where a judge's "impartiality might reasonably be questioned." *Id.* § 455(a). Section 455(a) does not require proof of actual bias; rather, it requires that bias "be evaluated on an *objective* basis, so that what matters is not the reality of bias or prejudice but its appearance." *Liteky v. United States*, 510 U.S. 540, 548 (1994) (emphasis in original); *see also Liljeberg v. Health Servs. Acquisition Corp.*, 486 U.S. 847, 860 (1988); *In re Kensington Int'l, Ltd.*, 368 F.3d 289, 301-02 (3d Cir. 2004); *In re Boston's Children First*, 244 F.3d 164, 171 (1st Cir. 2001).

Recusal is warranted under section 455(a) when "a reasonable person with knowledge of all the facts would conclude that the judge's impartiality might reasonably be questioned." *F.J. Hanshaw Enters., Inc. v. Emerald River Dev., Inc.*, 244 F.3d 1128, 1144 (9th Cir. 2001) (citing *United States v. Wilkerson*, 208 F.3d 794, 797 (9th Cir. 2000) (internal quotation marks omitted)); *see also Kensington*, 368 F.3d at 301; *United States v. Torkington*, 874 F.2d 1441, 1446 (11th Cir. 1989). The hypothetical "reasonable person" is an "average layperson" who is "outside the judicial system." *Kensington*, 368 F.3d at 303. Importantly, where recusal is warranted based on "opinions formed by the judge on the basis of facts introduced or events occurring in the course of . . . prior proceedings," the test is whether the judge has shown "a deep-seated favoritism or antagonism that would make fair

judgment impossible." *Liteky*, 510 U.S. at 555. Recusal is required "if [the judge's predisposition] is somehow *wrongful* or *inappropriate*, either because it is undeserved, or because it rests upon knowledge that the [judge] ought not to possess . . . or because it is excessive in degree." *Id.* at 550 (emphasis in original). In making a determination of bias, the court must examine the totality of the circumstances; although one event may not demonstrate either bias or appearance of bias, the circumstances may do so when taken together. *See United States v. Bremers*, 195 F.3d 221, 228 n.2 (5th Cir. 1999). If the question "is a close one, the balance tips in favor of recusal." *Boston's Children*, 244 F.3d at 167 (internal quotation marks omitted).

Under the Constitution, it is axiomatic that "[a] fair trial in a fair tribunal is a basic requirement of due process." *Hurles v. Ryan*, 650 F.3d 1301, 1309 (9th Cir. 2011) (quoting *In re Murchison*, 349 U.S. 133, 136 (1955)). Because the "legitimacy of the Judicial Branch ultimately depends on its reputation for impartiality and nonpartisanship," this precept "helps to ensure both litigants' and the public's confidence that each case has been fairly adjudicated by a neutral and detached arbiter." *Hurles*, 650 F.3d at 1309 (quoting *Mistretta v. United States*, 488 U.S. 361, 407 (1989)). As noted, "[a]n appearance of impropriety, regardless of whether such impropriety is actually present or proven, erodes that confidence and weakens our system of justice." *Hurles*, 650 F.3d at 1309; *see also Concrete*

Pipe and Prods. of Cal., Inc. v. Constr. Laborers Pension Trust for S. Cal., 508 U.S. 602, 617 (1993).

It follows that "[t]o safeguard the right to a fair trial, the Constitution requires judicial recusal in cases where 'the probability of actual bias on the part of the judge or decisionmaker is too high to be constitutionally tolerable.'" *Hurles*, 650 F.3d at 1309 (quoting *Withrow v. Larkin*, 421 U.S. 35, 47 (1975)). The relevant test is "not whether the judge is actually, subjectively biased, but whether the average judge in his position is 'likely' to be neutral, or whether there is an unconstitutional 'potential for bias.'" *Caperton v. A.T. Massey Coal Co.*, 129 S. Ct. 2252, 2262 (2009) (internal quotation marks omitted); *Hurles*, 650 F.3d at 1309. Accordingly, proof of actual bias is not required. *Hurles*, 650 F.3d at 1310 (citing *Johnson v. Mississippi*, 403 U.S. 212, 215 (1971); *Aetna Life Ins. Co. v. Lavoie*, 475 U.S. 813, 825 (1986)).

Under this standard, lack of neutrality may appear in a judge's remarks, conduct, or rulings. *Reyes-Melendez v. INS*, 342 F.3d 1001, 1007-08 (9th Cir. 2003); *see Liteky*, 510 U.S. at 545-55. Further, neutrality is obviously absent when the judge acts as an advocate for one side. *United States v. Singer*, 710 F.2d 431, 436-37 (8th Cir. 1983).

The record amply demonstrates that, under both section 455 and the Due Process Clause, the Judge displayed the appearance of partiality, the absence of

neutrality, and a deep-seated hostility toward Pierce that would make fair judgment impossible. *Liteky*, 510 U.S. at 555. To begin with, the Judge improperly assumed the role of partisan advocate in both the Vickie Case and the Debtors' case. For example, after Pierce appealed the Initial Sanctions Order in the Vickie Case, the Judge sent the Secret Memo to "assist" the district court in ruling against Pierce on the withdrawal of the case from the bankruptcy court. ER3492, 3517-18.

Further, in granting Vickie's request to extend her bankruptcy discharge to cover liability for post-discharge misconduct, the Judge assisted Vickie by ruling *sua sponte* in her favor on a novel "judicial estoppel" argument that Vickie never raised and that was neither briefed nor argued by the parties. ER3758-59. Because the Judge first disclosed this argument in his written opinion, Pierce never had the opportunity to respond to it. The Judge also initially based his $474 million judgment against Pierce on a novel "widow's election" argument that Vickie never asserted. ER3617. Once again, Pierce had no opportunity to respond to it.

Further, at a hearing on Pierce's recusal and reassignment motions, the Judge denied the motions "in all respects," yet he then undertook his own investigation to see if there were additional grounds, not raised by the Debtors, for denying the motion. Once the Judge's investigation showed that Pierce had not filed a proof of claim, he issued an order to show cause, requiring Pierce to litigate his standing to seek recusal. ER1567-71. A judge who acts as an advocate for one

party in this way is simply not neutral. *Alexander v. Primerica Holdings, Inc.*, 10 F.3d 155, 166 (3d Cir. 1993) ("a judge's participation in a case must never reach the point where it appears, or is even perceived to appear, that the judge is aligned with any party in the pending litigation.").

The Judge further demonstrated his bias and lack of neutrality by refusing to abide by the district court's rulings in the Vickie Case. The district court stayed the bankruptcy court's sanctions orders on February 1, 1999. ER3516-18. The next day, the Judge declared the stay to be ineffective, ER3507-12, entering the Initial Sanctions Order deeming critical elements of Vickie's claim to be established, ER3500-03. The district court vacated the Initial Sanctions Order for lack of evidence on March 9, 1999. ER3517, 3519-20. On May 20, 1999, however, the Judge reimposed essentially the same order in the form of the Final Sanctions Order. ER3527-30.

The magnitude of the penalties the Judge imposed on Pierce in the Vickie Case is also an indicator of bias, along with his willingness to sanction Pierce so harshly without actual evidence of wrongdoing, his method of calculating damages against Pierce, and the one-sidedness of his sanctions and other rulings. The Judge awarded Vickie nearly a half *billion* dollars for *alleged*, *unproven* discovery abuse. The excessive nature of a sanctions award is evidence that a trial judge "failed to

represent the impersonal authority of law," thus justifying reassignment of the case to a different judge. *Offut v. U.S.*, 348 U.S. 11, 15-16 (1954).

The Judge's critical statements to Pierce and his counsel are additional evidence of bias, appearance of bias, and lack of neutrality. *See Liteky*, 510 U.S. at 555; *Offutt*, 348 U.S. at 14-18; *Alexander*, 10 F.3d at 164. Further, the numerous press accounts chronicling the Judge's bias and lack of neutrality are also probative. ER2943-44, 2947-50; *see Haines v. Liggett Group, Inc.*, 975 F.2d 81, 97-98 (3d Cir. 1992) (considering press accounts with respect to appearance of bias); *United States v. Isaacs*, No. CR 07-732-GHK, 2008 WL 4346780, at *2 (C.D. Cal. Sept. 19, 2008) (taking judicial notice of articles in recusal inquiry), *aff'd*, 359 Fed. Appx. 875, 876 (9th Cir. 2009).

The Judge's bias, appearance of bias, and lack of neutrality were further illustrated by the in-court press conference he held on the first day of hearings in the Vickie Case. He addressed members of the press, inviting them to ask questions, giving them the contact information of his law clerk, and inviting them to call him. ER3574-2. He informed them where they could get copies of documents and invited them to obtain documents from the lawyers representing the parties. ER3574-2-4. He discussed the Probate Case and the Vickie Case with the press, stating, *inter alia*, "There is, as everybody knows, also a case pending in probate court in Texas . . . . There are some matters that are raised in this case that

are set for trial that are – that may be on the fringes of what might be handled in the probate court, and those matters could be handled in either court, and there may be some such matters that we handle in this court." ER3576-77.

Courts have warned that "in newsworthy cases where tensions may be high, judges should be particularly cautious about commenting on pending litigation." *Boston's Children*, 244 F.3d at 169-70. They have likewise instructed that judges should refrain from public comments that convey "an uncommon interest and degree of personal involvement in the subject matter," because such comments create "the appearance that the judge had become an active participant . . . rather than remaining as a detached adjudicator." *United States v. Cooley*, 1 F.3d 985, 995 (10th Cir. 1993); *see also* Canon 3 § A(6) (1998) of the Code of Judicial Conduct ("[a] judge should avoid public comment on the merits of a pending or impending action.").

Even an ambiguous comment can warrant recusal. In *Boston's Children*, the district judge participated in a press telephone interview and commented that a case pending before her was more "complex" than another case with similar issues. 244 F.3d at 166. The First Circuit held that the comment required recusal because a reasonable person might interpret the comment "as a preview of a ruling on the merits" of a pending motion. *Id.* at 170. Even if ambiguous, "[i]nterested members of the public might well consider [the judge's] actions as expressing an

undue degree of interest in the case, and thus pay special attention to the language of her comments. With such public attention to a matter, even ambiguous comments may create the appearance of impropriety that § 455(a) is designed to address." *Id.* at 170; *see also United States v. Microsoft Corp.*, 253 F.3d 34, 115 (D.C. Cir. 2001).

The Judge's statements to the press in this case were far more troubling, especially those concerning the interplay between the Vickie Case and the Probate Case. At the time of the statements, it remained a hotly disputed issue whether the Judge should hear and decide Vickie's counterclaim against Pierce, an issue ultimately resolved in Pierce's favor by this Court and the Supreme Court. The Judge's comments that he would be hearing at least some aspects of the matter could be interpreted as rejecting Pierce's position. A reasonable observer could also have concluded that the Judge was more concerned with the celebrity of the case than its merits. *Microsoft*, 253 F.3d at 115.

In light of all this, the Judge's failure to recuse himself warrants vacatur of his orders and remand for reassignment. *See Liljeberg*, 486 U.S. at 868 (section 455); *Aetna*, 475 U.S. at 827-28 (due process); *Franklin v. McCaughtry*, 398 F.3d 955, 962 (7th Cir. 2005) (due process); *Clemmons v. Wolfe*, 377 F.3d 322, 328 (3d Cir. 2004) (section 455). Notably, vacatur would not unfairly prejudice the Debtors; they deliberately engaged in impermissible judge-shopping. On the other

hand, vacatur is necessary to prevent unfairness to the Trusts. The Debtors filed their bankruptcy case to avoid paying the Fraud Judgment, and the Trusts are entitled to have their rights and interests adjudicated in an unbiased proceeding.

Given the Judge's willingness in the Vickie Case to allow Vickie to assert a counterclaim against Pierce in response to his proof of claim, and thereafter to award her a $474 million judgment on her counterclaim as an improper sanction for alleged discovery abuse that Pierce did not commit, Pierce declined to file a proof of claim in the Debtors' case. Because the Judge was assigned to the case, Pierce was faced with a Hobson's choice: either present his claim and risk litigation attacking him and his claim before a biased judge, or forego a claim and face the Debtors' argument that they could discharge the Fraud Judgment without paying anything on it. If this case had been assigned randomly to a different judge, Pierce would not have faced this choice and would have filed a proof of claim. In sum, vacatur of the Judge's orders and reassignment of the case to a different judge is critical to preserve the integrity of the bankruptcy system and avoid both the reality and appearance of partiality.

III. The Judge Improperly Denied the Motion to Dismiss.

In denying Pierce's motion to dismiss the Debtors' case for lack of good faith, the Judge disregarded relevant Ninth Circuit precedent and gave no weight to

critical factors that must be considered. *See Marsch v. Marsch (In re Marsch)*, 36 F.3d 825, 828 (9th Cir. 1994). Accordingly, the decision must be reversed.

As the Judge recognized, "[i]t is settled law that a bad faith filing is cause for dismissal" of a bankruptcy case. ER92.[14] In this Circuit, the burden of demonstrating good faith rests *on the debtor*. *Leavitt v. Soto (In re Leavitt)*, 209 B.R. 935, 940 (9th Cir. BAP 1997), *aff'd*, 171 F.3d 1219 (9th Cir. 1999); *In re Silberkraus*, 253 B.R. 890, 902 (Bankr. C.D. Cal. 2000), *aff'd*, 336 F.3d 864 (9th Cir. 2003). In this case, the record is replete with facts that Pierce brought to the attention of the bankruptcy court that properly serve as indicia of the Debtors' bad faith requiring dismissal. In response, the Debtors failed to carry their burden of demonstrating good faith, yet the Judge still denied the motion to dismiss.

When considering whether a bankruptcy case must be dismissed for bad faith, courts in this Circuit consider "an amalgam of factors" rather than "a specific fact" in isolation. *Marsch*, 36 F.3d at 828; *Idaho v. Arnold (In re Arnold)*, 806 F.2d 937, 939 (9th Cir. 1986). Nonetheless, even under this "totality of the circumstances" standard, this Court has emphasized several salient factors present in this case that are particularly indicative (indeed dispositive) of bad faith, including a solvent debtor's decision to commence a bankruptcy case to delay or

[14] The Trusts brought their motion to dismiss as a party in interest under 11 U.S.C. § 1109(b). The Judge found that the Trusts had standing to object to the Plan as well as move to dismiss the case. ER88.

avoid the enforcement of a state court judgment or the posting of an appellate bond. *See Marsch*, 36 F.3d at 830-31; *Chu v. Syntron Bioresearch, Inc. (In re Chu)*, 253 B.R. 92, 95 (S.D. Cal. 2000); *In re Boynton*, 184 B.R. 580, 584 (Bankr. S.D. Cal. 1995); *see also Little Creek Dev. Co. v. Commonwealth Mortg. Corp. (In re Little Creek Dev. Co.)*, 779 F.2d 1068, 1072-73 (5th Cir. 1986).

Another relevant factor also present here is the Debtors' strategic timing of their bankruptcy filing to evade a state court order or hearing. *See St. Paul Self Storage Ltd. P'ship v. Port Auth. (In re St. Paul Self Storage Ltd. P'ship)*, 185 B.R. 580, 583 (9th Cir. BAP 1995) (bad faith where debtor filed petition one day before hearing on creditor's discovery motion in state court litigation); *see also Chinichian v. Campolongo (In re Chinichian)*, 784 F.2d 1440, 1445 (9th Cir. 1986); *Silberkraus*, 253 B.R. at 904-05.

Yet another relevant factor present here is the existence of a single large disputed judgment creditor and few unsecured creditors. *See Chinichian*, 784 F.2d at 1445; *Silberkraus*, 253 B.R. at 904; *Chu*, 253 B.R. at 95. Additionally, the existence of financial misrepresentations, including concealing and undervaluing assets – all present here – are further indicia of bad faith. *See Leavitt*, 171 F.3d at 1225; *Chu*, 253 B.R. at 96. Collectively, these factors require dismissal, and the Judge erred in declining to afford them appropriate significance in his analysis.

A. The Debtors Filed Their Petition Improperly to Avoid Enforcement of the Fraud Judgment and the Need to Post an Appellate Bond.

The Judge determined that "[n]othing in the timing of this case . . . [suggests] that the debtors had an improper purpose in filing this chapter 11 case." ER94. That finding is possible, however, only if one ignores both the record and this Court's prior precedents.

In *Marsch*, the debtor, who was solvent, faced a state court restitution judgment that she could have satisfied from her nonbusiness assets. Nonetheless, she filed a bankruptcy petition to prevent entry of the judgment and avoid having to post an appellate bond. In ordering dismissal of her case for lack of good faith, this Court held that "the purpose for which the petition was filed was not consonant with the purpose of the Bankruptcy Code," *Marsch*, 36 F.3d at 828, e.g., to grant relief to the honest but unfortunate debtor. Further, this Court also imposed sanctions for the debtor's "transparent attempt to use a Chapter 11 petition and the resulting [automatic] stay as an inexpensive substitute for the bond required under state law." *Id.* at 829, 831.

In conducting its analysis, the Ninth Circuit noted that "[s]everal bankruptcy courts have held that a debtor may use a Chapter 11 petition to avoid posting an appeal bond if satisfaction of the judgment would severely disrupt the debtor's business," but concluded that such an action was improper "if the debtor can satisfy the judgment with nonbusiness assets." *Id.* at 828. The Court reasoned that

it did not need to "decide whether bankruptcy laws can be used to skirt state court procedural rules" where "enforcement of a judgment would cause severe business disruption," because the debtor "wasn't involved in a business venture." *Id.* at 829; *see also In re SGL Carbon Corp.*, 200 F.3d 154, 165-66 (3d Cir. 1999).

Other cases are in accord. For example, in *Boynton*, the IRS obtained a judgment against the debtors in a state court proceeding. *In re Boynton*, 184 B.R. 580 (Bankr. S.D. Cal. 1995). Instead of posting a bond while they pursued an appeal, the debtors filed for bankruptcy to prevent the IRS from levying on their assets even though they had "significant assets" and "may have been able" to post a bond. *Id.* at 581. The bankruptcy case was accordingly dismissed for bad faith. *Id.* at 583-84; *see also Chinichian*, 784 F.2d at 1446; *Silberkraus*, 253 B.R. at 906; *Chu*, 253 B.R. at 95-96.

As in *Marsch*, the Debtors here commenced their bankruptcy case for the improper purpose of preventing the enforcement of the Fraud Judgment, ER1498-1500, 1504-05, 2141-62, and to avoid posting an appellate bond, ER2167-68, even though they can satisfy the Fraud Judgment from their extensive nonbusiness assets. *Marsch* is directly on point, and the Debtors' case should have been dismissed.

B. The Debtors Filed Their Petition as a Strategic Attempt to Gain a Litigation Advantage.

The Debtors began taking steps to file their Petition the day after the Probate Court asked Howard to consider moving assets to Texas to satisfy the Fraud Judgment. ER1498-1500, 1504-05. Those steps culminated in the filing of their bankruptcy case only five days after the Probate Court's request and two days before a scheduled enforcement hearing. ER1504-05, 2141-62. Courts have commonly inferred bad faith from such suspicious timing, and the Judge should have done so here. *E.g.*, *Leavitt*, 171 F.3d at 1225; *Chinichian*, 784 F.2d at 1446; *St. Paul Storage*, 185 B.R. at 583.

C. The Debtors' Numerous Misrepresentations and Undervaluations Demonstrate Bad Faith.

Courts have found a debtor's misrepresentations and undervaluation of assets, and likewise a debtor's solvency, to be further indicia of bad faith. *E.g.*, *Leavitt*, 171 F.3d at 1225; *Chu*, 253 B.R. at 96. The Debtors here are wealthy, solvent individuals, and their incomplete and misleading schedules, which attempted to portray them implausibly as destitute, were simply a ruse. Insolvency is determined by a simple balance sheet test. 11 U.S.C. § 101(32); *Wolkowitz v. Am. Research Corp. (In re DAK Indus., Inc.)*, 170 F.3d 1197, 1199-1200 (9th Cir. 1999); *Akers v. Koubourlis (In re Koubourlis)*, 869 F.2d 1319, 1321 (9th Cir. 1989). The Debtors' schedules indicate liabilities on the Petition Date totaling

$13,914,112.39. ER2195. As of the same date, the Debtors had assets of a value of at least $17,928,869, ER2453, 2457, leaving them with at least $4,000,000 to spare after satisfying all claims. Throwing candor to the winds, the Debtors' initial schedules valued their "Total Assets" at $8,391,904. ER2195. That undervaluation is insupportable, and clearly indicates bad faith.

With respect to their stock holdings, the Debtors initially failed to disclose, and later undervalued, their publicly traded equity portfolio. Despite the fact that Howard possessed a June 30, 2002 statement that valued his stock holdings at $5,800,000, ER2177-80, he falsely swore on his schedules that a little over a month later (on the Petition Date) the value of those publicly traded assets was "unknown," and he therefore attributed *no* value to them. ER2198. Then, when he subsequently amended his schedules, he undervalued them. ER2443-46.

On both their initial and amended schedules, the Debtors ascribed no value to the $6 million Debenture. Instead, they claimed it was "contingent" and "cannot be valued." ER2329. This was also a ruse. Previously, on January 31, 2002, Howard told the Probate Court the Debenture was worth $6,050,000. ER2033-34. The Debenture produced cash flows of $50,000 per month until July 2009, followed by a $6,000,000 lump sum principal payment to Howard on January 1, 2010. ER2448-49. The Trusts introduced evidence that, even using the most conservative valuation standard, the Debenture had a fair market value on the

Petition Date of *at least* $3,583,375. ER2452, 2470-72. Adding this value to the Debtors' schedules alone rendered them solvent by *at least* $2,807,574.

As noted, Howard also understated the value of his partnership interests, including an interest in MDH Industries that he valued at $1,170,400 in January of 2002, ER2040, but claimed in his schedules was worth only $427,059, ER2200, 2440-43. Howard's representations concerning his other partnership interests were also inconsistent with his earlier Probate Affidavit. *Compare* ER2040 *with* ER2200. The Debtors similarly understated the value of their real estate holdings. The Trusts introduced evidence that the Debtors likely undervalued their real estate by at least $191,000, and as much as $641,000. ER1223-24, 2195, 2437.

Incomplete and misleading asset valuations and disclosures are a hallmark of bad faith. *Chu*, 253 B.R. at 96. Incomprehensibly, the Judge excused the Debtors' misrepresentations, assigning "no weight" to their undervaluations and omissions. ER89. In particular, the bankruptcy court gave "no weight" to the Debtors' assignment of zero value to the $6 million Debenture. ER90. This was error.

In *Velasquez v. Burchard (In re Velasquez)*, No. 06-1150, 2006 WL 6811040 (B.A.P. 9th Cir. 2006), *aff'd*, 280 Fed. Appx. 652 (9th Cir. 2008), the court affirmed a bad faith dismissal where the debtor failed to disclose all of his assets in his schedules, "including details concerning substantial assets he owned," and filed his bankruptcy petition for the purpose of preventing a creditor from

enforcing a state court judgment. *Id*. at *3. There, the court properly rejected the debtor's argument that he should have been permitted to amend his schedules because "even if Debtor had been allowed to amend his schedules to include the missing information, his purpose for filing . . . still 'violate[s] the spirit of the chapter.'" *Id.* at *4 (quoting *Chinichian*, 784 F.2d at 1445). According to the court, "Debtor in this case does not represent 'the poor, the oppressed and the unfortunate seeking a fresh start.'" *Id.* The same is true of the Debtors here, and their case should have been dismissed.

D. The Absence of Significant Unsecured Debt Other Than the Fraud Judgment Is Another Indication that the Filing Was Made in Bad Faith.

Finally, courts have found the absence of general unsecured debt to be yet another indication of a bad faith filing. *E.g.*, *Chinichian*, 784 F.2d at 1445; *Little Creek*, 779 F.2d at 1073; *Silberkraus*, 253 B.R. at 904. In this case, the Debtors paid off over $89,000 of unsecured claims the day before they commenced their bankruptcy case. ER2336, 2339. Notably, the Plan lists only $16,375 of general unsecured debts other than the Fraud Judgment. ER1367. This is yet another indication of bad faith, and the Judge erred in refusing to dismiss the Debtors' case.

IV. The Bankruptcy Court Erred in Confirming the Plan.

Because the Debtors are solvent, they could not use the bankruptcy process to discharge the Fraud Judgment. First, Congress' authority to enact bankruptcy legislation is constitutionally limited to laws on "the subject of bankruptcies," and

the Debtors are in no sense "bankrupt" within the meaning of this limitation. They are wealthy individuals who simply wish to avoid paying for Howard's fraud. Second, under section 1129 of the Bankruptcy Code, a plan cannot be confirmed unless it satisfies the "best interest of creditors" test, meaning that creditors must receive more under the plan than they would in a Chapter 7 liquidation of the debtor's assets. Where a debtor is solvent, creditors in a Chapter 7 proceeding are entitled to payment even in the absence of a timely filed claim. Because the Plan in this case proposes to pay nothing on the Fraud Judgment, the Plan fails this test and should not have been confirmed.

A. Discharging the Debts of Solvent Debtors Exceeds Congress' Power Under the Bankruptcy Clause.

The "Bankruptcy Clause" provides that "Congress shall have Power . . . [t]o establish . . . uniform Laws on the subject of Bankruptcies throughout the United States . . ." (the "Bankruptcy Power"). U.S. CONST., art. I, § 8, cl. 4. Pursuant to the Bankruptcy Power, Congress may enact laws that permit the restructuring of relations between debtors and creditors. *Northern Pipeline Constr. Co. v. Marathon Pipe Line Co.*, 458 U.S. 50, 71 (1982) (plurality opinion). As the Supreme Court has recognized, however, the Bankruptcy Power is limited, *Continental Illinois Nat'l Bank & Trust Co. v. Chicago, Rock Island & Pac. Ry. Co.*, 294 U.S. 648, 669 (1935), and the Court has invalidated bankruptcy legislation that exceeds constitutional boundaries. *See, e.g., Stern v. Marshall*, 131

S. Ct. 2594 (2011); *United States v. Security Indus. Bank*, 459 U.S. 70, 75 (1982); *Railway Labor Execs. Ass'n v. Gibbons*, 455 U.S. 457, 473 (1982); *Louisville Joint Stock Land Bank v. Radford*, 295 U.S. 555, 589 (1935).

Congress' authority under the Bankruptcy Clause extends generally to enacting "uniform laws on the subject of any person's *general inability to pay his debts*." *Continental*, 294 U.S. at 670 (internal quotations and citations omitted) (emphasis added). In contrast, it does not extend to eliminate the debts of perfectly solvent individuals who simply do not wish to pay their debts because obligors of this kind are not in any sense "bankrupt."

Limiting Congress' authority under the Bankruptcy Clause to address "the subject of bankruptcies" is necessary to maintain the boundary between the Bankruptcy Clause and the Commerce Clause. The Bankruptcy Clause authorizes the enactment of "uniform laws" on the "subject of bankruptcies" and thus contains a limitation the Commerce Clause does not – bankruptcy laws must be "uniform." In contrast, the Commerce Clause authorizes the enactment of regulation affecting "interstate commerce" and thus contains a limitation the Bankruptcy Clause does not – commercial regulation under it must be "interstate" in nature.

As the Supreme Court has explained, "if we were to hold that Congress had the power to enact nonuniform bankruptcy laws pursuant to the Commerce Clause,

we would eradicate from the Constitution a limitation on the power of Congress to enact bankruptcy laws." *Gibbons*, 455 U.S. at 468-69. Of course, the converse is also true – if Congress could enact non-interstate regulation pursuant to the Bankruptcy Clause, this would eradicate a limitation on the power of Congress under the Commerce Clause. And the relevant limit here on the scope of the Bankruptcy Clause is precisely the one the Constitution expressly states – it is limited to the "subject of bankruptcies," which properly embraces relief for and against debtors who are *insolvent*.

As the Supreme Court has frequently stressed, "[t]he principal purpose of the Bankruptcy Code is to grant a "'fresh start' to the 'honest but unfortunate debtor.'" *Marrama v. Citizens Bank*, 549 U.S. 365, 367 (2007) (quoting *Grogan v. Garner*, 498 U.S. 279, 286, 287 (1991)). The Court has also emphasized equality of distribution among creditors and maximization of the debtor's assets as legitimate bankruptcy goals. *Continental*, 294 U.S. at 670-71. Where a debtor is solvent, of course, a discharge is unnecessary to "relieve the honest debtor from the weight of oppressive indebtedness." *Local Loan Co. v. Hunt*, 292 U.S. 234, 244 (1934). Likewise, the creditors of a solvent debtor will all be paid in full so equality of distribution and maximization of the debtor's assets is also not relevant.

Because the Debtors are fully solvent in this case, using the Bankruptcy Code to discharge the Fraud Judgment is not only unnecessary to fulfill any

fundamental bankruptcy policy, but would also exceed Congress' constitutional authority. Accordingly, the bankruptcy court should not have confirmed the Plan.

B. The Plan Cannot Be Confirmed Because It Fails to Satisfy the Best Interest of Creditors Test.

A Chapter 11 plan cannot be confirmed unless every dissenting creditor receives on account of its claim an amount "that is not less than the amount that such holder would so receive or retain if the debtor were liquidated under chapter 7 of this title." 11 U.S.C. § 1129(a)(7). The Fraud Judgment is a general unsecured claim held by dissenting creditors. ER1367. As unpaid creditors, the Trusts must be treated as a separate class from the other unsecured claims that will be paid in full, *see* 11 U.S.C. §§ 1122 & 1123(a)(4), and must be deemed to reject the Plan, *see id.* § 1126(g). Because the Trusts would receive full payment of the Fraud Judgment in a Chapter 7 liquidation of the Debtors' assets, and will instead receive nothing under the Plan, the Plan fails the best interest of creditors test. It is no defense that the Trusts have not yet filed a claim because the Trusts would receive payment in a Chapter 7 liquidation here since the Debtors are fully solvent, and even late-filed claims are paid under 11 U.S.C. § 726(a)(2) in cases such as this. Accordingly, the Plan could not be confirmed.

CONCLUSION

For the foregoing reasons, the Court should vacate the decisions below and remand with instructions to reassign the case, to dismiss for lack of good faith, or, failing that, to deny confirmation of the Plan.

Respectfully submitted,

/s/ G. Eric Brunstad, Jr.
G. Eric Brunstad, Jr.
Counsel of Record
Collin O'Connor Udell
Matthew J. Delude
Kate O'Keeffe
DECHERT, LLP
90 State House Square
Hartford, CT 06103
(860) 524-3999

STATEMENT OF RELATED CASES

There are no related cases pending in this Court that have not already been consolidated with the present case.

STATUTORY ADDENDUM

11 U.S.C. § 101(32) – Definitions:

The term "insolvent" means--

(A) with reference to an entity other than a partnership and a municipality, financial condition such that the sum of such entity's debts is greater than all of such entity's property, at a fair valuation, exclusive of--

(i) property transferred, concealed, or removed with intent to hinder, delay, or defraud such entity's creditors; and

(ii) property that may be exempted from property of the estate under section 522 of this title;

(B) with reference to a partnership, financial condition such that the sum of such partnership's debts is greater than the aggregate of, at a fair valuation--

(i) all of such partnership's property, exclusive of property of the kind specified in subparagraph (A)(i) of this paragraph; and

(ii) the sum of the excess of the value of each general partner's nonpartnership property, exclusive of property of the kind specified in subparagraph (A) of this paragraph, over such partner's nonpartnership debts; and

(C) with reference to a municipality, financial condition such that the municipality is--

(i) generally not paying its debts as they become due unless such debts are the subject of a bona fide dispute; or

(ii) unable to pay its debts as they become due.

11 U.S.C. § 726(a)(2) – Distribution of property of the estate:

(a) Except as provided in section 510 of this title, property of the estate shall be distributed—

***

(2) second, in payment of any allowed unsecured claim, other than a claim of a kind specified in paragraph (1), (3), or (4) of this subsection, proof of which is—

(A) timely filed under section 501(a) of this title;

(B) timely filed under section 501(b) or 501(c) of this title; or

(C) tardily filed under section 501(a) of this title, if—

(i) the creditor that holds such claim did not have notice or actual knowledge of the case in time for timely filing of a proof of such claim under section 501(a) of this title; and

(ii) proof of such claim is filed in time to permit payment of such claim;

11 U.S.C. § 1122 – Classification of claims or interests:

(a) Except as provided in subsection (b) of this section, a plan may place a claim or an interest in a particular class only if such claim or interest is substantially similar to the other claims or interests of such class.

(b) A plan may designate a separate class of claims consisting only of every unsecured claim that is less than or reduced to an amount that the court approves as reasonable and necessary for administrative convenience.

11 U.S.C. § 1123(a)(4) – Contents of plan:

(a) Notwithstanding any otherwise applicable nonbankruptcy law, a plan shall--

***

(4) provide the same treatment for each claim or interest of a particular class, unless the holder of a particular claim or interest agrees to a less favorable treatment of such particular claim or interest;

11 U.S.C. § 1124 – Impairment of claims or interests:

Except as provided in section 1123(a)(4) of this title, a class of claims or interests is impaired under a plan unless, with respect to each claim or interest of such class, the plan—

(1) leaves unaltered the legal, equitable, and contractual rights to which such claim or interest entitles the holder of such claim or interest; or

(2) notwithstanding any contractual provision or applicable law that entitles the holder of such claim or interest to demand or receive accelerated payment of such claim or interest after the occurrence of a default—

(A) cures any such default that occurred before or after the commencement of the case under this title, other than a default of a kind specified in section 365(b)(2) of this title or of a kind that section 365(b)(2) expressly does not require to be cured;

(B) reinstates the maturity of such claim or interest as such maturity existed before such default;

(C) compensates the holder of such claim or interest for any damages incurred as a result of any reasonable reliance by such holder on such contractual provision or such applicable law;

(D) if such claim or such interest arises from any failure to perform a nonmonetary obligation, other than a default arising from failure to operate a nonresidential real property lease subject to section 365(b)(1)(A), compensates the holder of such claim or such interest (other than the debtor or an insider) for any actual pecuniary loss incurred by such holder as a result of such failure; and

(E) does not otherwise alter the legal, equitable, or contractual rights to which such claim or interest entitles the holder of such claim or interest.

11 U.S.C. § 1126(g) – Acceptance of plan:

(g) Notwithstanding any other provision of this section, a class is deemed not to have accepted a plan if such plan provides that the claims or interests of such class do not entitle the holders of such claims or interests to receive or retain any property under the plan on account of such claims or interests.

11 U.S.C. § 1129(a)(7) – Confirmation of plan:

(a) The court shall confirm a plan only if all of the following requirements are met:

(7) With respect to each impaired class of claims or interests--

(A) each holder of a claim or interest of such class--

(i) has accepted the plan; or

(ii) will receive or retain under the plan on account of such claim or interest property of a value, as of the effective date of the plan, that is not less than the amount that such holder would so receive or retain if the debtor were liquidated under chapter 7 of this title on such date; or

(B) if section 1111(b)(2) of this title applies to the claims of such class, each holder of a claim of such class will receive or retain under the plan on account of such claim property of a value, as of the effective date of the plan, that is not less than the value of such holder's interest in the estate's interest in the property that secures such claims.

11 U.S.C. § 1141 – Effect of confirmation:

(a) Except as provided in subsections (d)(2) and (d)(3) of this section, the provisions of a confirmed plan bind the debtor, any entity issuing securities under the plan, any entity acquiring property under the plan, and any creditor, equity security holder, or general partner in the debtor, whether or not the claim or interest of such creditor, equity security holder, or general partner is impaired under the plan and whether or not such creditor, equity security holder, or general partner has accepted the plan.

(b) Except as otherwise provided in the plan or the order confirming the plan, the confirmation of a plan vests all of the property of the estate in the debtor.

(c) Except as provided in subsections (d)(2) and (d)(3) of this section and except as otherwise provided in the plan or in the order confirming the plan, after confirmation of a plan, the property dealt with by the plan is free and clear of all claims and interests of creditors, equity security holders, and of general partners in the debtor.

(d)(1) Except as otherwise provided in this subsection, in the plan, or in the order confirming the plan, the confirmation of a plan--

(A) discharges the debtor from any debt that arose before the date of such confirmation, and any debt of a kind specified in section 502(g), 502(h), or 502(i) of this title, whether or not--

(i) a proof of the claim based on such debt is filed or deemed filed under section 501 of this title;

(ii) such claim is allowed under section 502 of this title; or

(iii) the holder of such claim has accepted the plan; and

(B) terminates all rights and interests of equity security holders and general partners provided for by the plan.

(2) A discharge under this chapter does not discharge a debtor who is an individual from any debt excepted from discharge under section 523 of this title.

(3) The confirmation of a plan does not discharge a debtor if--

(A) the plan provides for the liquidation of all or substantially all of the property of the estate;

(B) the debtor does not engage in business after consummation of the plan; and

(C) the debtor would be denied a discharge under section 727(a) of this title if the case were a case under chapter 7 of this title.

(4) The court may approve a written waiver of discharge executed by the debtor after the order for relief under this chapter.

(5) In a case in which the debtor is an individual--

(A) unless after notice and a hearing the court orders otherwise for cause, confirmation of the plan does not discharge any debt provided for in the plan until the court grants a discharge on completion of all payments under the plan;

(B) at any time after the confirmation of the plan, and after notice and a hearing, the court may grant a discharge to the debtor who has not completed payments under the plan if--

(i) the value, as of the effective date of the plan, of property actually distributed under the plan on account of each allowed unsecured claim is not less than the amount that would have been paid on such claim if the estate of the debtor had been liquidated under chapter 7 on such date;

(ii) modification of the plan under section 1127 is not practicable; and

(iii) subparagraph (C) permits the court to grant a discharge; and

(C) the court may grant a discharge if, after notice and a hearing held not more than 10 days before the date of the entry of the order granting the discharge, the court finds that there is no reasonable cause to believe that--

(i) section 522(q)(1) may be applicable to the debtor; and

(ii) there is pending any proceeding in which the debtor may be found guilty of a felony of the kind described in section 522(q)(1)(A) or liable for a debt of the kind described in section 522(q)(1)(B);

and if the requirements of subparagraph (A) or (B) are met.

(6) Notwithstanding paragraph (1), the confirmation of a plan does not discharge a debtor that is a corporation from any debt--

(A) of a kind specified in paragraph (2)(A) or (2)(B) of section 523(a) that is owed to a domestic governmental unit, or owed to a person as the result of an action filed under subchapter III of chapter 37 of title 31 or any similar State statute; or

(B) for a tax or customs duty with respect to which the debtor--

(i) made a fraudulent return; or

(ii) willfully attempted in any manner to evade or to defeat such tax or such customs duty.

28 U.S.C. § 137 – Division of business among district judges:

The business of a court having more than one judge shall be divided among the judges as provided by the rules and orders of the court.

The chief judge of the district court shall be responsible for the observance of such rules and orders, and shall divide the business and assign the cases so far as such rules and orders do not otherwise prescribe.

If the district judges in any district are unable to agree upon the adoption of rules or orders for that purpose the judicial council of the circuit shall make the necessary orders.

28 U.S.C. § 455 – Disqualification of justice, judge, or magistrate judge:

(a) Any justice, judge, or magistrate judge of the United States shall disqualify himself in any proceeding in which his impartiality might reasonably be questioned.

(b) He shall also disqualify himself in the following circumstances:

(1) Where he has a personal bias or prejudice concerning a party, or personal knowledge of disputed evidentiary facts concerning the proceeding;

(2) Where in private practice he served as lawyer in the matter in controversy, or a lawyer with whom he previously practiced law served during such association as a lawyer concerning the matter, or the judge or such lawyer has been a material witness concerning it;

(3) Where he has served in governmental employment and in such capacity participated as counsel, adviser or material witness concerning the proceeding or expressed an opinion concerning the merits of the particular case in controversy;

(4) He knows that he, individually or as a fiduciary, or his spouse or minor child residing in his household, has a financial interest in the subject matter in controversy or in a party to the proceeding, or any other interest that could be substantially affected by the outcome of the proceeding;

(5) He or his spouse, or a person within the third degree of relationship to either of them, or the spouse of such a person:

(i) Is a party to the proceeding, or an officer, director, or trustee of a party;

(ii) Is acting as a lawyer in the proceeding;

(iii) Is known by the judge to have an interest that could be substantially affected by the outcome of the proceeding;

(iv) Is to the judge's knowledge likely to be a material witness in the proceeding.

(c) A judge should inform himself about his personal and fiduciary financial interests, and make a reasonable effort to inform himself about the personal financial interests of his spouse and minor children residing in his household.

(d) For the purposes of this section the following words or phrases shall have the meaning indicated:

(1) "proceeding" includes pretrial, trial, appellate review, or other stages of litigation;

(2) the degree of relationship is calculated according to the civil law system;

(3) "fiduciary" includes such relationships as executor, administrator, trustee, and guardian;

(4) "financial interest" means ownership of a legal or equitable interest, however small, or a relationship as director, adviser, or other active participant in the affairs of a party, except that:

(i) Ownership in a mutual or common investment fund that holds securities is not a "financial interest" in such securities unless the judge participates in the management of the fund;

(ii) An office in an educational, religious, charitable, fraternal, or civic organization is not a "financial interest" in securities held by the organization;

(iii) The proprietary interest of a policyholder in a mutual insurance company, of a depositor in a mutual savings association, or a similar proprietary interest, is a "financial interest" in the organization only if the outcome of the proceeding could substantially affect the value of the interest;

(iv) Ownership of government securities is a "financial interest" in the issuer only if the outcome of the proceeding could substantially affect the value of the securities.

(e) No justice, judge, or magistrate judge shall accept from the parties to the proceeding a waiver of any ground for disqualification enumerated in subsection (b). Where the ground for disqualification arises only under subsection (a), waiver may be accepted provided it is preceded by a full disclosure on the record of the basis for disqualification.

(f) Notwithstanding the preceding provisions of this section, if any justice, judge, magistrate judge, or bankruptcy judge to whom a matter has been assigned would be disqualified, after substantial judicial time has been devoted to the matter,

because of the appearance or discovery, after the matter was assigned to him or her, that he or she individually or as a fiduciary, or his or her spouse or minor child residing in his or her household, has a financial interest in a party (other than an interest that could be substantially affected by the outcome), disqualification is not required if the justice, judge, magistrate judge, bankruptcy judge, spouse or minor child, as the case may be, divests himself or herself of the interest that provides the grounds for the disqualification.

U.S. District Court (Central District) General Order No. 224 (Oct. 22, 1993) Section 1.2 – Assignment of Civil Cases:

The assignment of civil cases shall be completely at random through the Automated Case Assignment System, or otherwise, as approved by the Court and under the supervision of the Chief Judge. The assignments shall be in such a manner that each active judge of the Court over a period of time shall be assigned substantially an equal number of cases.

Neither the Clerk nor any Deputy Clerk shall have discretion in determining the judge to whom any civil case shall be assigned. The action of the Clerk in the assignment of cases is ministerial only.

U.S. Bankruptcy Court (Central District) General Order No. 99-02 (March 31, 1999) – Procedure for Assignment and Reassignment of Related Cases and Proceedings:

Assignment of Related Cases

The following procedure shall be used for the assignment of related cases by the Clerk of the Court.

When a "Rule 1015-2 Statement" (as defined in Local Bankruptcy Rule 1015-2(2)(b)) discloses a Related Case (as defined in Local Bankruptcy Rule 1015-2(1)) which is or was pending in this District, the newly-filed case shall be assigned by the Clerk in the following manner:

(a) Except as provided in subsection (c), if the Judge to whom such Related Case was most recently assigned is still in office, then to such judge;
(b) If such Judge is no longer in office, then according to the administrative orders of this Court; and
(c) If the new petition was properly filed in a division of this District different from the division in which the Judge to whom the prior case was assigned

now sits, the new case will be assigned to a Judge in the division in which it was filed and not to the Judge to whom the prior case was assigned.

U.S. Bankruptcy Court (Central District) Local Bankruptcy Rule 1015-2 (Jan. 2008) – Related Cases:

(a) DEFINITION OF RELATED CASES

Cases shall be deemed "related cases" for purposes of this Local Bankruptcy Rule if the earlier bankruptcy case was filed or pending at any time before the filing of the new petition, and the debtors in such cases:

(1) Are the same;

(2) Are spouses or ex-spouses;

(3) Are "affiliates," as defined in 11 U.S.C. § 101(2), except that § 101(2)(B) shall not apply;

(4) Are general partners in the same partnership;

(5) Are a partnership and one or more of its general partners;

(6) Are partnerships that share one or more common general partners; or

(7) Have, or within 180 days of the commencement of either of the related cases had, an interest in property that was or is included in the property of another estate under 11 U.S.C. § 541(a).

(b) DISCLOSURE OF RELATED CASES

(1) A petition commencing a case shall be accompanied by Official Form F 1015-2.1, "Statement of Related Cases."

(2) Official Form F 1015-2.1 shall be executed by the petitioner under penalty of perjury and shall disclose, to the petitioner's best knowledge, information and belief:

(A) Whether any related case(s) was filed or has been pending at any time.

(B) The name of the debtor in related case(s).

(C) The case number of related case(s).

(D) The district and division in which related case(s) is or was pending.

(E) The judge(s) to whom related case(s) was assigned.

(F) The current status of the related case(s).

(G) The manner in which the cases are related.

(H) Any real property included in "Schedule A - Real Property" that was filed with any prior proceeding.

(3) The failure fully and truthfully to provide all information required by Official Form F 1015-2.1 may subject the petitioner and its attorney to appropriate sanctions, including without limitation conversion, the appointment of a trustee or the dismissal of the case with prejudice.

(4) Unless otherwise ordered by the court, any petition (including emergency) that is not accompanied by Official Form F 1015-2.1 shall be deemed deficient.

CERTIFICATION OF COMPLIANCE

I hereby certify that the foregoing brief complies with the type-volume limitation provided in Rule 32(a)(7)(C)(i) of the Federal Rules of Appellate Procedure. The foregoing brief contains 13,984 words of Times New Roman (14 pt) proportional type. Microsoft Word is the word-processing software that was used to prepare the brief.

/s/ Collin O'Connor Udell
Collin O'Connor Udell

CERTIFICATE OF SERVICE

I hereby certify that on February 13, 2011, I electronically filed the foregoing with the Clerk of the Court for the United States Court of Appeals for the Ninth Circuit by using the appellate CM/ECF system.

Participants in the case who are registered CM/ECF users will be served by the appellate CM/ECF system.

I further certify that some of the participants in the case are not registered CM/ECF users. I have mailed the foregoing document by First-Class Mail, postage prepaid, or have dispatched it to a third party commercial carrier for delivery within 3 calendar days, to the following non-CM/ECF participant:

Jeffrey W. Chambers
Ware Jackson Lee Chambers
2929 Allen Parkway
America Tower 42nd Floor
Houston, TX 77019

/s/ Collin O'Connor Udell
Collin O'Connor Udell

14321834.2.LITIGATION