

In re Water Sports, Inc. - Case No. 694-61950-psh11

BAP. Case. No. 95-1386-HVJ

8/26/96

BAP. Affirming PSH

Published at

The BAP affirmed the bankruptcy court's order granting an injunction which required Terry Whitlock and Linda DiBlasi to turnover estate property and denied Whitlock's motion to dismiss the debtor's Chapter 11 petition. The bankruptcy court's order was based on its finding that Terry Bendar, not Whitlock was the debtor's majority shareholder and that the petition was therefore properly filed. On appeal Whitlock contended that the court lacked subject matter jurisdiction to determine ownership of the corporate shares and, alternatively, contended that the bankruptcy court erred in determining that he was not the debtor's majority shareholder.

The BAP held that the issue of subject matter jurisdiction was properly before it, despite Whitlock's failure to raise it at the trial court level, because it may properly be raised at any time. The BAP agreed that stock ownership was not a core matter over which the court had jurisdiction but concluded that, in this case, the issue of stock ownership was central to a determination of the motion to compel turnover and the motion to dismiss, both of which were core issues, and the bankruptcy court therefore had jurisdiction to determine the stock ownership question.

The BAP rejected Whitlock's arguments that the bankruptcy court had considered improper hearsay testimony and applied an improper burden of proof in making its decision regarding stock ownership. The BAP affirmed the court's ruling that Whitlock was not the debtor's majority shareholder.

EUGENE DC CT

# NOT FOR PUBLICATION

# FILED

U.S. BANKRUPTCY COURT  
DISTRICT OF OREGON  
FILED

AUG 26 1996

AUG 26 1996 *C.A.*

NANCY B. DICKERSON, CLERK  
U.S. BKCY. APP. PANEL  
OF THE NINTH CIRCUIT

TERENCE H. DUNN, CLERK  
BY Be DEPUTY

UNITED STATES BANKRUPTCY APPELLATE PANEL  
OF THE NINTH CIRCUIT

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25  
26

In re	)	BAP No. OR-95-1386-HVJ
	)	
WATER SPORTS, INC.,	)	Bk. No. 694-61950-psh11
	)	
Debtor.	)	Adv. No. 694-6226-psh11
	)	
<hr/>		
TERRY S. WHITLOCK and	)	
LINDA DIBLASI,	)	
	)	
Appellants,	)	
	)	
v.	)	<u>MEMORANDUM</u>
	)	
WATER SPORTS, INC.,	)	
	)	
Appellee.	)	
	)	
<hr/>		

Argued and Submitted on May 23, 1996  
at Portland, Oregon

Filed - AUG 26 1996

Appeal from the United States Bankruptcy Court  
for the District of Oregon

Honorable Polly S. Higdon, Bankruptcy Judge, Presiding

Before: HAGAN, VOLINN, and JONES, Bankruptcy Judges.

896-27(25) 117

1  
2 Terry S. Whitlock ("Whitlock") and Linda DiBlasi  
3 ("DiBlasi"), appeal: (1) an injunction requiring them to  
4 turnover the books and records of chapter 11 debtor, Water  
5 Sports, Inc. ("Water Sports"); and (2) the denial of Whitlock's  
6 motion to dismiss Water Sport's chapter 11 petition. We AFFIRM.

7 Both issues turn on whether William Bednar ("Bednar") or  
8 Whitlock owns a majority interest in Water Sports.

9 PROCEEDINGS BELOW

10 A. Procedural History

11 Water Sports filed a voluntary petition for relief under  
12 chapter 11 of title 11 of the United States Code on May 18,  
13 1994. Shortly after the petition for relief was filed, Bednar  
14 caused Water Sports to file an adversary proceeding against  
15 Whitlock and DiBlasi for intentional interference with business  
16 relations and turnover of corporate records. Whitlock responded  
17 by filing a motion to dismiss Water Sports' voluntary petition  
18 on the grounds that (1) Bednar did not have authority to file a  
19 bankruptcy petition on Water Sports' behalf; and (2) the  
20 petition was filed in bad faith. In the alternative Whitlock  
21 requested a chapter 11 trustee be appointed.

22 An extended hearing on Water Sports' motion for turnover of  
23 estate property and Whitlock's motion to dismiss was held on  
24 August 10, 1994, September 15, 1994, and September 16, 1994.  
25 However, on the morning of September 15, 1994, Whitlock withdrew  
26 his motion to dismiss and his motion for appointment of a

1 chapter 11 trustee because he wanted the case to remain in  
2 bankruptcy in the event he was determined to be the majority  
3 shareholder. The bankruptcy court granted him permission to  
4 refile his motion for appointment of a trustee in the event she  
5 found that Bednar was the majority shareholder of Water Sports.

6 B. Summary of the Evidence Presented At Trial

7 In July of 1990, Mike Neyt ("Neyt"), Dorian Corliss  
8 ("Corliss") and Bednar incorporated Water Sports for the purpose  
9 of manufacturing and selling a squirt gun known as the "Dip  
10 Stick." Water Sports was initially authorized to issue 30,000  
11 shares of common stock, of which 10,000 shares were issued to  
12 each of the incorporators.

13 In August of 1992, Whitlock approached Water Sports and  
14 offered his marketing expertise and a squirt gun called the  
15 "Stream Machine" in exchange for employment by and a shareholder  
16 stake in Water Sports. Whitlock became the president of Water  
17 Sports in January of 1993. However, negotiations concerning  
18 Whitlock's stock ownership continued until March of 1993 when  
19 Water Sports issued 2,800 shares to him.

20 Meanwhile, Corliss and Neyt sold or redeemed their Water  
21 Sports' stock and the John Duke Trust (the "Duke Trust")  
22 purchased shares in Water Sports. Until mid-1994 Bednar,  
23 Whitlock, and the Duke Trust agreed that the effect of these  
24 transactions was that only 10,000 of Water Sports' 30,000  
25 authorized shares remained outstanding and of the outstanding  
26 shares, Bednar owned 5,200 shares, Whitlock owned 2,800 shares

1 and the Duke Trust owned 2,000 shares.

2 By September of 1993, Whitlock and Bednar began to disagree  
3 about Whitlock's job performance and Bednar's business expenses.  
4 The dispute culminated in Bednar terminating Whitlock's  
5 employment. Bednar also maintained that Whitlock's stock had  
6 never been paid for and caused Water Sports to cancel Whitlock's  
7 shares.

8 In late 1993, Whitlock and DiBlasi filed an action in the  
9 Circuit Court for the State of Oregon, Jackson County, against  
10 Water Sports and Bednar for wages. At a stockholders meeting  
11 held in January of 1994, Whitlock also contended he, not Bednar,  
12 was the majority shareholder of Water Sports. After Bednar  
13 adjourned the meeting, Whitlock and DiBlasi reconvened the  
14 meeting and Whitlock "elected" himself as president of Water  
15 Sports. Whitlock amended his Jackson County complaint in April  
16 of 1994 to include his contention that he is the majority  
17 shareholder of Water Sports.

18 Relations between Bednar and Whitlock continued to  
19 deteriorate, and on the night of May 16, 1994, Whitlock removed  
20 some of the office equipment and all of the corporate records  
21 from Water Sports' offices. On May 18, 1994, Bednar responded  
22 by causing Water Sports to file a voluntary petition for relief  
23 under chapter 11 of title 11 of the U.S. Code. On the date the  
24 petition was filed, Bednar remained in control of Water Sports'  
25 finances and day to day operations, but Whitlock held all of its  
26 corporate records.

1           The transactions underlying the dispute began in September  
2 of 1992, when Bednar purchased Corliss' shares for \$170,000.  
3 Bednar borrowed the money to purchase Corliss' shares from his  
4 friend, Faye D. Madson ("Madson"). Corliss' and Bednar's 10,000  
5 share certificates were cancelled and Bednar was issued a new  
6 20,000 share certificate. In January of 1993, Bednar redeemed  
7 the 10,000 shares he purchased from Corliss in exchange for  
8 Water Sports' assumption of his debt to Madison. However,  
9 Bednar's 20,000 share certificate was never cancelled and Bednar  
10 was never issued a new 10,000 share certificate. Whitlock  
11 contends that neither the stock redemption nor Water Sports'  
12 \$170,000 debt to Madison was disclosed to him until after he had  
13 purchased his shares from Bednar.

14           Meanwhile, on November 20, 1992, as part of their ongoing  
15 negotiations, Bednar gave Whitlock a letter assuring him of a  
16 25% interest in Water Sports upon the signing of the agreement  
17 with Neyt. Bednar testified that at the time he wrote the  
18 letter, he believed that upon execution of the Neyt agreement he  
19 would own 100% of the outstanding stock of Water Sports.  
20 Whitlock testified that Bednar told him that he would get 25% of  
21 Water Sports' 30,000 outstanding shares (i.e., 7500 shares), and  
22 that when Bednar completed the purchase of Neyt's shares,  
23 Whitlock and Bednar would become fifty-fifty partners. Bednar  
24 denies he ever offered Whitlock more than 25% of the post-sale  
25 stock.

26           However, in the end, Bednar did not purchase Neyt's shares.

1 Instead, in December of 1992, Neyt entered into an agreement  
2 with Water Sports to redeem his shares for \$50,000. Water  
3 Sports paid \$10,000 for the shares upon execution of the  
4 redemption agreement with \$40,000 to be paid on April 1, 1993.  
5 The agreement provided that Water Sports' attorney, John  
6 Grantland ("Grantland"), would hold Neyt's shares in escrow  
7 pending the final payment.

8 Although Neyt's shares remained in escrow until Water  
9 Sports made its final payment in April of 1993, Bednar believed  
10 and began behaving as if there were only 10,000 shares of Water  
11 Sports stock outstanding and that he was the sole owner thereof.  
12 This belief is reflected in his subsequent dealings with the  
13 Duke Trust and Whitlock. Bednar further confused the escrow  
14 issue by referring to Neyt's stock redemption as if he had  
15 personally purchased the shares from Neyt.

16 Sometime during this period, Bednar, Grantland, and Water  
17 Sport's accountant, Mr. Kosmatka, began to refer to Water  
18 Sports' outstanding shares as if there were only the 10,000  
19 shares owned by Bednar. Whitlock contends that a reverse stock  
20 split occurred at this time, but there is no written evidence a  
21 reverse stock split actually occurred. Nor is there evidence of  
22 a formal stock reduction. Rather, the parties simply ignored  
23 the Neyt stock and treated Bednar's stock as if it were the only  
24 outstanding stock.

25 Also during the later part of 1992, Bednar began  
26 negotiations to sell the Duke Trust a minority share of the

1 stock. Ultimately, Water Sports issued 2000 shares directly to  
2 the Duke Trust. The sale was memorialized in two separate  
3 agreements for the sale of 1000 shares each. The recitals in  
4 the agreements ignore the existence of the Neyt stock. For  
5 example, while the second agreement states that upon purchase of  
6 the second 1000 shares, the Duke Trust owned 20% of the  
7 outstanding shares, the actual percentage of stock received by  
8 the Duke Trust was only 10% (1000 shares of the 20,000 shares  
9 outstanding).

10 The agreements are also somewhat ambiguous as to whether  
11 Water Sports or Bednar is the seller. The agreements state that  
12 Water Sports is selling the shares to the Duke Trust, but in the  
13 recitals, the number of Bednar's shares drops 1000 shares with  
14 each 1000 shares issued to the Duke Trust.

15 The agreements were executed in March of 1993 but recite  
16 that they are effective December 29, 1992. This effective date  
17 proved problematic because on December 29, 1992, Water Sports  
18 did not have any authorized shares which were not outstanding.<sup>1</sup>  
19 However, the agreements were later revised and re-executed  
20 effective January 1, 1993, not December 29, 1992. This revision  
21 solved the outstanding stock problem because by December 30,  
22 1992, Bednar had redeemed the shares he purchased from Corliss,  
23 thus creating a 10,000 share pool of authorized but unissued  
24

---

25 <sup>1</sup>The Neyt shares were in escrow and Bednar had not yet  
26 transferred the Corliss shares to Water Sports. Thus all 30,000  
shares remained outstanding.



1 stock.

2 Bednar's negotiations with Whitlock continued, and in early  
3 March of 1993, Grantland prepared a stock option agreement  
4 giving Whitlock the option to purchase 28% of the stock for  
5 \$42,000. Grantland recommended the stock option agreement to  
6 avoid issuing shares to Whitlock without adequate consideration.  
7 Whitlock refused to sign the agreement on the grounds he and  
8 Bednar had agreed he was to receive 25% of the stock in exchange  
9 for the Stream Machine and his sales expertise.

10 Whitlock, Bednar, Grantland and Kosmatka met on March 18,  
11 1993, to resolve the issue. At that meeting, the parties agreed  
12 that Whitlock would own 28%, Bednar would own 52%, and the Duke  
13 Trust would own 20% of the corporation. Accordingly, on March  
14 20, 1993, Whitlock was issued 2,800 shares, Bednar was issued  
15 5,200 shares and Duke Trust was issued 2,000 shares. All of the  
16 shares were backdated to January 1, 1993. The parties agreed  
17 that Whitlock would be given \$42,000 in bonuses for the purpose  
18 of allowing him to pay for his stock. However, Whitlock never  
19 signed an agreement to pay Water Sports \$42,000 for his stock  
20 and his stock certificate was unrestricted. Consequently, there  
21 was some tension between the shareholders as to whether  
22 Whitlock's shares were properly issued, and whether Whitlock  
23 owed Water Sports \$42,000.

24 According to the stock ledger, all of the other share  
25 certificates previously issued were cancelled effective January  
26 1, 1993. However, despite the entry in the stock ledger, Neyt's

1 shares remained uncanceled in escrow. Thus, until the escrow  
2 closed and Neyt's shares were redeemed in April of 1993, the  
3 parties' actual percentages of ownership in the corporation  
4 were: Neyt 50%, Bednar 26%, the Duke Trust 10% and Whitlock 14%.

5 Based upon the confused stock records of Water Sports,  
6 Whitlock has proposed a variety of scenarios under which he  
7 claims that he is the majority shareholder of Water Sports. His  
8 early theories maintain that his 2,800 shares constitute a  
9 majority because Bednar's shares were decreased by a reverse  
10 stock split and by sale to the Duke Trust and Whitlock. Later,  
11 Whitlock began contending that he received 7,500 shares (25% of  
12 30,000) upon execution of the Neyt agreement.

13 At the close of the hearing, Whitlock presented three  
14 separate scenarios under which he claimed to be the majority  
15 shareholder. First, Whitlock contended that on December 15,  
16 1992, Bednar had 20,000 shares and the 10,000 Neyt shares were  
17 in escrow. On that date a three for one reverse stock split  
18 occurred leaving Bednar with 6,667 shares. On January 1, 1993,  
19 Bednar sold 2,800 shares to Whitlock and 2000 shares to Duke  
20 Trust leaving Bednar with 1,867 shares. However, Bednar still  
21 owed Water Sports 3,333 shares (the 10,000 shares he purchased  
22 from Corliss as reduced by the three to one reverse stock split)  
23 leaving Bednar with a negative number of shares.

24 Second, Whitlock contended that on December 10, 1992, a two  
25 for one reverse stock split occurred and that Bednar's 20,000  
26 shares were reduced to 10,000. Bednar then transferred 2,800

1 shares to Whitlock and 2,000 shares to Duke Trust leaving him  
2 with 5,200 shares. Bednar then transferred the 5,000 shares he  
3 received from Corliss (10,000 shares reduced two to one) to  
4 Water Sports leaving Bednar with 200 shares.

5 Third, Whitlock contended that when Bednar executed the  
6 Neyt redemption agreement, Whitlock automatically received 28%  
7 of the outstanding stock from Bednar, leaving Whitlock with  
8 8,400 shares and Bednar with 11,600 shares. Thereafter Bednar  
9 transferred 20% of the outstanding stock (6000 shares) to Duke  
10 Trust, leaving Bednar with 5,600 shares. However, Bednar still  
11 owed Water Sports the 10,000 Corliss shares, which left Bednar  
12 with a 4,400 share deficit.

### 13 C. The Trial Court's Determination

14 On March 1, 1995, after three days of testimony and a  
15 painstaking examination of the corporate records and numerous  
16 agreements and draft agreements concerning the disputed  
17 transactions, the bankruptcy judge entered detailed findings of  
18 fact and conclusions of law.

19 She concluded that Bednar transferred his Corliss stock to  
20 Water Sports in December of 1992 leaving Bednar with a total of  
21 10,000 shares. Thereafter, on January 4, 1993, several  
22 simultaneous transactions occurred: (1) Water Sports determined  
23 that it would be expedient to issue only 10,000 of its  
24 authorized shares; (2) Bednar surrendered his 10,000 shares in  
25 exchange for 5,800 shares; (3) Water Sports issued 2000 shares  
26 to the Duke Trust; and (4) Water Sports issued 2,800 shares to

1 Whitlock. The parties ignored the Neyt shares.

2 The bankruptcy judge gave careful consideration to each of  
3 the three alternative stock ownership theories presented by  
4 Whitlock, but rejected all three on the grounds that no reverse  
5 stock split had occurred and Whitlock had purchased a specific  
6 number of shares (i.e. 2,800) not a percentage of the stock. In  
7 the alternative, the court noted that because Whitlock and the  
8 Duke Trust purchased their shares from Water Sports, not Bednar,  
9 even if a reverse stock split had occurred, Bednar would still  
10 be the majority shareholder. In so holding, she noted that  
11 because it had legal (but not equitable title) to the escrowed  
12 Neyt shares, Water Sports could have issued the Neyt shares in  
13 violation of the escrow agreement.

14 Based on these findings, the bankruptcy judge granted Water  
15 Sports' motion for turnover of estate property and denied  
16 Whitlock's motion to dismiss.

#### 17 STANDARD OF REVIEW

18 The bankruptcy court's conclusions of law are reviewed de  
19 novo. *Tilley v. Vucurevich (In re Pecan Groves of Arizona)*, 951  
20 F.2d 242, 244 (9th Cir. 1991). Subject matter jurisdiction is  
21 also reviewed de novo. *Maitland v. Mitchell (In re Harris Pine*  
22 *Mills)*, 44 F.3d 1431, 1434 and 1438 (9th Cir.), cert. denied, --  
23 U.S.--, 115 S.Ct. 2555 (1995). The bankruptcy court's findings  
24 of fact are reviewed for clear error. *Siriani v. Northwestern*  
25 *Nat'l Insurance Co., of Milwaukee, Wisconsin (In re Siriani)*,  
26 967 F.2d 302, 303-304 (9th Cir. 1992).

DISCUSSION

On appeal Whitlock contends the bankruptcy court did not have subject matter jurisdiction to determine who held the majority interest in Water Sports. In the alternative, Whitlock sets forth a slightly different scenario under which he maintains he is the majority shareholder of Water Sports. He also maintains he is the majority shareholder under several new legal theories not argued below. In addition, although he withdrew his motion to dismiss, Whitlock now contends the bankruptcy court erred in not considering dismissal of the chapter 11 petition for bad faith.

A. Subject Matter Jurisdiction

Whitlock contends that the issue of who owns a majority interest in Water Sports is a noncore matter over which the bankruptcy court does not have subject matter jurisdiction. See *Wiley v. Costal Corporation*, 503 U.S. 131, 137 (subject matter jurisdiction may be raised at any time on appeal), *reh'g denied*, 504 U.S. 935 (1992). This distinction between core and noncore matters is important, because it determines whether the bankruptcy court has subject matter jurisdiction to decide the issue:

In noncore matters, the bankruptcy court may not enter final judgments without the consent of the parties, and its findings of fact and conclusions of law in noncore matters are subject to de novo review by the district court. . . . In contrast to the bankruptcy court's authority in noncore cases, the bankruptcy court may enter final judgments in so-called core cases, which are

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25  
26

appealable to the district court [or the BAP]. . . .

*In re Harris Pine Mills*, 44 F.3d at 1436 (quoting *Taxel v. Electronic Sports Research (In re Cinematronics, Inc.)*, 916 F.2d 1444, 1449 (9th Cir.1990) (other cases quoted in turn omitted); see also 28 U.S.C. § 157(b),(c).

The Ninth Circuit Court of Appeals has held that there are two types of core proceedings: proceedings "arising under" title 11, and proceedings "arising in" title 11. See *Harris Pine Mills*, 44 F.3d at 1435. Proceedings "arising under" title 11 are "proceedings that involve a cause of action created or determined by a statutory provision of title 11." *Harris Pine Mills*, 44 F.3d at 1435 (internal quotation marks omitted) (quoting *Eastport Assocs. v. City of Los Angeles (In re Eastport Assocs.)*, 935 F.2d 1071, 1076 (9th Cir. 1991) (as amended) (quoting in turn *In re Wood*, 825 F.2d 90, 96 (5th Cir. 1987) (footnote omitted))). Proceedings "arising in" title 11 are administrative matters "that are not based on any right expressly created by title 11, but [which] nevertheless, would have no existence outside of the bankruptcy." *Id.* (internal quotation marks omitted) (quoting *Eastport Assocs.*, 935 F.2d at 1076 (quoting in turn *Wood*, 825 F.2d at 97)). In contrast, noncore proceedings are proceedings "related to" title 11. *Id.* "If the proceeding does not invoke a substantive right created by the federal bankruptcy law and is one that could exist outside of bankruptcy it is not a core proceeding . . . ." *Id.*

1 (internal quotation marks omitted) (quoting *Eastport Assocs.*,  
2 935 F.2d at 1076 (quoting in turn *Wood*, 825 F.2d at 97)).

3 Determination of whether the petition was properly filed  
4 is clearly a proceeding arising under title 11 as the right to  
5 file a petition is a creation of bankruptcy law and has no  
6 existence outside of bankruptcy. Thus, Whitlock's motion to  
7 dismiss is a core matter. Similarly, a motion for turnover of  
8 estate property is also a proceeding arising under title 11.  
9 See 28 U.S.C. § 157(a)(2)(A) (matters concerning the  
10 administration of the estate) and (E) (orders to turnover  
11 property of the estate).

12 However, in the present case the resolution of both  
13 proceedings hinges on a stock ownership dispute between third  
14 parties, governed exclusively by state law. Several courts have  
15 held that such controversies over the ownership of stock in a  
16 debtor corporation are noncore matters. For example in *Uranga*  
17 *v. Geib (In re Paso Del Norte Oil Co.)*, 755 F.2d 421, 424 (5th  
18 Cir. 1985), *Uranga* brought an adversary proceeding contending  
19 that *Geib* had fraudulently induced *Uranga* to sell his majority  
20 interest in the debtor. The bankruptcy court confirmed the  
21 chapter 11 plan over *Uranga's* objections and specifically  
22 retained jurisdiction to determine the stock controversy. The  
23 court of appeals first noted that a corporation does not have an  
24 ownership interest in its outstanding stock and that the  
25 controversy was therefore an action between third parties, not  
26 an action by or against the debtor. *In re Paso Del Norte*, 755

1 F.2d at 424. The court ruled that unless it was impossible for  
2 the bankruptcy court to administer the estate without first  
3 determining the controversy that the controversy was a noncore  
4 matter. The court concluded that the controversy had little  
5 effect on the administration of the estate and therefore the  
6 bankruptcy court had no jurisdiction to determine the action.

7 *Id.*

8 If the order appealed in this case were merely a  
9 determination of the percentage of stock ownership of the Duke  
10 Trust, Bednar, and Whitlock, it would be a noncore matter.  
11 However, the proceedings appealed are the determination of  
12 whether the petition was properly filed and whether Whitlock had  
13 a right to remain in control of estate property. Because it is  
14 not possible to determine either controversy without first  
15 determining whether Whitlock or Bednar is the majority  
16 shareholder, it is impossible to administer the estate without  
17 first resolving the ownership dispute. Thus, under the Fifth  
18 Circuit's analysis, the issue of stock ownership is a core  
19 proceeding in this context.

20 The bankruptcy court reached the same conclusion in  
21 *Rosenblum v. Constantin (In re SCX Corp.)*, 54 B.R. 165  
22 (Bankr.D.N.J. 1984). In *SCX*, the debtor corporation brought an  
23 adversary proceeding against Rosenblum seeking a determination  
24 that Rosenblum was no longer a shareholder of the debtor.  
25 Rosenblum then commenced a state court action against two other  
26 shareholders seeking a declaration that he was the majority



1 shareholder of the debtor. The defendant shareholders removed  
2 Rosenblum's state court action to the bankruptcy court. The  
3 bankruptcy court concluded it had jurisdiction over both actions  
4 because:

5 control of a debtor in possession goes to the very  
6 heart of the administration of the debtor's estate, it  
7 necessarily follows that the bankruptcy court may  
8 properly determine where such control resides.

9 *In re SCK Corp.*, 54 B.R. at 169. C.f., *Izdebski v. Central Ice*  
10 *Cream Co. (In re Central Ice Cream Co.)*, 82 B.R. 933 (N.D.Ill.  
11 1987) (in a chapter 7 proceeding in which there will be a surplus  
12 of funds available for distribution to the equity holders, a  
13 dispute concerning which shareholder has a controlling interest  
14 in the debtor is a noncore matter).

15 In the present case, both Whitlock's motion to dismiss and  
16 the Water Sports' motion for turnover of property hinge on  
17 whether Whitlock or Bednar controlled Water Sports. Thus, as in  
18 *SCK*, and unlike *Paso Del Norte*, knowing who controls the debtor  
19 is necessary to the administration of the estate.

20 In addition, we note that unlike the case in *Paso Del*  
21 *Norte*, in the present case Water Sports is a party to both the  
22 motion to dismiss and the turnover motion. Thus, the  
23 proceedings at issue are not merely disputes between third  
24 parties. Further, Whitlock's contentions regarding stock  
25 ownership go beyond who has ownership of the outstanding stock.  
26 Rather, Whitlock contends there are 12,000 shares outstanding,  
not the 10,000 shares shown on the debtor's books. He also

1 contends that various shares sold by the corporation were  
2 actually owned and sold by Bednar. Therefore, Whitlock's  
3 allegations concern not only who owns the corporate debtor's  
4 stock, but whether the debtor did or did not sell the stock.  
5 Accordingly, we conclude that the orders appealed do not merely  
6 resolve disputes between third parties, and that the bankruptcy  
7 court had jurisdiction to determine them.

8 Whitlock cites *Connell v. Coastal Cable T.V., Inc. (In re*  
9 *Coastal Cable T.V., Inc.)*, 709 F.2d 762 (1st Cir. 1983) for the  
10 proposition that the determination of who owns a majority  
11 interest in Water Sports is a noncore matter. In *Coastal Cable*,  
12 appellants pledged funds to promoter Paul Burke for the purpose  
13 of founding Coastal Cable and agreed to serve as its officers  
14 and directors. When Coastal Cable obtained a cable TV license,  
15 Burke refused to issue appellants share certificates and issued  
16 all of Coastal Cable's shares to himself. Burke then sold the  
17 shares to a third party who sold them to Berkshire Cable  
18 Television, Co. Berkshire filed for relief under chapter 11.

19 The bankruptcy court authorized the sale of Coastal Cable's  
20 TV license without first determining who owned the Coastal  
21 Cable's outstanding stock. The circuit court reversed and  
22 remanded to the district court for determination of who owned  
23 the Coastal Cable shares. The circuit court reasoned that the  
24 issue was primarily one of state law and that therefore *Northern*  
25 *Pipeline Construction Co. v. Marathon Pipeline Co.*, 458 U.S. 50,  
26 83 (1982) required that the matter be determined by the district

1 court.

2           Essentially, the First Circuit held that the bankruptcy  
3 court did not have subject matter jurisdiction over the sale  
4 unless Burke was the majority shareholder of the debtor and that  
5 the bankruptcy court was without subject matter jurisdiction to  
6 determine its own subject matter jurisdiction. Controlling case  
7 law is to the contrary. A bankruptcy court, like all other  
8 courts, always has subject matter jurisdiction to determine its  
9 own subject matter jurisdiction. *Visoneering Const. and*  
10 *Development Co. v. United States Fidelity & Guaranty (In re*  
11 *Visoneering Const.)*, 661 F.2d 119, 122 (9th Cir. 1981) (citing  
12 *Chichot Co. Drainage Dist. v. Baxter State Bank*, 308 U.S. 371,  
13 376-77, (1940)). Accordingly, we conclude that because the  
14 determination of who is the majority shareholder of Water Sports  
15 is necessary to the determination of whether the petition was  
16 properly filed, the determination of who owns the majority  
17 interest is a core matter in the present proceeding.

18 B. Bad Faith

19           Whitlock contends for the first time in his reply brief  
20 that the bankruptcy court should have dismissed Water Sports'  
21 chapter 11 petition for bad faith because: (1) Bednar filed the  
22 petition to avoid a state court action brought by Whitlock; and  
23 (2) newly discovered evidence shows Bednar is looting Water  
24 Sports post-petition. Whitlock withdrew his motion to dismiss  
25 below. Nevertheless, Whitlock contends we should consider his  
26 motion on appeal because whether a petition is filed in good

1 faith is jurisdictional.

2 Whitlock cites *In re Coastal Cable*, for the novel  
3 proposition that whether a petition is filed in good faith is an  
4 issue of subject matter jurisdiction. In *Coastal Cable*, the  
5 court held that whether Coastal Cable had any debts was a matter  
6 of subject matter jurisdiction. The court concluded that if the  
7 appellants owned Coastal Cable's stock, then Coastal Cable did  
8 not have any debts. The court added that whether appellants or  
9 Berkshire owned the stock depended upon whether Burke committed  
10 fraud by issuing the stock to himself. *Coastal Cable*, 709 F.2d  
11 at 765. *Coastal Cable* did not hold that "bad faith" is a matter  
12 of subject matter jurisdiction. Nor are we aware of any cases  
13 holding that bad faith is a matter of subject matter  
14 jurisdiction. Accordingly, we decline to consider Whitlock's  
15 allegations of bad faith.

16 C. Who is the Majority Shareholder of Water Sports?

17 In the alternative, Whitlock contends that even if the case  
18 is not dismissed, he should not be required to return the  
19 corporate records of Water Sports because he is the majority  
20 shareholder. Whitlock maintains that in accordance with  
21 Bednar's November 1992 letter, when Bednar signed the redemption  
22 agreement with Neyt, he automatically became the owner of 7,500  
23 shares (i.e. 25% of the outstanding shares of Water Sports which  
24 had previously belonged to Bednar) leaving Bednar with 12,500  
25 shares. Thereafter, Bednar returned the 10,000 Corliss shares  
26 to Water Sports, leaving him with 12,500 shares. Then, on

1 January 5, 1993, Bednar gave Whitlock an additional 900 shares  
2 (bringing Whitlock's percentage of all of the authorized shares  
3 to 28%) leaving Bednar with 1,600 shares and Whitlock with 8,400  
4 shares. Simultaneously, Water Sports issued 2,000 shares to the  
5 Duke Trust.

6 This argument assumes that an agreement to transfer stock  
7 automatically accomplishes the transfer thereof. However,  
8 certificated securities are transferred under Oregon law only  
9 when (1) the purchaser or his agent acquires possession of  
10 bearer certificates (O.R.S. § 78.3130(1)(a), (e)(1993)); or (2)  
11 the purchaser or his agent acquires possession of endorsed share  
12 certificates (O.R.S. § 78.3130(1)(c), (e)(1993)). Recognizing  
13 that he could not have received certified shares by operation of  
14 the November 1992 letter, Whitlock contends that pursuant to  
15 O.R.S. § 78-3080 (1993), uncertificated shares<sup>2</sup> were transferred  
16 to him by written instruction.

17 However, the shares originally issued by Water Sports were  
18

19 \_\_\_\_\_  
20 <sup>2</sup>O.R.S. § 78.1020(1)(b)(1993) provides in relevant part:

- 21 (1)(b) An "uncertificated security" is a  
22 share. . . of the issuer . . . which is:  
23 (A) Not represented by an instrument  
24 and the transfer of which is registered upon  
25 books maintained for that purpose by or on  
26 behalf of the issuer;  
(B) Of a type commonly dealt in on  
commercial exchanges or markets; and  
(C) Either one of a class or series or  
by its terms divisible into a class or  
series of shares . . . .

1 all certificated, and all of the shares subsequently issued by  
2 the Water Sports were certificated. At the time Whitlock  
3 contends Bednar transferred 7,500 uncertificated shares to him,  
4 all of Bednar's shares were documented by a certificate for  
5 20,000 shares. Thus, Bednar did not own any uncertificated  
6 shares.

7 Shareholders cannot create uncertificated shares. Only the  
8 corporation can issue uncertificated shares. See O.R.S. §  
9 60.164 (1993) (providing that absent a prohibition in the bylaws  
10 or articles of incorporation, the board of directors may  
11 authorize the issuance of shares without certificates). Water  
12 Sports' board of directors never authorized the issuance of  
13 uncertificated shares. Accordingly, Bednar could not have sold  
14 Whitlock any uncertificated shares.

15 D. Burden of Proof and Factors Considered by the Court

16 Whitlock also contends that the bankruptcy court improperly  
17 assigned the burden of proof on Water Sports' motion for  
18 turnover of estate property to Whitlock. However, there is no  
19 indication in the opinion or the transcript that the bankruptcy  
20 court placed the burden of proof on Whitlock.

21 In addition, Whitlock contends the bankruptcy court  
22 considered "impermissible factors" in reaching its conclusion.  
23 It is difficult to determine from his brief what "factors"  
24 Whitlock objects to. However, we surmise from page 2 of his  
25 opening brief that he believes the bankruptcy court's opinion  
26 was based on hearsay testimony regarding the ownership of the

1 corporate stock. No objection to the "hearsay" was made below  
2 and much of this so-called impermissible testimony was presented  
3 by Whitlock himself. Further, the parties to the transactions  
4 (Whitlock, John Duke (a principal of the Duke Trust), and  
5 Bednar) all testified as to their own involvement in the  
6 transactions and to their own personal intent. Where the  
7 contracts were not entirely oral, the court was presented with  
8 the written contracts themselves. Accordingly, the bankruptcy  
9 court did not base her decision on inadmissible hearsay.

10 Whitlock also contends the Court erred by requiring the  
11 shareholders to document corporate transactions. The bankruptcy  
12 judge did note that the transactions between the parties were  
13 frequently undocumented. She did not hold that shareholders  
14 have the burden of documenting corporate transactions.

15 Accordingly, we conclude the bankruptcy court neither  
16 misapplied the burden of proof, nor considered "impermissible  
17 factors."

18 E. Issues Raised For the First Time on Appeal

19 On appeal, Whitlock raises three new theories as to why he  
20 is the majority shareholder of Water Sports, the doctrine of  
21 unclean hands, breach of contract, and equitable subordination.

22 Generally, an appellate court will not  
23 consider arguments not first raised before  
24 the district court unless there were  
25 exceptional circumstances. *Valuer v.*  
26 *Crowley Maritime Corp.*, 782 F.2d 1478, 1483  
(9th Cir. 1986). The specific "exceptional  
circumstances" that this circuit has  
identified are as follows: (1) review is  
necessary to prevent a miscarriage of

1 justice; (2) a new issue arises while an  
2 appeal is pending because of a change in the  
3 law; and (3) the "issue presented is purely  
4 one of law and either does not depend on the  
5 factual record developed below, or the  
6 pertinent record has been fully developed."  
7 *In re Bolker v. C.I.R.*, 760 F.2d 1039, 1042  
8 (9th Cir.1985).

9 *Briggs v. Kent (In re Professional Inv. Properties of America)*,  
10 955 F.2d 623, 625 (9th Cir.), cert. denied, 506 U.S. 818 (1992);  
11 See also *Trattoria v. Lansford (In re Lansford)* 822 F.2d 902,  
12 905 (9th Cir. 1987)(applying rule to bankruptcy proceeding).

13 Neither the doctrine of unclean hands, the equitable  
14 subordination, nor the breach of contract contention meets the  
15 above exceptions to the rule. Further, all three contentions  
16 are raised for the first time in Whitlock's reply brief. See  
17 *Kirkland v. Security Pacific National Bank (In re Kirkland)*, 915  
18 F.2d 1236, 1241 n.7 (9th Cir. 1990); *The Preservation Coalition,*  
19 *Inc. v. Pierce*, 667 F.2d 851 (9th Cir. 1981).

20 Even if we could consider these new causes of action under  
21 *Briggs v. Kent*, it would be inappropriate to do so because all  
22 three causes of action concern remedies for fraud or breach of  
23 contract not current legal title to corporate stock. The motion  
24 for turnover of estate property is determined by who is legally  
25 in control of the debtor-in-possession, not who might gain legal  
26 title through a civil action. Whether Bednar or Water Sports  
has breached a contract, or defrauded Whitlock is beyond the  
scope of Water Sports' motion for turnover of estate property.  
Accordingly, we decline to consider Whitlock's new causes of



1 action.

2 Also raised for the first time in Whitlock's reply brief is  
3 his contention the bankruptcy court should have summarily  
4 dismissed either the turnover motion or the petition for relief  
5 in favor of the pending state court action. However, no motion  
6 to abstain was ever filed and the issue is raised for the first  
7 time on appeal. The filing of a motion to abstain is a  
8 necessary element to a request for mandatory abstention. See 28  
9 U.S.C. 1334(c)(2). This issue will not be considered on appeal.

10 F. The Appellee's Request That the Order Denying Whitlock's  
11 Motion to Dismiss Be Reversed

12 Water Sports contends that the bankruptcy court erred in  
13 denying Whitlock's motion to dismiss because Whitlock had  
14 previously withdrawn the motion. To the extent the motion  
15 concerns the validity of the petition, it is jurisdictional and  
16 cannot be waived. The bankruptcy court did not err in denying  
17 the motion to dismiss.

18 CONCLUSION

19 Generally, disputes concerning the ownership of stock  
20 issued by a debtor corporation are not core proceedings.  
21 However, in the present case, the determination of who owns the  
22 corporate stock in the debtor is an integral part of two core  
23 questions: (1) was the petition for relief properly filed; and  
24 (2) who is authorized to act and hold property for the debtor-in-  
25 -possession. Accordingly, the bankruptcy court had core  
26 jurisdiction to determine the ownership of the stock.

1           The bankruptcy court order was based on a meticulous and  
2 thorough analysis of the stock ownership of Water Sports. The  
3 bankruptcy court's finding that Bednar owns the majority of the  
4 corporate stock is supported by the testimony of Bednar, John  
5 Duke, and Grantland as well as by the documentation admitted  
6 into evidence. Accordingly, the bankruptcy court correctly  
7 concluded that Bednar, not Whitlock, is the majority shareholder  
8 of Water Sports. The bankruptcy court's order requiring  
9 Whitlock and DiBasi to return Water Sports' corporate records is  
10 AFFIRMED.

11           Because Whitlock withdrew his motion to dismiss, he may not  
12 contend on appeal that his motion to dismiss should be granted  
13 on the grounds of bad faith. His contention that Bednar did not  
14 have corporate authority to file the petition is jurisdictional  
15 and should be considered on appeal. However, as the bankruptcy  
16 court's finding that Bednar had the authority to file the  
17 petition on behalf of Water Sports is correct, her decision to  
18 deny Whitlock's motion to dismiss is AFFIRMED.

19  
20  
21  
22  
23  
24  
25  
26