UNITED STATES BANKRUPTCY COURT

CENTRAL DISTRICT OF CALIFORNIA

LOS ANGELES DIVISION

In re **MARTIN PEMSTEIN and DIANA PEMSTEIN**, Debtors. **MARTIN PEMSTEIN**, Plaintiff, vs. **HAROLD PEMSTEIN**, Defendant.	Case No. 2:12-bk-15900-RK Chapter 11 Adv. No. 2:12-ap-02467-RK **SEPARATE STATEMENT OF DECISION ON DEFENDANT'S MOTION TO DISMISS ADVERSARY COMPLAINT**

Defendant Harold Pemstein has moved to dismiss the adversary complaint of plaintiff Martin Pemstein, one of the debtors in this joint Chapter 11 bankruptcy case, for failure to state a claim upon which relief can be granted pursuant to Rule 7012 of the Federal Rules of Bankruptcy Procedure, incorporating by reference, Rule 12(b)(6) of the Federal Rules of Civil Procedure.

Having considered the moving and opposing papers and the other papers and pleadings in this case, and having heard the oral arguments of the parties at the hearings on the motion, the court concludes that the motion should be granted.

In the adversary complaint, plaintiff alleged claims for breach of contract, contempt of court and declaratory relief against defendant on grounds that defendant breached a settlement agreement and stipulation purportedly fixing the amount of the claim that defendant had against plaintiff for unpaid rent, which was approved by an order of this court in other bankruptcy cases involving the companies that the parties had owned, *In re Pemma Corp.,* and *In re HMS Holding Co.,* No. SA 05-50043 JR Chapter 11, Jointly Administered with No. SA 05-50044 JR Chapter 11 (Bankr. C.D. Cal., order approving settlement stipulation filed on October 26, 2006 and entered on October 27, 2006).

Defendant had obtained a judgment for unpaid rent against plaintiff in state court by a judgment entered on January 5, 2010, which was the subject of a proof of claim filed by him with the court in this bankruptcy case. Plaintiff and his spouse as debtors in this bankruptcy case objected to defendant's proof of claim. Debtors' objection to defendant's proof of claim was fully litigated, including evidentiary hearings in which both plaintiff and defendant participated, and defendant's claim was allowed by final orders of this court entered on June 21, 2011 and October 17, 2012.

Debtors' Chapter 11 reorganization plan filed on January 21, 2011 and supplemented on March 16, 2011 and March 31, 2011 was objected to by defendant, and the objection to the plan was fully litigated by the parties, including an evidentiary hearing in which both plaintiff and defendant participated. The plan was confirmed by final order of this court on April 27, 2012, and the confirmed plan provided for payment of defendant's allowed claim.

Based on these circumstances, defendant has moved to dismiss plaintiff's adversary complaint for failure to state a claim upon which relief can be granted pursuant to Rule 7012 of the Federal Rules of Bankruptcy Procedure, incorporating by reference, Rule 12(b)(6) of the Federal Rules of Civil Procedure. A complaint must allege sufficient factual matter, which if accepted as true would "state a claim to relief that is plausible on its face." *Ashcroft v. Iqbal,* 556 U.S. 662, 129 S. Ct. 1937, 1949 (2009), *quoting, Bell Atlantic Corp. v. Twombly,* 550 U.S. 544, 570 (2007). A claim is facially plausible when a

court can draw a reasonable inference that the defendant is liable for misconduct. *Id.* The complaint must state a claim for relief that is plausible in order to survive a motion to dismiss. *Ashcroft v. Iqbal,* 129 S. Ct. at 1950. A dismissal without leave to amend should not be granted unless "the complaint could not be saved by any amendment." *Polich v. Burlington Northern, Inc.,* 942 F.2d 1467, 1472 (9th Cir. 1991) (citation omitted).

As a general rule, the court may not consider any material beyond the pleadings in considering a motion to dismiss under Rule 12(b)(6). *Lee v. City of Los Angeles,* 250 F.3d 668, 688 (9th Cir. 2001) (citation omitted). A court may "take judicial notice of matters of public record without converting a motion to dismiss into a motion for summary judgment . . . but [only when taking] judicial notice of a fact that is [not] subject to reasonable dispute. *Id.* at 689-690; *see also,* Fed. R. Evid. 201. In considering defendant's motion to dismiss, the court may take judicial notice of the proceedings before this court in this bankruptcy case, such as the matters described above relating to the orders for allowance of defendant's claim and the confirmation of debtors' reorganization plan in this case.

Defendant has moved to dismiss plaintiff's adversary complaint on grounds that the claims in the complaint are precluded by the res judicata effect of the state court judgment in his favor and against plaintiff and this court's orders allowing defendant's claim and that plaintiff's claims are barred by the doctrine of judicial estoppel.

A judgment may have preclusive effect under the doctrines of claim preclusion and issue preclusion, which are collectively known as res judicata. *Taylor v. Sturgell*, 553 U.S. 880, 892 and n. 3 (2008), *citing inter alia, New Hampshire v. Maine*, 532 U.S. 742, 748 (2001). "Under the doctrine of claim preclusion, a final judgment forecloses successive litigation of the very same claim, whether or not relitigation of the claim raises the same issues as the earlier suit." *Id.* Issue preclusion "bars 'successive litigation of an issue of fact or law that was actually litigated and resolved in a valid court determination essential to that prior judgment,' even if the issue recurs in the context of a different

claim." *Taylor v. Sturgell*, 553 U.S. at 892, *quoting, New Hampshire v. Maine*, 532 U.S. at 748-749.

Under the doctrine of claim preclusion, "a final judgment on the merits bars further claims by parties or their privies based on the same cause of action." *Brown v. Felsen,* 442 U.S. 127, 131 (1979), *quoting Montana v. United States,* 440 U.S. 147, 153 (1979). Under the federal standard of claim preclusion (or res judicata) applicable to this court's orders, three elements must be met for issue preclusion to apply: (1) an identity of claims; (2) a final judgment on the merits; and (3) privity between parties. *Stratosphere Litigation L.L.C. v. Grand Casinos, Inc.*, 298 F.3d 1137, 1142 n. 3 (9th Cir. 2002) (citation omitted). The doctrine of claim preclusion is applicable here because the court's orders allowing defendant's creditor claim involve the same cause of action since the plaintiff in this adversary proceeding seeks damages based on defendant's assertion of his creditor claim; the orders are final judgments on the merits; and the same parties are involved in both the claims allowance litigation and in this adversary proceeding. *See Complaint* at 3 ("By attempting to enforce the state court judgment in the bankruptcy matter of Martin and Diana Pemstein Defendant is further breaching the agreement."). Claim preclusion prevents litigation of all grounds for, or defenses to, recovery that were previously available to the parties, regardless of whether they were asserted or determined in the prior proceeding. *Brown v. Felsen,* 442 U.S. at 131, *citing Chicot County Drainage District v. Baxter,* 308 U.S. 371, 378 (1940). Plaintiff could have raised his claims of breach of contract and contempt of court now asserted in his adversary complaint earlier in objecting to defendant's creditor claim in the claims allowance litigation, but did not. The doctrine of claim preclusion prevents plaintiff from doing so now.

Under the federal standard of issue preclusion applicable to this court's orders, four elements must be met for issue preclusion to apply: (1) the issue sought to be precluded must be the same as that involved in the prior action; (2) the issue must have been actually litigated; (3) it must have been determined by a valid and final judgment;

and (4) the determination must have been essential to the final judgment. *Palm v. Klapperman (In re Cady)*, 266 B.R. 172, 183 (9th Cir. BAP 2001) (citation omitted). This court's orders allowing defendant's creditor claim meets this standard and bars further action of plaintiff to contest defendant's creditor claim. In this adversary action, plaintiff is seeking to litigate the validity of defendant's allowed creditor claim, which is the same issue already determined by the prior claims objection litigation. The allowance of defendant's creditor claim was actually litigated by the parties. The allowance of defendant's creditor claim was determined by valid and final judgments of this court, namely, the orders allowing the claims entered on June 21, 2011 and October 17, 2012. The determination of the issue of the validity of defendant's creditor claim was essential to the final orders allowing the claims. Accordingly, plaintiff is barred by the doctrine of issue preclusion from contesting defendant's creditor claim in this adversary proceeding.

This court's order confirming debtors' reorganization plan providing for payment of defendant's allowed claim also meets the federal standard for issue preclusion and bars further action of plaintiff to contest defendant's creditor claim. In this adversary action, plaintiff is seeking to litigate the validity of defendant's allowed creditor claim, which is the same issue already determined by the plan confirmation litigation resulting in an order for payment of defendant's creditor claim. The allowance of defendant's creditor claim was actually litigated by the parties in the plan confirmation proceedings. The allowance of defendant's creditor claim was determined by a valid and final judgment of this court, namely, the order confirming debtors' reorganization plan entered on April 27, 2012. The determination of the issue of the validity of defendant's creditor claim was essential to the final orders confirming debtors' reorganization plan. Accordingly, plaintiff is barred by the doctrine of issue preclusion from contesting payment of defendant's creditor claim under the confirmed plan in this adversary proceeding. *United States v. Taffi (In re Taffi),* 68 F.3d 306, 310 (9th Cir. 1995)(preclusive effect of a confirmed Chapter 11 reorganization plan)(citation omitted), *affirmed as modified,* 96 F.3d 1190, 1192 (9th Cir. 1996)(*en banc*); *Siegel v. Federal Home Loan Mortgage Corp*., 143 F.3d 525, 529 (9th Cir. 1998)

(preclusive effect of a claims allowance order); *see also United Student Aid Funds, Inc. v. Espinosa*, 559 U.S. 260, 130 S. Ct. 1367, 1380 (2010) (preclusive effect of a Chapter 13 bankruptcy plan); Because the doctrines of claim preclusion and issue preclusion bar plaintiff from relitigating the validity of defendant's creditor claim, the court concludes that plaintiff cannot plead a plausible claim upon which relief can be granted to contest the validity of the claim. Accordingly, the court determines that it is appropriate to grant defendant's motion to dismiss plaintiff's adversary complaint for failure to state a claim upon which relief can be granted without leave to amend.

Alternatively, the court concludes that the motion to dismiss should be granted based on the doctrine of judicial estoppel. "Judicial estoppel is an equitable doctrine that precludes a party from gaining an advantage by asserting one position, and then later seeking an advantage by taking a clearly inconsistent position." *Hamilton v. State Farm Fire & Casualty Co.,* 275 F.3d 778, 782 (9th Cir. 2001). "In the bankruptcy context, a party is judicially estopped from asserting a cause of action not raised in a reorganization plan or otherwise mentioned in the debtor's schedules or disclosure statements." *Hamilton v. State Farm Fire & Casualty Co.,* 275 F.3d at 783, *quoted in HPG Corp. v. Aurora Loan Service, LLC,* 436 B.R. 569, 577 (E.D. Cal. 2010). As the United States Court of Appeals for the Ninth Circuit observed,

> The rationale for . . . decisions [invoking judicial estoppel to prevent a party who failed to disclose a claim in bankruptcy proceedings from asserting that claim after emerging from bankruptcy] is that the *integrity of the bankruptcy system depends on full and honest disclosure by debtors of all of their assets.* The courts will not permit a debtor to obtain relief from the bankruptcy court by representing that no claims exist and then subsequently to assert those claims for his own benefit. *The interests of both the creditors, who plan their actions in the bankruptcy proceeding on the basis of information supplied in the disclosure statements, and the bankruptcy court, which must decide whether to approve the plan of reorganization*

on the same basis, are impaired when disclosure provided by the debtor is incomplete.

Hamilton v. State Farm Fire & Casualty Co., 275 F.3d at 785, *quoting In re Coastal Plains, Inc.,* 179 F.3d 197, 208 (5th Cir. 1999)(italics in original).

As alleged in plaintiff's adversary complaint, plaintiff asserts causes of action that existed before he filed his bankruptcy petition in 2010 based on alleged misconduct of defendant which occurred between 2006 and 2009. *Complaint* at 1-2. The court may take judicial notice of plaintiff's bankruptcy schedules filed in this bankruptcy case on May 10, 2010, the disclosure statement filed on November 16, 2010 (supplemented on January 5, 2011), and the plan of reorganization filed on January 21, 2011 (supplemented on March 31, 2011). Neither plaintiff's bankruptcy schedules (such as Schedule B, Personal Property), nor his plan of reorganization and disclosure statement listed the prepetition causes of action asserted in the adversary complaint. Accordingly, under *Hamilton,* the doctrine of judicial estoppel precludes plaintiff from asserting the causes of action in the adversary complaint against defendant since they were not raised in the plan of reorganization or otherwise disclosed in debtors' bankruptcy schedules or disclosure statement. Therefore, the motion to dismiss should also be granted for failure to state a claim upon which relief can be granted based on judicial estoppel.

In the moving papers, defendant contends that the state court judgment has also preclusive effect, but the record before the court is unclear whether the judgment is final under state law for claim or issue preclusion purposes as the court is aware that plaintiff had appealed the state court judgment. *See Sandoval v. Superior Court*, 140 Cal. App. 3d 932, 936 (1983) (for purposes of collateral estoppel, a judgment of a California court is not final under California law until appeal has been exhausted).

At the court's request, the parties filed supplemental briefing regarding the jurisdiction of this court as a non-Article III court to enter a final judgment in this adversary proceeding since plaintiff sought compensatory damages against defendant. *Stern v. Marshall,* 131 S. Ct. 2594 (2011). Both parties acknowledge in their briefing that this

court has jurisdiction to enter a final judgment and explicitly request that the court enter a final judgment, which may be deemed express consent to the court's authority to enter a final judgment. *Executive Benefits Insurance Agency v. Arkinson (In re Bellingham Insurance Agency, Inc.)*, 702 F.3d 553, 569 (9th Cir. 2012). Moreover, the court also concludes that as to plaintiff, this court has jurisdiction to enter a final judgment since he brought this action in this court, which also indicates his express consent to the court's jurisdiction to enter a final judgment. *Id.* Moreover, the court further concludes that the court has jurisdiction to enter a final judgment in this adversary action because in effect, plaintiff is seeking disallowance of defendant's creditor claim in this case, which is a matter within the court's constitutional jurisdiction to enter a final judgment. *Stern v. Marshall,* 131 S. Ct. at 2618 ("the question is whether the action at issue stems from the bankruptcy itself or would necessarily be resolved in the claims allowance process").

For the foregoing reasons, the court concludes that it should grant defendant's motion to dismiss plaintiff's adversary complaint for failure to state a claim upon which relief can be granted without leave to amend.

By separate decision and order, the court addresses defendant's related motion for sanctions.

IT IS SO ORDERED.

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Date: May 30, 2013

Robert Kwan
United States Bankruptcy Judge

NOTICE OF ENTERED ORDER AND SERVICE LIST

Notice is given by the court that a judgment or order entitled (*specify*) **SEPARATE STATEMENT OF DECISION ON DEFENDANT'S MOTION TO DISMISS ADVERSARY COMPLAINT** was entered on the date indicated as "Entered" on the first page of this judgment or order and will be served in the manner indicated below:

I. SERVED BY THE COURT VIA NOTICE OF ELECTRONIC FILING ("NEF") – Pursuant to controlling General Order(s) and Local Bankruptcy Rule(s), the foregoing document was served on the following person(s) by the court via NEF and hyperlink to the judgment or order. As of **May 30, 2013**, the following person(s) are currently on the Electronic Mail Notice List for this bankruptcy case or adversary proceeding to receive NEF transmission at the email address(es) indicated below:

Christopher L Blank clblank@pacbell.net
Alan W Forsley awf@fl-lawyers.net, awf@fkllawfirm.com,addy@fl-lawyers.net,lc@fl-lawyers.net,awf@fl-lawyers.net
United States Trustee (SA) ustpregion16.sa.ecf@usdoj.gov

II. SERVED BY THE COURT VIA U.S. MAIL: A copy of this notice and a true copy of this judgment or order was sent by U.S. Mail, first class, postage prepaid, to the following person(s) and/or entity(ies) at the address(es) indicated below:

Martin Pemstein
2516 Vista Baya
Newport Beach, CA 92660

Martin Pemstein
38 Calle Aragon, Unit F
Laguna Wood, CA 92637

III. TO BE SERVED BY THE LODGING PARTY: Within 72 hours after receipt of a copy of this judgment or order which bears an "Entered" stamp, the party lodging the judgment or order will serve a complete copy bearing an "Entered" stamp by U.S. Mail, overnight mail, facsimile transmission or email and file a proof of service of the entered order on the following person(s) and/or entity(ies) at the address(es), facsimile transmission number(s) and/or email address(es) indicated below: