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IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MONTANA
MISSOULA DIVISION

IN RE: STEVEN VINCENT SANN, Debtor.	U.S. District Court Case No. 9:15-cv-00057-DLC
STEVEN V. SANN, Appellant, vs. GAIL BREHM GEIGER, Acting United States Trustee, FEDERAL TRADE COMMISSION, and MONTANA DEPARTMENT OF REVENUE, Appellees.	Bankruptcy Court Case No. 14-61370-RBK **RESPONSE BRIEF FOR APPELLEE FEDERAL TRADE COMMISSION**

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The Court should affirm the decision of the bankruptcy court to convert this case from a chapter 11 to a chapter 7 proceeding. Appellant Steven Vincent Sann concedes that under Section 1112(b) of the Bankruptcy Code, 11 U.S.C. § 1112(b), the case must be either converted or dismissed. The bankruptcy court acted well within its discretion when it concluded that conversion rather than dismissal would be in "the best interests of creditors and the estate." Appendix ("App.") 25 [Bankruptcy Court Docket No. ("Bank. Dkt.") 248 at 25]. The court properly determined in its thorough and well-reasoned opinion that conversion would be "far more advantageous to all creditors than dismissing the case and leaving Sann in … control [of] … his assets." *Id.* Among other things, Sann has proven himself untrustworthy, not only having been convicted of multiple felonies but also having violated court orders intended to preserve his assets. Moreover, conversion would allow a trustee to investigate Sann's financial affairs, marshal his assets, and secure the return of improperly transferred assets for the benefit of all creditors. Dismissal would have no such benefits.

I. JURISDICTIONAL STATEMENT

The Federal Trade Commission ("FTC") adopts the "Statement of Appellate Jurisdiction" in the Brief of the Acting United States Trustee ("UST").

II. STATEMENT OF THE ISSUE

Section 1112(b) of the Bankruptcy Code requires that, when "cause" is shown, the bankruptcy court must either convert a chapter 11 case to a chapter 7 case or dismiss it, whichever is in the best interests of creditors and the estate. Sann concedes that there was such "cause" here. The only issue presented is whether the bankruptcy court abused its discretion in deciding to convert the case rather than dismiss it.

III. STATEMENT OF THE CASE

This case involves the conversion of Sann's bankruptcy case from one governed by chapter 11 of the Bankruptcy Code to one governed by chapter 7. The bankruptcy was precipitated by civil and criminal charges against Sann, as described below.

A. Statutory Background

The Bankruptcy Code created several mechanisms for relief to debtors whose liabilities exceed their assets. Individual debtors may file under chapters 7, 11, or 13 of the Code. Here, chapters 7 and 11 are most pertinent.

When a debtor files under chapter 11, 11 U.S.C. § 1101 *et seq.,* the debtor retains its assets, its "estate" (which is defined to include all of the debtor's assets with some exceptions) is reorganized, debts are restructured, and creditors are paid (usually less than they are owed) pursuant to a plan that must be approved by a

bankruptcy court. *See generally* 1-1 *Collier Bankruptcy Manual* ¶ 1.07[3] (4th ed. 2015). Typically, the debtor itself remains in control of the estate (and is called a "debtor-in-possession," *see* 11 U.S.C. § 1101) during the bankruptcy proceedings. Once the plan is approved, all debts formerly owed are discharged, with some exceptions for non-dischargeable debts. 11 U.S.C. § 1141. The purpose of chapter 11 "is to permit a potentially viable debtor to restructure and emerge from bankruptcy protection." *Casse v. Key Bank Nat'l Ass'n (In re Casse)*, 198 F.3d 327, 334 (2d Cir. 1999) (citation omitted).

In a proceeding under chapter 7, 11 U.S.C. § 701 *et seq.*, the debtor's estate is not reorganized but is liquidated by a trustee who collects the nonexempt property of the debtor, converts that property to cash, and distributes it equitably to all creditors. Creditors are typically paid less than they are owed. *See generally* 1-1 *Collier Bankruptcy Manual* ¶ 1.07[1] (4th ed. 2015); *see also* 11 U.S.C. § 704 (duties of trustee); *Coastal Production Credit Ass'n v. Oil Screw "Santee,"* 51 B.R. 1018, 1020 (S.D. Ga. 1985). The trustee has authority to recover assets improperly transferred by the debtor prior to the bankruptcy filing and that properly belong to the estate. *See* 11 U.S.C. § 544.

Section 1112(b) of the Bankruptcy Code provides that upon the "request of a party in interest," a chapter 11 case can be converted to a chapter 7 case or dismissed, "whichever is in the best interests of creditors and the estate, for cause …." 11 U.S.C. § 1112(b). To apply that provision, courts first assess whether "cause" exists using the nonexclusive list of factors in 11 U.S.C. § 1112(b)(4). If it does, the court then determines: 1) "whether dismissal, conversion, or the appointment of a [chapter 11] trustee or examiner is in the best interests of creditors and the estate," and 2) "whether there are unusual circumstances that establish that dismissal or conversion is not in the best interests of creditors and the estate." *Sullivan v. Harnisch* (*In re Sullivan*), 522 B.R. 604, 612 (B.A.P. 9th Cir. 2014) (citing 11 U.S.C. §§ 1112(b)(1), (b)(2)); *see also* 7 *Collier on Bankruptcy*, ¶ 1112.04[7] (16th ed. 2015).

If a chapter 11 case is converted, the estate is liquidated, and the assets are distributed as described above. If a chapter 11 case is dismissed, the debtor regains full control over its assets, and the debtor and its creditors are placed once again in the same positions they held before the bankruptcy filing.

B. The FTC's Civil Action Against Sann for Deceptive Trade Practices

On January 8, 2013, the FTC sued Sann and 12 other defendants for engaging in deceptive practices in violation of Section 5 of the FTC Act, 15 U.S.C.

§ 45. App. 167-184 [Bank. Dkt. 223-5]. The FTC alleges that Sann and his co-defendants engaged in a "cramming" scheme to place $70 million of charges on consumers' phone bills for services that they never authorized or used. Other defendants include Sann's wife (Terry Lane) and a number of related business entities including relief defendant Bibliologic, Ltd. *Id.* The FTC sought a permanent injunction, equitable monetary relief, and the imposition of a constructive trust over Sann's assets derived from the illegal scheme.

On May 8, 2013, this Court entered a preliminary injunction against Sann enjoining the cramming scheme and freezing his assets, including all assets listed in Sann's bankruptcy schedules in this case. App. 190-194 [Bank. Dkt. 223-6 at 6-10]. The Court nevertheless allowed Sann and Lane to spend up to $17,844 per month to support the mortgage on their primary residence and for other personal and business expenses. App. 195 [Bank. Dkt. 223-6 at 11]. At that rate of withdrawals, Sann and Lane have spent more than $400,000 of their assets since the asset freeze was imposed, including as much as $6,000 a month on meals, entertainment, and other personal expenses. *See* App. 14 [Bank. Dkt. 248 at 14]; App. 793-837 [Bank. Dkt. 225-17]. The asset freeze also permitted defendants to pay mortgages on two Montana properties known as "Big Waters Ranch" and the "Salmon Lake Property." App. 195-196 [Bank. Dkt. 223-6 at 11-12]. But despite

being allowed to withdraw money from the frozen assets to make those payments, Sann willfully refused to pay the mortgages for over 18 months, which led to foreclosure proceedings on the properties. App. 19 [Bank. Dkt. 248 at 19]. Additional frozen funds could be released only with the consent of the FTC or by court order. App. 196 [Bank. Dkt. 223-6 at 12]. Despite that restriction, Sann paid his bankruptcy counsel before the bankruptcy filing without authorization. App. 578 [Bank. Dkt. 222-2 at 27 (item 9)].

C. Parallel Criminal Fraud Action Relating to Sann's Deceptive Conduct

On September 12, 2013, Sann was indicted by a grand jury on 35 counts of criminal wire fraud, money laundering, and conspiracy arising from substantially the same conduct at issue in the FTC's civil case. App. 109-126 [Bank. Dkt. 53-3, 223-8]. On April 3, 2015, after agreeing with the government's offer of proof substantiating the criminal charges for one count of wire fraud and one count of money laundering, he pled guilty to those two counts. App. 147-153, 157-166 [Bank. Dkt. 223-9, 223-10 at 21-27]. On July 17, 2015, Sann was sentenced to two years in prison and ordered to pay a forfeiture of $500,000. No. CR-13-43-M-DLC (Doc. 102, 103).

D. Sann's Bankruptcy Case

While the criminal and civil cases were pending, on September 29, 2014, Sann filed a voluntary chapter 11 petition in the District of Nevada. App. 32-50 [Bank. Dkt. 1]. From the start, his petition was problematic. Sann sought reorganization, but he lacked any legitimate operating businesses to reorganize. Of the twenty businesses he claimed to own or control, nearly all were defunct and two companies had no ongoing operations, but merely received rents or receivables. App. 538-539 [Bank. Dkt. 222-1 at 42-43 (item 18)]; App. 581-82 [Bank. Dkt. 222-2 at 30-31 (item 18); App. 219-222 [Bank. Dkt. 223-4 at 48-58]. Sann's schedules and Statement of Financial Affairs supporting his filing were inaccurate. He initially reported expenses of $37,349 per month (mainly the mortgages he stopped paying in March 2013), but later admitted he only had $9,607 in monthly expenses. *Compare* App. 527-528 [Bank. Dkt. 222-1 at 31-32 (Schedule J)] *with* App. 572 [Bank. Dkt. 222-2 at 20-21 (Schedule J)]. Similarly, Sann initially reported liabilities of $3.3 million; in fact, he owed approximately $5.5 million including significant state and federal tax liabilities. *Compare* App. 501 [Bank. Dkt. 222-1 at 5] *with* App. 590 [Bank. Dkt. 222-3 at 6]. He failed to list the FTC and Montana as large "contingent" creditors even though he knew of their pending claims. App. 448-449 [Bank. Dkt. 53-6]. Moreover, Sann acknowledged that he had given

others much of his property, App. 535-536 [Bank. Dkt. 222-1 at 39-40, item 10), App. 578-579 [Bank. Dkt. 222-2 at 27-28, item 10), but he filed no avoidance actions to regain that property for the benefit of the estate.

Indeed, the case was not properly brought in Nevada to begin with. Sann asserted domicile there even though the terms of a 2013 guilty plea in an unrelated case forbade him from leaving Montana without permission. App. 440 [Bank. Dkt. 53-4 at 2]; App. 88-89, 96, 100 [Bank. Dkt. 223-3 at 6-7, 14, 18]. Moreover, as the Nevada bankruptcy court ultimately concluded, "[o]ne of the primary purposes here for filing the case appears to be to simply escape the existing exercise of jurisdiction by the Article III Court in Montana," which had frozen Sann's assets in the FTC litigation. App. 106 [Bank. Dkt. 223-3 at 24]. The FTC thus moved to transfer, and on November 20, 2014, the Nevada bankruptcy court transferred the case to the Montana bankruptcy court. App. 61-62 [Bank. Dkt. 114, 223-2].

Motions filed by Sann in the bankruptcy case similarly represented back-door attempts to evade the asset freeze in the FTC's civil case. In Nevada, he sought to transfer to himself both real property he had fraudulently transferred to several of his co-defendants in the FTC civil suit and funds held in the trust accounts of his various civil and criminal defense attorneys. All of those assets were subject to the asset freeze order. App. 597-607 [Bank. Dkt. 222-10] (Sann withdrew that motion

before it was acted upon). He then tried the same approach before this Court, asking that it "transfer all assets" – *i.e.*, frozen assets – to the bankruptcy court. Case No. 9:13-cv-00003 (D. Mont.), Dkt. 94, 99. This Court denied Sann's motion because Sann had a "history of unauthorized use of frozen assets" to pay his bankruptcy lawyers and because any assets resulting from the cramming scheme would not be estate property and thus not within the bankruptcy court's jurisdiction. App. 656-660 [Bank. Dkt. 223-7].

Sann's conduct as debtor-in-possession during the chapter 11 proceeding also proved problematic. He regularly filed monthly operating reports late, prompting the bankruptcy court to issue multiple show cause orders. Bank. Dkt. 132, 133, 148, 171. He also failed to receive the required bankruptcy court approval before hiring professionals, refused to produce documents requested by the U.S. Trustee and the Montana Department of Revenue, and failed to file a chapter 11 disclosure statement or plan.

E. The Bankruptcy Court's Decision on Review

On March 6, 2015, the U.S. Trustee, subsequently joined by the FTC and the Montana Department of Revenue, filed a motion to dismiss or convert the chapter 11 proceeding to a liquidation case under chapter 7. At an April 16, 2015, hearing on the motion, Sann conceded that "cause" existed under 11 U.S.C. § 1112(b)(1). He argued that the case should not be converted to a Chapter 7 case, but should

simply be dismissed. App. 309 [April 16, 2015 hearing tr. at 12].[1] In the April 29, 2015, ruling on review, the court ordered that the case be converted to a chapter 7 liquidation such that a trustee would carry out the liquidation process. App. 1-28 [Bank. Dkt. 248, 250].

The bankruptcy court agreed with the parties that cause existed to convert or dismiss the case under four of the criteria of 11 U.S.C. § 1112(b)(4). The court found that Sann's $17,844 monthly draw constituted a "substantial and continuing loss or diminution of the estate" within the meaning of § 1112(b)(4)(A). App. 18-19 [Bank. Dkt. 248 at 18-19]. The court found further that Sann had grossly mismanaged the estate within the meaning of § 1112(b)(4)(B) by failing to pay mortgages (with funds exempted from the asset freeze for that purpose) which lead to foreclosure proceedings, by paying his bankruptcy attorneys without authorization, and by failing to initiate actions to recover fraudulent transfers. Finally, the court found that Sann failed to timely file his monthly operating reports

[1] Sann did not contend that "unusual circumstances" barred conversion or dismissal under 11 U.S.C. § 1112(b)(2), and the bankruptcy court found that there were no such "unusual circumstances." The court further determined that Section 1112(b)(2) would not apply in any event because one of the grounds for conversion or dismissal was diminution of the estate. Section 1112(b)(2) does not apply in that situation. App. 20, 26 [Bank. Dkt. 248 at 20, 26].

under § 1112(b)(4)(F), and he failed to file the required disclosure statement or plan under § 1112(b)(4)(J). App. 19-20 [Bank. Dkt. 248 at 19-20].

The court next determined that conversion would be "far more advantageous to all creditors than dismissing the case and leaving Sann in whatever control he has in his assets." App. 25 [Bank. Dkt. 248 at 25]. Noting Sann's criminal convictions, forum shopping, and improper diversion of funds that were supposed to pay mortgages, the court found that dismissal would leave Sann "in place, subject to a preliminary injunction and asset freeze which he has demonstrated he has violated." App. 23 [Bank. Dkt. 248 at 23]. Sann had "committed criminal offenses" and "ignored his fiduciary obligations to creditors." *Id*. In contrast, a chapter 7 trustee could investigate Sann's business affairs, marshal his assets, and possibly cure the defaulted mortgages. *Id.* A trustee also would have the incentive, which Sann does not, to seek to "stop the $17,844 monthly draw" from the estate and to cure the mortgage defaults and preserve estate property. App. 24 [Bank. Dkt. 248 at 24]. A trustee also could negotiate a settlement with the FTC and the Montana Department of Revenue, "which Sann cannot do because of the state of his relations with these entities." *Id*. Conversion would also "extend[] the lookback period for recovering property" that Sann improperly transferred out of the estate, while dismissal would have no such benefit to creditors. *Id*. The court recognized that Sann's impending

imprisonment would "constrain[]" his ability to defend against the foreclosure actions. App. 22 [Bank. Dkt. 248 at 22].

The court rejected Sann's contention that dismissal would benefit creditors because he was likely to prevail over the FTC in its lawsuit, presumably leaving the rest of his assets available for other creditors. App. 24 [Bank. Dkt. 248 at 24]. Given Sann's guilty plea to criminal charges stemming from the same course of conduct, winning against the FTC was "unlikely," the Court determined, and in the meantime creditors would have to wait for the litigation to conclude. *Id*. Conversion to a chapter 7 proceeding therefore was "in the best interests of creditors and the estate." App. 26 [Bank. Dkt. 248 at 26].

IV. STANDARD OF REVIEW

The bankruptcy court has broad discretion under 11 U.S.C. § 1112(b), and its conclusion that conversion is in the best interests of the creditors and the estate can be reversed only if Sann shows an abuse of that discretion. *Shulkin Hutton, Inc., P.S. v. Treiger (In re Owens)*, 552 F.3d 958, 960-61 (9th Cir. 2009). "A bankruptcy court abuses its discretion if it applies the law incorrectly or if it rests its decision on a clearly erroneous finding of material fact." *Marshall v. Marshall (In re Marshall)*, 721 F.3d 1032, 1039 (9th Cir. 2013). Because Sann concedes that the bankruptcy court applied the proper legal standard, *see* Appellant's Brief ("Br.") 13,

he can prevail only if the bankruptcy court's factual findings were clearly erroneous. To show clear error, Sann must meet the heavy burden of showing that the bankruptcy court's factual determinations were "illogical, implausible, or without support in the record." *Sullivan*, 522 B.R. at 612 (citing *United States v. Hinkson*, 585 F.3d 1247, 1261-62 (9th Cir. 2009) (en banc)). The bankruptcy court's decision may be affirmed on any ground supported by the record. *Rosson v. Fitzgerald (In re Rosson)*, 545 F.3d 764, 777 (9th Cir. 2008) (citation omitted).

V. SUMMARY OF ARGUMENT

The bankruptcy court acted well within its discretion when it concluded that conversion to chapter 7 rather than dismissal would be in the "best interests of creditors and the estate." Sann engaged in ongoing misconduct both in and outside of bankruptcy that shows that he cannot be trusted to protect his creditors' assets if the case were dismissed. Sann also depleted the bankruptcy estate and would likely continue to do so if the case were dismissed and he retained control of the assets. Creditors would suffer as a result.

By contrast, conversion of the case and appointment of a chapter 7 trustee will protect the interests of creditors and the estate. The trustee can seek to stop the depletion of estate assets, resolve the foreclosure proceedings pending against two major estate assets, recover fraudulent transfers, and settle government charges.

Conversion also will best protect *all* of Sann's creditors because the trustee would distribute estate assets *pro rata* to all creditors. Dismissal would lead to a winner-take-all approach, under which the first creditor to recover could receive the lion's share of the assets, to the detriment of other creditors. A trustee also could reach back further to regain such transfers than could creditors outside of bankruptcy.

Sann does not even challenge the bankruptcy court's finding that he is an untrustworthy steward of the estate. That finding is sufficient in itself to sustain the judgment. In any event, Sann's arguments lack merit. His argument that the bankruptcy court erred by opining that his chances of prevailing against the FTC was "unlikely" fails because the FTC's suit is based on the same facts as Sann's criminal convictions. For similar reasons, his complaint that the bankruptcy court improperly relied upon the higher likelihood that a trustee could settle the government charges is meritless. He fails in his further contention that the court erred in concluding that he could not effectively defend against the FTC's charges while in prison, because the court instead made the perfectly reasonable observation that his ability to defend himself would be "constrained." His argument that the court ignored the rights of his wife to disbursements under the asset freeze is misplaced because she is not a creditor. The court properly focused on the best interests of creditors and the estate. Sann's assertion that creditors outside of

bankruptcy could recover fraudulent transfers as well as the trustee within bankruptcy ignores both the trustee's singular ability to distribute recovered assets *pro rata* to all creditors and its more favorable lookback authority.

VI. THE BANKRUPTCY COURT PROPERLY EXERCISED ITS DISCRETION TO CONVERT SANN'S BANKRUPTCY CASE FROM CHAPTER 11 TO CHAPTER 7

Section 1112(b) of the Bankruptcy Code provides that upon a showing of cause, "the court *shall* convert" a chapter 11 case into a chapter 7 one or dismiss it, "whichever is in the best interests of creditors and the estate." 11 U.S.C. § 1112(b) (emphasis added). The interests of the *debtor* play no part in the analysis. *In re Staff Inv., Co.,* 146 B.R. 256, 261 (E.D. Cal. 1992). The determination is committed to the sound discretion of the bankruptcy court. *Sullivan,* 522 B.R. at 612.

A. The Bankruptcy Court Correctly Decided To Convert

The bankruptcy court found numerous reasons why conversion would be "far more advantageous to all creditors than dismissing the case and leaving Sann in … control" of his assets. App. 25 [Bank. Dkt. 248 at 25]. That decision was correct.

First, the record showed that Sann had not been a trustworthy steward of the estate and likely would not protect his creditors' assets outside of bankruptcy. He had already: 1) violated the asset freeze through "unauthorized payments" to his

bankruptcy attorneys; 2) committed criminal fraud; 3) failed to receive the required permission before attempting to move his residence; 4) engaged in forum shopping with the intent to evade the asset freeze; and 5) "ignored his fiduciary obligations to creditors" by failing to pay mortgages on estate property. App. 23 [Bank. Dkt. 248 at 23]. That consistent pattern of misconduct – "gross mismanagement of the estate" the bankruptcy court put it, App. 19, 25 [Bank. Dkt. 248 at 19, 25] – amply supports the inference that Sann likely would behave no better in the future. On that record – unchallenged by Sann – the bankruptcy court correctly found that converting the case and removing Sann from control of the assets would be "far more advantageous to creditors than dismissing the case." App. 25 [Bank. Dkt. 248 at 25]. *See* 7 *Collier on Bankruptcy,* ¶ 1112.04[7] (debtor misconduct favors conversion). Indeed, in light of Sann's pattern of misconduct, it would have been clear error *not* to convert this case. *See Kates v. Mazzocone (In re Mazzocone)*, 180 B.R. 782, 788 (E.D. Pa. 1995) (bankruptcy court erred in dismissing case by failing to consider allegations that debtor improperly transferred assets, made improper payments, and failed to maintain financial records).

Second, the record showed that conversion, and the concomitant appointment of a trustee, was necessary to preserve the value of the estate. Sann has siphoned up to $17,844 each month from the estate since the asset freeze went

into effect; at that rate, he has dissipated more than $400,000 of assets since May 2013. Conversion would allow a chapter 7 trustee to seek reduction or elimination of the asset freeze loophole. App. 23, 24 [Bank. Dkt. 248 at 23, 24]. Had the case been dismissed and assets left in Sann's hands, he would have had no incentive to cut off his own cash flow.

Sann also has failed to pay the mortgage on two valuable properties, which as a result are now in foreclosure proceedings. A trustee can attempt to cure the mortgage defaults and stop the foreclosure proceedings. Dismissal, by contrast, would have left Sann to handle the foreclosure litigation. As the bankruptcy court found, Sann's impending two-year prison sentence will "constrain" his ability to litigate the cases. App. 22 [Bank. Dkt. 248 at 22]. The trustee also can seek recovery of assets fraudulently transferred out of the estate. App. 23 [Bank. Dkt. 248 at 23]. And as the bankruptcy court noted, a trustee (unlike Sann, who has proved to be untrustworthy) could negotiate in good faith with the FTC and Montana to settle their claims against the estate. App. 24 [Bank. Dkt. 248 at 24]. The best interests of the estate turn on "whether the economic value of the estate is greater inside or outside of bankruptcy." *Staff Inv.,* 146 B.R. at 261. The court properly found that conversion will lead to an estate of greater value than dismissal.

Third, the record showed that conversion would best protect the rights of all creditors. *See* 7 *Collier on Bankruptcy*, ¶ 1112.04[7] (courts should consider whether creditors would lose rights if case were dismissed rather than converted). Indeed, both the FTC and Montana Department of Revenue, two large creditors, sought conversion – no creditor requested dismissal. *See In re Stokes*, No. 09-60265-11, 2009 WL 3062314, at *19 (Bankr. D. Mont. Sept. 21, 2009) ("[t]he interest of a single creditor with a large enough claim will suffice under the § 1112(b) test.") (citations omitted).

Further, as debtor-in-possession, Sann did not file actions to seek the return of property that had been fraudulently transferred to third parties, despite his fiduciary duty to creditors to do so. Had the case been dismissed, Sann's non-federal-government creditors could have pursued fraudulent transfer actions only under Montana law, which has a four-year statute of limitations. Mont. Code Ann. § 31-2-341 (2015). As the bankruptcy court recognized, "keeping the case in bankruptcy …. extends the lookback period for recovering property …." App. 24 [Bank. Dkt. 248 at 24]. This is because, since the federal government is a creditor, the chapter 7 trustee can seek the return of *all* fraudulent transfers under a six-year statute of limitations. *See* 28 U.S.C. §§ 3304, 3306(b) (fraudulent transfer provisions under the Federal Debt Collection Procedure Act ("FDCPA"); *see also*

11 U.S.C. § 544(b)(1) (trustee succeeds to the rights of any unsecured creditor to "avoid any transfer of an interest of the debtor in property …. that is voidable under applicable law …."); *Koch Ref. v. Farmers Union Cent. Exch., Inc.,* 831 F.2d 1339, 1348-49 (7th Cir. 1987) ("[a]llegations that could be asserted by any creditor could be brought by the trustee as a representative of all creditors"); *Gordon v. Harrison (In re Alpha Protective Servs.)*, 531 B.R. 889, 905-906 (Bankr. M.D. Ga. 2015) (the FDCPA constitutes "applicable law" under Section 544(b)(1) such that a trustee steps into the shoes of a federal creditor to use the FDCPA lookback). The two-year difference is critical here, because Sann began transferring assets more than four years ago. If the case had been dismissed, many creditors would likely have lost the ability to recover substantial assets.[2]

[2] Sann asserts that creditors outside of bankruptcy have the same rights as the chapter 7 trustee, in part, because the limitations period to bring a fraudulent transfer claim in Montana is stayed while a case is in bankruptcy. Br. 15 (citing Mont. Code Ann. § 27-2-406 (2015)). By failing to raise this argument below, Sann waived it. In any event, even if the limitation period had been stayed, it is likely that at least some creditors would not have brought avoidance actions within the remaining limitations period. In contrast, the trustee has, under 11 U.S.C. § 546(a), up to two years after the filing of the bankruptcy petition on September 29, 2014 to bring an avoidance action, and its lookback period is established as of the petition date. *See Rund v. Bank of Am. Corp*. (*In re EPD Inv. Co., LLC),* 523 B.R. 680, 685-86 (B.A.P. 9th Cir. 2015). In other words, the trustee has until September 29, 2016 to seek the return of fraudulent transfers that occurred up to six years before September 29, 2014.

Moreover, in a chapter 7 proceeding, any property that the trustee recovers in a fraudulent transfer action is recovered "for the benefit of the estate," 11 U.S.C. § 550(a) – *i.e.,* for the benefit of *all* creditors – and any proceeds derived from the sale of that property would be distributed *pro rata* to *all* creditors, not just some of them. *See Koch Ref.*, 831 F.2d at 1352 ("the paramount duty of a trustee …. is the amassing of estate assets for a *pro rata* distribution to all creditors."); *Gordon*, 531 B.R. at 906 (trustee "recover[s] the property for the benefit of the estate") (quoting *In re Equip. Acquisition Res., Inc.*, 742 F.3d 743, 746 (7th Cir. 2014)). By contrast, had the case been dismissed, each creditor would have been required to file its own lawsuit to seek the return of fraudulent transfers. The first filers would have been entitled to all of the assets they recovered, and late filers would have been able to recover only what was left – which likely would have been nothing.

B. Sann's Arguments Lack Merit

Sann does not challenge the bankruptcy court's well-supported findings that he is insufficiently trustworthy to remain in control of his assets without bankruptcy court supervision. By themselves, those findings fully support the court's judgment that the case be converted and not dismissed because the appointment of a chapter 7 trustee will be "more advantageous" to creditors. On review, this court need not proceed further.

Sann's main argument is that the bankruptcy court erroneously determined that Sann was unlikely to defeat the FTC in its lawsuit against him. Br. 14. He does not say so explicitly, but his point appears to be that if he wins the FTC case, there will be more money in the estate to satisfy other creditors. *See*, *e.g.*, App. 22 [Bank. Dkt. 248 at 22]. Thus, the argument goes, other creditors will be better off if he is left in charge of the assets and free to litigate the FTC case.

Sann is wrong that that the bankruptcy court incorrectly assessed his likelihood of success against the FTC. In fact, the court's probability determination was a reasonable inference from the record. The court found that "[w]hile it certainly is possible that Sann ultimately will prevail against the FTC," that outcome was "unlikely." App. 24 [Bank. Dkt. 248 at 24]. It reached that conclusion because Sann had already pleaded guilty to criminal charges arising from the same set of facts as the FTC's suit. *See* App. 109-126, 157-166, 167-184 [Bank. Dkt. 223-5, 223-8, 223-9]. Indeed, the government faces a higher burden of proof in a criminal case than a civil case. Moreover, Sann did not object at the plea hearing to the government's offer of proof substantiating those charges. App. 149-151 [Bank. Dkt. 223-10 at 23-25]. Sann's more optimistic assessment of his likelihood of success does not nearly meet his burden to show that the court's

conclusion was "illogical, implausible, or without support in the record." *Sullivan*, 522 B.R. at 612.

The same reasoning defeats Sann's claim that the court abused its discretion when it concluded that a chapter 7 trustee could negotiate a settlement of the FTC's claims more effectively than Sann. Br. 16. Sann asserts that the court erred because its conclusion assumes that the FTC has a valid claim in the first place. Given Sann's guilty plea to criminal charges stemming from the same conduct at issue in the FTC case, the court acted well within its discretion when it assumed the FTC's claims likely have merit. Sann's assertion that the FTC and the trustee simply want to "make a deal," Br. 16, ignores the trustee's fiduciary duty to act in the best interest of all creditors and the role of the bankruptcy court to ensure that any proposed settlement is "fair and equitable" to all creditors. *See* Fed. R. Bank. Proc. 9019(a); *Martin v. Kane (In re A & C Properties)*, 784 F.2d 1377, 1380-81 (9th Cir. 1986) (review of proposed settlement must consider "the paramount interest of the creditors").[3] Indeed, a settlement that minimized litigation costs would leave more assets for other creditors.

[3] This is particularly true because any funds in Sann's possession determined to result from the cramming scheme and thus part of the equitable constructive trust remedy sought by the FTC for the benefit of injured consumers will not be deemed "property of the estate" under 11 U.S.C. § 541(d) and will not be distributed to
[footnote continues on next page]

Likewise without merit is Sann's contention that the bankruptcy court improperly found that Sann could not effectively litigate the various matters pending against the bankruptcy estate while he is incarcerated. Br. 14. The court did not find that Sann could not defend himself while in prison, but noted that his ability to do so would be "constrained." App. 22 [Bank. Dkt. 248 at 22]. Given the restrictions placed on prison inmates, that conclusion was plainly reasonable. Indeed, Sann recently admitted in a motion in his criminal case that "[i]n prison, it will be enormously difficult to assist his attorneys and accountants with the pending FTC litigation and bankruptcy appeal …." No. 9:13-cr-00043-DLC, Doc. No. 100 at 2 (D. Mont. July 1, 2015).[4]

Sann next argues that the bankruptcy court erred in its conclusion that a chapter 7 trustee could seek to reduce the amount of money Sann withdraws monthly from the estate under the asset freeze. The claim is that the court failed to recognize that Sann's wife also has an interest in those disbursements. Br. 15. Even if that were true, however, the court's statutory duty was to determine the best interests of the creditors. Sann's wife is not a creditor. Sann therefore has failed to

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other creditors. *See Taylor Assocs. v. Diamant (In re Advent Mgmt. Corp.)*, 104 F.3d 293, 295 (9th Cir. 1997) (citation omitted).

[4] The court may take judicial notice of such matters in the public record. *Lee v. City of Los Angeles*, 250 F.3d 668, 689 (9th Cir. 2001); Fed. R. Evid. 201(b).

explain how the alleged error would be a ground for reversal of the court's judgment that conversion would best serve the creditors and the estate.

In any event, Sann's argument fails on the facts. He provided no evidence in the bankruptcy court that his wife separately owned any portion of the monthly allowance. In fact, nearly all of the $17,844 that Sann and Lane have withdrawn from the estate each month derives from proceeds of a company (Sann, LLC) controlled by Sann that is undeniably part of the bankruptcy estate. *See* App. 581 [Bank. Dkt. 222-2 at 30]; App. 220-221 [Bank. Dkt. 223-4 at 52-53]. Thus, each withdrawal diminishes the estate and reduces the creditors' eventual recovery.

Sann next claims that a trustee is unnecessary to recover fraudulent transfers of property from the estate. Br. 15. As with his earlier claim, he does not explain how the court's determination to the contrary can amount to clear error. Even if Sann were correct that a trustee is not necessary to recover estate assets, he has not shown that dismissal of the case would protect creditors better than conversion. Indeed, as explained above, conversion provides significant benefits over dismissal by allowing the trustee to distribute any proceeds it receives through avoidance actions *pro rata* to all creditors. It also provides the trustee with a longer statute of limitations than individual creditors suing in state court.

Finally, Sann claims that converting the case was reversible error in the face of the bankruptcy court's recognition that "dismissal would avoid a potential for inconsistent decisions by this Court and the district court" adjudicating the FTC's civil enforcement case. App. 25 [Bank. Dkt. 248 at 25]; Br. 16. But after weighing *all* of the pertinent factors, pro and con, the court concluded that conversion "is far more advantageous to all creditors than dismissing the case …." App. 25 [Bank. Dkt. 248 at 25]. Sann's reliance on one factor that may have favored dismissal demonstrates no clear error in the court's overall balancing.

VII. CONCLUSION

For the foregoing reasons, this Court should affirm the April 29, 2015, decision of the bankruptcy court.

Respectfully submitted,

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Dated: September 2, 2015

CERTIFICATE OF COMPLIANCE

Pursuant to D. Montana Standing Order No. 12 (Revised) (Jan. 11, 2000) and D. Mont. Local Rule 7.1(d)(2), I hereby certify that the foregoing document consists of 5,948 words, excluding the caption, certificates, and tables of contents and authorities.

/s/ *Michael D. Bergman*
Michael D. Bergman
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Federal Trade Commission

CERTIFICATE OF SERVICE

I hereby certify that on September 2, 2015, a copy of the foregoing document was served via CM/ECF.

/s *Michael D. Bergman*
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