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UNITED STATES DISTRICT COURT  
EASTERN DISTRICT OF CALIFORNIA

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NATOMAS GARDENS INVESTMENT  
GROUP LLC, a California  
limited liability company,  
ORCHARD PARK DEVELOPMENT LLC,  
a California limited liability  
company,

NO. CIV. S-08-2308 FCD/KJM

Plaintiffs,

v.

MEMORANDUM AND ORDER

JOHN G. SINADINOS, STANLEY J.  
FOONDOS, STEPHEN FOONDOS, et  
al.,

Defendants.

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On June 1, 2009, defendant Larry Deane ("Deane") filed a counterclaim against plaintiff/counter-defendant Natomas Gardens Investment Group, LLC ("Natomas") and third-party claim against third-party defendant Eric Solorio ("Solorio"), a shareholder in Natomas. Therein, Deane, also a shareholder in Natomas, alleges individual claims for express indemnity, breach of contract,

1 implied indemnity, and equitable indemnity against Natomas and  
2 Solorio, as well as shareholder derivative claims on behalf of  
3 Natomas against Solorio for breach of fiduciary duty, breach of  
4 contract and the implied covenant of good faith and fair dealing  
5 and intentional interference with prospective economic advantage.  
6 (Docket #125.)

7 This matter is now before the court on Deane's motion to  
8 disqualify the law firm of Barth, Tozer & Timm ("Barth") as  
9 counsel for plaintiff/counter-defendant Natomas in this action;<sup>1</sup>  
10 Deane also seeks a ruling precluding Barth from representing  
11 Solorio in this action and in a related state court action.  
12 Deane contends disqualification is required because Natomas' and  
13 Solorio's interests are adverse in this action due to Deane's  
14 assertion of derivative claims on behalf of Natomas against  
15 Solorio, and thus, Barth's simultaneous representation of them is  
16 unethical and in violation of California law. Barth opposes the  
17 motion, arguing that Deane's counter- and third-party claim is so  
18 frivolous that the court should dismiss Deane's claims against  
19 Natomas and Solorio, thereby mooting any alleged conflict between  
20 the parties or, alternatively, permit Barth to "cure" the  
21 conflict of interest by withdrawing as Solorio's counsel.<sup>2</sup>

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22  
23 <sup>1</sup> Deane did not assert a counterclaim against plaintiff  
24 Orchard Park Development LLC ("Orchard Park"), also represented  
25 by Barth, and he does not move to disqualify Barth from  
26 representing Orchard Park. Thus, nothing herein precludes Barth  
27 from continuing to represent Orchard Park in this action. As set  
28 forth below, Orchard Park asserts the same claims for relief  
against defendants as does Natomas. (2<sup>nd</sup> Am. Compl., filed June  
1, 2009.)

<sup>2</sup> Because oral argument will not be of material  
assistance, the court orders this matter submitted on the briefs.  
E.D. Cal. L.R. 78-230(h).

1 For the reasons set forth below, the court GRANTS in part  
2 and DENIES in part Deane's motion to disqualify Barth from  
3 representing Natomas and Solorio.

4 **BACKGROUND**

5 This case originally arose out of a failed business venture  
6 between Solorio and Deane, and their various alleged co-  
7 conspirators. As alleged in Natomas' and Orchard Park's second  
8 amended complaint ("SAC"), beginning in 2003, Solorio negotiated  
9 to obtain rights to purchase undeveloped real property from  
10 several property owners in the Sacramento area. (SAC, filed June  
11 1, 2009, ¶ 44.) Solorio endeavored to subsequently develop and  
12 sell this land, for which he formed a limited liability company,  
13 Natomas. (Id. at ¶ 45.) In seeking financing for his potential  
14 project, Solorio met defendants Deane and John Sinadinos  
15 ("Sinadinos"). (Id. at ¶ 46.) Sinadinos recommended that  
16 Stanley Foondos, a certified public accountant, support Solorio's  
17 proposed development project through performance of all  
18 accounting and tax reporting responsibilities. (Id. at ¶ 52.)

19 By the end of 2003, Solorio, acting on behalf of Natomas,  
20 had assembled purchase rights to a number of contiguous parcels  
21 in the Sacramento area, upon which Sinadinos made the necessary  
22 deposits in escrow. (Id. at ¶ 53.) By mid-2004, Natomas had  
23 obtained rights to purchase and develop fourteen parcels of land  
24 in Sacramento county comprising approximately 109 acres. (Id. at  
25 ¶ 54.) This development project was designated Florin Vineyards,  
26 and Sinadinos formed a limited liability company, Village Capital  
27 Group LLC ("Village"), as the development company associated with  
28 the project. (Id. at ¶¶ 54-55.) Natomas was given a 45 percent

1 stake in Village, while the other 55 percent was held by Chi-Sac  
2 Village Capital Group Investors LLC ("Village Investors LLC"), a  
3 company managed and controlled by Sinadinos and Stanley Foondos.  
4 (Id. at ¶¶ 12, 20.) In October 2004, Solorio bought an  
5 additional 85 acres. The development project was named Vintage  
6 Creek, and Sinadinos formed another limited liability company,  
7 Vintage Creek LLC, to be associated with the project. (Id. at  
8 ¶ 57.)

9       Additionally, during April-May 2005, Solorio assembled  
10 property acquisition rights for a development project located in  
11 Madera County, California. (Id. at ¶ 61.) Solorio, acting  
12 through his own limited liability company, Orchard Park,  
13 negotiated and executed five option agreements to purchase  
14 contiguous parcels of real property comprising approximately 265  
15 acres. (Id.) Acting upon Sinadinos' representations as to his  
16 substantial development experience, Solorio agreed to include  
17 Sinadinos as a shareholder of Madera Avenue 12 Capital Group LLC  
18 ("Madera"), a limited liability company formed for the  
19 development of the Madera properties. (Id. at ¶ 62.)

20       According to Deane, "the basic structure of each company was  
21 identical. Natomas was to assign the various purchase agreements  
22 to the two LLC's (Vintage and Village), and provide the sweat  
23 equity with respect to entitlements, and the Chi-Sac groups were  
24 to provide the capital necessary to make the non-refundable down-  
25 payments on the various parcels, in amounts of up to \$4 million  
26 for each project." (Counter- and Third-Party Claim, filed June  
27 1, 2009, at ¶ 9.) Deane further alleges that Natomas is  
28 "comprised of two "camps" of persons, those aligned with Solorio

1 and those who are the friends and family of Deane." (Id. at  
2 ¶ 10.) Deane and Solorio comprise the majority of the shares in  
3 Natomas; Deane representing a 34.28% interest and Solorio  
4 representing a 57.13% interest as the former managing member.  
5 (Id. at ¶ 11.) The remaining 8.59% is divided between 12 other  
6 investors who are not controlling members. Two of the investors  
7 are aligned with Solorio, and the remaining ten are Deane's  
8 friends and family. (Id.)

9 When Natomas was in full operation, Solorio managed the  
10 daily operations but required Deane's consent as the other major  
11 shareholder for more "significant operational decisions." (Id.  
12 at ¶ 12.) Deane alleges that Vintage and Village were also  
13 managed through this same operational structure, with Natomas  
14 being the controlling branch from which consent was required for  
15 any significant transactions. (Id. at ¶ 13.)

16 Deane alleges that the business relationship between himself  
17 and Solorio began to deteriorate around October 2007. (Id. at  
18 ¶ 18). Further, Deane asserts Solorio became less interested in  
19 the progress of what was becoming a failed business venture as a  
20 result of the downturn in the economy and began seeking a buy out  
21 of his interests in Natomas. (Id.) Around this same time,  
22 Solorio retained Barth who had no prior association with either  
23 Solorio, Natomas, or any of the other Natomas shareholders.  
24 (Id.)

25 Deane became suspicious of Solorio's attempt to secure a buy  
26 out. He claims Solorio continually sought to obstruct Natomas'  
27 business with frivolous investigations; he defamed members of  
28 Natomas and the other related LLCs; and he sabotaged potential

1 investment deals. (Id. at ¶ 19.) Deane alleges Solorio and  
2 Barth began investigating misconduct by members of the LLCs,  
3 which not only wasted valuable resources, but also cost Natomas  
4 necessary capital in the form of lost investment opportunities.  
5 (Id.)

6 Natomas and Orchard Park filed the original complaint in  
7 this court on September 29, 2008; however, that complaint was  
8 never served and plaintiffs thereafter filed and served a first  
9 amended complaint on November 4, 2008, alleging claims against  
10 defendants for individual violations of the Racketeer Influence  
11 and Corrupt Organizations Act, 18 U.S.C. §§ 1961 et seq. ("RICO"),  
12 RICO conspiracy, fraud, breach of fiduciary duty, professional  
13 legal malpractice, professional accounting malpractice, and  
14 conversion. Plaintiffs also sought a petition for writ of  
15 mandate to compel inspection of records. (FAC at ¶¶ 192-251.)  
16 As the majority shareholder of Natomas, Solorio states that due  
17 to the expiring statute of limitations, and the potential risk  
18 that inaction could cause harm to Natomas, he was compelled to  
19 retain Barth as counsel for Natomas in this action. (Opp'n to  
20 Mot. to Disqualify, filed Aug. 7, 2009, at 6.)

21 On October 21, 2008, Deane filed suit against Solorio and  
22 Natomas, among others, in Sacramento County Superior Court  
23 (sometimes referred to herein as the "State Court Action") and  
24 served an amended complaint against the parties on October 30,  
25 2008. In that action, Deane alleges claims for involuntary or  
26 voluntary dissolution of Natomas and breach of fiduciary duties  
27 by Solorio and others. (Barth Decl., filed Aug. 7, 2009, at ¶ 5,  
28 Ex. C.) Barth initially represented Solorio in the State Court

1 Action, but because of its involvement with Natomas in this  
2 action, Barth later accepted representation of Natomas in the  
3 State Court Action as well.

4 In the State Court Action, Deane filed an ex parte  
5 application for appointment of receiver for Natomas on November  
6 20, 2008. The state court granted the motion on December 19,  
7 2008, citing Deane and Solorio's complete "inability to work  
8 together," and on March 12, 2009, the court appointed Scott  
9 Sacket as the receiver for Natomas. (Opp'n RJN, filed August 7,  
10 2009, Ex. 6 at 2.)

11 Thereafter, Deane moved the state court to disqualify Barth  
12 as counsel for Natomas and Solorio in both the State Court Action  
13 and in this action. Deane argued disqualification was mandated  
14 because an attorney who represents a corporate entity (Natomas)  
15 is automatically disqualified from representing its principals,  
16 especially in situations involving allegations of fraud and  
17 corporate dissolution. (Id.) On May 26, 2009, the state court  
18 granted Deane's motion to disqualify Barth from further  
19 representation of Natomas, but found that Barth could continue to  
20 represent Solorio in state court because there was no evidence  
21 that the prior dual representation resulted in any prejudice to  
22 the parties. (Id. at 3.) The state court ordered the receiver  
23 to obtain independent counsel for Natomas. (Id.) The state  
24 court declined to consider Deane's request to disqualify Barth  
25 from this action, stating that it lacked authority to make such a  
26 ruling.

27 On August 3, 2009, the state court discharged the receiver  
28 because Deane failed to comply with a July 6, 2009 order

1 directing him to pay all funds requested by and owed to the  
2 receiver. (Opp'n RJN, Ex. 7 at 1.) The state court then stayed  
3 the State Court Action pending resolution of these proceedings.  
4 (Id. at Ex. 10 at 1.)

5 While the above matters took place in state court, various  
6 defendants in this action filed motions to dismiss plaintiffs'  
7 FAC. After this court granted in part and denied in part the  
8 various motions (Docket #123), giving plaintiffs leave to file a  
9 second amended complaint,<sup>3</sup> Deane filed the subject counter- and  
10 third-party claim against Natomas and Solorio, asserting:  
11 (1) individual claims for express indemnity and breach of  
12 contract against Natomas; (2) implied indemnity and equitable  
13 indemnity claims against Solorio; and (3) three shareholder  
14 derivative claims against Solorio on behalf of Natomas. (Docket  
15 #125.) The derivative claims allege breach of fiduciary duty,  
16 breach of contract and the implied covenant of good faith and  
17 fair dealing and intentional interference with prospective  
18 economic advantage. (Id.) Barth accepted service of the  
19 counter- and third-party claim on behalf of Natomas and Solorio.  
20 However, Barth answered Deane's claim and filed a counterclaim  
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22 <sup>3</sup> In said complaint, plaintiffs allege federal claims for  
23 relief for violation of RICO and state law claims for fraud,  
24 breach of fiduciary duties, professional legal malpractice,  
25 professional accounting malpractice, conversion and for writ of  
26 mandate to compel inspection of records. Defendants have filed  
27 various motions to dismiss in response thereto; said motions are  
28 currently set to be heard October 16, 2009. However, due to the  
stay entered by this court and in order to give Natomas' new  
counsel adequate time to respond, said motions will be continued  
to January 15, 2010. If new counsel for Natomas is retained  
quickly and the parties wish to hear these motions at an earlier  
time, they may file a stipulation and order advancing the hearing  
to an available law and motion date in 2009.



1 against Deane on behalf of Natomas only. (Docket #153.) Solorio  
2 answered Deane's third-party claim against him in *pro per*.  
3 (Docket #152.)

#### 4 **ANALYSIS**

5 At the time Deane filed the instant motion to disqualify,  
6 Barth represented Natomas in this action and Solorio in the State  
7 Court Action. Deane contends that this joint representation of  
8 the parties violates California law because due to Deane's  
9 shareholder derivative claims brought on behalf of Natomas  
10 against Solorio, Natomas' and Solorio's interests are adverse and  
11 Solorio cannot waive the conflict of interest on behalf of  
12 Natomas.<sup>4</sup> Barth opposes the motion, arguing primarily that  
13 (1) the court should consider the merits of Deane's counter- and  
14 third-party claim and find that it is frivolous, thereby mooting  
15 the alleged conflict of interest and rendering consideration of  
16 the motion to disqualify unnecessary, and (2) if the court  
17 reaches the motion to disqualify, Barth can "cure" the conflict  
18 of interest by withdrawing as Solorio's counsel in the State  
19 Court Action.

#### 20 **I. Applicable Standards**

21 Barth contends that the court may properly deny the motion  
22 to disqualify because the allegations of Deane's counter- and  
23 third-party claim are wholly frivolous. Barth asserts that under  
24 federal law, this court can assess the merits of Deane's claim

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26 <sup>4</sup> At times, Deane suggests that Barth's representation of  
27 Natomas and Solorio violated ethical rules from the inception of  
28 this case. However, the court does not rule on that issue herein  
since the basis for the instant motion is the alleged conflict of  
interest which arose as a result of Deane's assertion of  
derivative claims on behalf of Natomas against Solorio.

1 against Natomas and Solorio in the context of ruling on the  
2 disqualification motion. The cases relied upon by Barth,  
3 however, are not persuasive because the authorities are either  
4 inapplicable or directly contradict its contentions. For  
5 example, the Hausman case, cited by Barth, involved a shareholder  
6 derivative action where the court had to determine whether the  
7 shareholder's right to bring such an action was "substantive,"  
8 thus bringing choice of law rules into play. Hausman v. Buckley,  
9 299 F.2d 696 (2d Cir. 1962). The case did not involve a  
10 disqualification motion nor did it address the more specific  
11 issue of whether a court should consider the substantive merits  
12 of a pleading in assessing whether disqualification of counsel is  
13 warranted. Hausman is thus wholly inapplicable to this case.<sup>5</sup>

14 Barth also cites Lewis v. Shaffer Stores Co., 218 F. Supp.  
15 238 (S.D.N.Y. 1963). Barth maintains this case supports its  
16 contention that in deciding a motion to disqualify, a court  
17 should consider the substantive merits of the party's claim  
18 allegedly giving rise to the conflict. However, the court in  
19 Lewis indicates just the opposite. The court held:

20 The interests of the officer, director and majority  
21 shareholder defendants in this action are clearly  
22 adverse, *on the face of the complaint*, to the interests

23 <sup>5</sup> Similarly, Barth's citation to In re Oracle is also  
24 inapposite. Like Hausman, that case did not involve a motion for  
25 disqualification or any discussion of the propriety of  
26 considering the merits of a party's pleading to assess whether an  
27 actual conflict of interest exists. In re Oracle Sec.  
28 Litigation, 829 F. Supp. 1176, 1179 (N.D. Cal. 1993). Rather, in  
In re Oracle, the court considered whether a proposed settlement  
agreement in a joint derivative and class action suit was  
stipulated to in a fair manner; in the course of that inquiry,  
the court took into consideration the fact that Oracle's in house  
counsel represented both the company and the defendant  
principals. Id.

1 of the stockholders [of the company] other than  
2 defendants. I have no doubt that [the conflicted law  
3 firm] believe[s] that there is no merit to this action.  
4 Plaintiff, of course, vigorously contends to the contrary.  
5 *The court cannot and should not attempt to pass upon the  
6 merits at this stage.*

7 Id. at 239-40 (emphasis added).

8 Barth has not cited any authority to support the proposition  
9 that this court should evaluate the substantive merits of Deane's  
10 claim against Natomas and Solorio in the context of a motion to  
11 disqualify. And, the authority on point, supports the opposite  
12 conclusion. In Lewis, the court held that whether the interests  
13 of the parties are adverse should be determined on the face of  
14 the complaint rather than through an examination of the  
15 underlying merits of the derivative action. This court finds  
16 Lewis persuasive and consistent with the case law discussed below  
17 addressing disqualification motions in the context of shareholder  
18 derivative claims. Thus, the court considers here only the  
19 allegations of Deane's counter- and third-party claim to  
20 ascertain whether an actual conflict of interest was created by  
21 Deane's assertion of shareholder derivative claims on behalf of  
22 Natomas against Solorio.<sup>6</sup>

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23 <sup>6</sup> Because the court finds that consideration of the  
24 substantive merits of Deane's counter- and third-party claim is  
25 not appropriate at this juncture, it has disregarded the parties'  
26 arguments on the merits of Deane's claim. Both sides submitted  
27 lengthy arguments and extensive declarations to support their  
28 respective *factual* contentions in this case. Those arguments are  
not relevant to the motion. Additionally, Barth makes certain  
procedural objections to Deane's pleading, arguing it does not  
sufficiently allege a derivative claim pursuant to Fed. R. Civ.  
P. 23.1. Again, that issue goes to the merits of Deane's  
pleading, and while an appropriate argument for a Fed. R. Civ. P.  
12(b)(6) motion, it is not an argument this court must address in  
the context of a disqualification motion.

1           **II. Actual Conflicts in Derivative Suits**

2           In determining motions for disqualification, the court  
3 applies the applicable state law. In re County of Los Angeles,  
4 223 F.3d 990, 994 (9th Cir. 2000); E.D. Cal. L.R. 83-  
5 180(e)(adopting California’s standards of professional conduct  
6 and providing that the American Bar Association’s Model Rules of  
7 Professional Conduct may be considered for guidance).  
8 “Ultimately, disqualification motions involve a conflict between  
9 the clients’ right to counsel of their choice and the need to  
10 maintain ethical standards of professional responsibility.” UMG  
11 Recordings Inc. v. MySpace, Inc., 526 F. Supp. 2d 1046, 1058  
12 (C.D. Cal. 2007) (citations omitted). In accordance with the  
13 local rules, it is appropriate to examine the applicable  
14 standards of professional conduct required of members of the  
15 State Bar of California. Rule 3-310 of the California Rules of  
16 Professional Conduct provides in pertinent part:

- 17           (C) A member shall not, without the informed written  
18           consent of each client;
- 19           (1) Accept representation of more than one client in a  
20           matter in which the interests of the clients  
21           potentially conflict; or  
22           (2) accept or continue representation of more than one  
23           client in a matter in which the interests of the  
24           clients actually conflict; or  
25           (3) Represent a client in a matter and at the same  
26           time in a separate matter accept as a client a  
27           person or entity whose interest in the first  
28           matter is adverse to the client in the first  
29           matter.

26           Deane incorrectly asserts, at times, that Barth represents  
27 both Natomas and Solorio in this action. While Barth accepted  
28 service for both parties in this action, ultimately, Solorio

1 answered Deane's third-party claim in *pro per* and Barth filed an  
2 answer and counterclaim on behalf of only Natomas. However,  
3 Barth does represent Solorio in the related State Court Action.<sup>7</sup>  
4 Thus, Deane has appropriately raised the issue of an actual  
5 conflict of interest arising due to Deane's assertion of  
6 derivative claims in this action. oblige

7 Deane's counter- and third-party claim named both Natomas  
8 and Solorio as defendants, but Natomas is also a real *plaintiff-*  
9 *in-interest* because Deane is bringing the shareholder derivative  
10 claims against Solorio on Natomas' behalf. In a derivative suit,  
11 a minority shareholder in a corporation can bring claims on  
12 behalf of the corporation. Typically, the action is an  
13 extraordinary measure brought against corporate officers and  
14 directors who refuse to acknowledge any breach of fiduciary duty  
15 or mismanagement of funds, often because of their own involvement  
16 in the wrongdoing. Due to the circumstances, Natomas is also a  
17 defendant in this action. "It is only a 'nominal defendant,'  
18 however, because any relief that the plaintiff obtains from the  
19 defendant officers and directors accrues to the benefit of the  
20 corporation, making it the real party in interest. Thus, it has  
21 been said, the corporation in a derivative action 'is in the  
22 anomalous position of being both a plaintiff and a defendant.'" Baytree Capital Associates, LLC v. Quan, Case No. 08-2822 CAS,  
23 2008 U.S. Dist. LEXIS 87872, \*20-21 (C.D. Cal. Aug. 18, 2008)  
24 (citations omitted).  
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26  
27 <sup>7</sup> The fact that the State Court Action is currently  
28 stayed is of no avail because Barth simultaneously represents the  
interests of Solorio and Natomas in matters involving the same  
corporate actors and many of the same substantive issues.

1           When an attorney simultaneously represents two seemingly  
2 adverse parties, the court must question whether the attorney can  
3 ever impartially preserve its duty of loyalty to both parties  
4 simultaneously. Flatt v. Superior Court, 9 Cal. 4th 275, 284  
5 (1994). There are a few rare instances when simultaneous  
6 representation is permissible, despite an actual conflict of  
7 interest, but generally "the rule of disqualification in  
8 simultaneous representation cases [involving actual conflicts of  
9 interest] is a per se or 'automatic' one." Id. (citing Cinema 5,  
10 Ltd. v. Cinerama Inc., 528 F.2d 1387 (2d Cir. 1976)).

11           In the specific context of shareholder derivative actions,  
12 courts have consistently recognized that the "law clearly forbids  
13 dual representation of a corporation and directors in a  
14 shareholder derivative suit, at least where, as here, the  
15 directors are alleged to have committed fraud." Forrest v.  
16 Baeza, 58 Cal. App. 4th 65, 74 (1997); see also Gong v. RFG Oil,  
17 Inc., 166 Cal. App. 4th 209, 215 (2008) (holding that in a  
18 derivative suit, the organization named as a defendant is  
19 actually a plaintiff and case law forbids dual representation in  
20 a derivative suit alleging fraud by the principals because the  
21 principals and the organization have adverse, conflicting  
22 interests); In re Oracle, 829 F. Supp. at 1188 (disqualification  
23 warranted where "the same counsel represents both the corporation  
24 and the director and officer defendants, [and thus] the interests  
25 of the corporation are likely to receive insufficient  
26 protection"); Bell Atlantic Corp. v. Bolger, 2 F.3d 1304, 1317  
27 (3d Cir. 1993)(recognizing that "except in patently frivolous  
28 cases -- allegations of directors' fraud, intentional misconduct,

1 or self-dealing require separate counsel" for the corporation and  
2 its directors); Lewis, 218 F. Supp. at 239 (holding that "the  
3 interests of the officer, director and majority stockholder  
4 defendants in this action are clearly adverse, on the face of the  
5 complaint, to the interest of the stockholders," thus mandating  
6 disqualification of counsel); Messing v. FDI, Inc. 439 F. Supp.  
7 776, 782 (D. N.J. 1977) (finding that "because in the instant  
8 case the directors have been accused of fraud and the corporation  
9 has elected to take an active stance in the litigation, it is  
10 enough for now to decide that, under these combined  
11 circumstances, the corporation must retain independent counsel").

12 In each of these cases, the courts recognized the  
13 difficulties created by dual representation in a shareholder  
14 derivative suit, including the inability to ensure an attorney's  
15 duty of loyalty to his client, preventing conflicts of interest  
16 which could prejudice a client, and maintaining client  
17 confidentiality. In general, the courts emphasized that to  
18 permit such dual representation would *unfairly* prejudice the  
19 shareholder bringing the derivative action on behalf of the  
20 corporation. Id.

21 For example, in Forrest, the court found an actual conflict  
22 of interest existed where an attorney simultaneously represented  
23 two closely held family-run corporations as well as two of the  
24 three shareholders of those corporations in a derivative action.  
25 The court noted that the paramount concern in a dual  
26 representation scenario is "the preservation of public trust in  
27 the scrupulous administration of justice and the integrity of the  
28 bar." 58 Cal. App. 4th at 73. Ultimately, the court found that

1 the interests of the corporations and the individual defendants  
2 were adverse, in light of the derivative claims, and held that  
3 the integrity of the justice system was best served by allowing  
4 the attorney to represent the individual defendants and requiring  
5 independent counsel for the corporation. Id. at 82.

6 Barth's reliance on cases involving merely *potential*  
7 conflicts of interest are unavailing. For example, Barth relies  
8 primarily on Klemm v. Superior Court, 75 Cal. App. 3d 893, 898  
9 (1977), a case which involved joint representation of a husband  
10 and wife in a child custody matter. In Klemm, it was undisputed  
11 that no actual conflict of interest presently existed between the  
12 husband and wife. Rather, the court held that only a potential  
13 conflict existed since at the present time the husband and wife  
14 had settled their disputes by agreement. Id. The court,  
15 however, acknowledged that if the wife later sought support  
16 outside the terms of the agreement, the attorney would be  
17 disqualified from representing either party. Id. at 900 (holding  
18 that "common sense dictates that it would be unthinkable to  
19 permit an attorney to assume a position at a trial or hearing  
20 where he could not advocate the interests of one client without  
21 adversely injuring those of the other.")

22 To the contrary here, due to Deane's assertion of derivative  
23 claims on behalf of Natomas against Solorio, there is necessarily  
24 a conflict between the corporation (Natomas) and the alleged  
25 wrongful actor (Solorio). The central allegation in Deane's  
26 counter- and third-party claim is that Solorio breached his  
27 fiduciary duty to Natomas and its shareholders by obstructing the  
28 sales of real property, defaming Natomas' stockholders, and



1 generally abusing his position as majority shareholder.  
2 (Counter- Third-Party Claim at ¶ 43.) Thus, this case is wholly  
3 distinguishable from Klemm because nothing has been settled  
4 between the parties and there remains contentious litigation  
5 regarding improprieties and unethical business practices claimed  
6 by both sides which affect Natomas. As the above cases  
7 recognize, under these circumstances, it is impossible for Barth  
8 to represent Solorio in the State Court Action and simultaneously  
9 maintain an unbiased posture on behalf of Natomas' interests in  
10 this action because Natomas' interests in the shareholder  
11 derivative action are adverse and actually conflicting with  
12 Solorio. Because Deane alleges wrongdoing against Solorio on  
13 behalf of Natomas, the two parties are diametrically opposed.<sup>8</sup>  
14 Therefore, the court rejects the notion that the conflict of  
15 interest is merely hypothetical or potential and concludes that  
16 disqualification is required based on the allegations of Deane's  
17 counter- and third-party claim which creates an actual conflict  
18 of interest between Natomas and Solorio.

### 19 **III. Complete Disqualification**

20 If the court concludes, as it has, that an actual conflict  
21 of interest has been created by Deane's assertion of derivative  
22 claims on behalf of Natomas against Solorio, Barth requests  
23 permission to "cure" the conflict by withdrawing as Solorio's  
24

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25 <sup>8</sup> For this reason, Barth's reliance on Federal Home Loan  
26 Mortgage Corp. v. La Conchita Ranch Co., 68 Cal. App. 4th 856  
27 (1998) is also unavailing since it too involved only an  
28 undisputed *potential* conflict of interest. Likewise, Barth's  
citation to a State Bar of California opinion is unpersuasive;  
that opinion did not involve a shareholder derivative action  
where, like in the above cases, the dual representation of the  
corporation and the shareholder defendant is unavoidably adverse.

1 counsel in the State Court Action. Deane objects, arguing that  
2 Barth should be disqualified from representing both Natomas and  
3 Solorio because to permit otherwise would "reward" Barth for its  
4 unethical conduct. Neither party's argument is supported by the  
5 case law.

6 Barth's suggestion that the conflict at issue could be  
7 "cured" by its withdrawal as the individual shareholder's counsel  
8 has been rejected by the courts:

9 While this procedure removes the outward appearances  
10 of dual representation, the substance of the wrong  
11 remains. A residual bias in favor of the individual  
12 defendan[t] might continue to undermine counsel's  
13 judgment. This potential bias would stem from the  
14 fact that counsel's first loyalty might remain with  
15 the directors and officers of the corporation, who  
16 have been his principal contact with the inanimate  
17 corporate client in the past. In addition, counsel  
18 might fear that rendering advice antagonistic to  
19 the insiders' interest would impair future relations  
20 with his corporate client. For these reasons...[having]  
21 the corporation secure new counsel seems the sounder  
22 alternative.

23 Baytree Capital, 2008 U.S. Dist. LEXIS 87872 at \*28-29 (*quoting*  
24 *Comment, Independent Representation for Corporate Defendants in*  
25 *Derivative Suits*, 74 Yale L.J. 524, 533-534 (1965)). Baytree  
26 Capital involved a request to recuse an attorney who represented  
27 the corporation in the derivative suit and had previously  
28 represented the individual corporate defendants in related  
29 matters. The court concluded that it would be inappropriate to  
30 allow a firm to continue representing a corporation with ties to  
31 the individual defendants because of the high likelihood of bias  
32 and inadequate representation. Id. Thus, Barth cannot cure the  
33 conflict at issue simply by withdrawing as Solorio's counsel.

1           However, Deane's assertion that Barth must be disqualified  
2 from representing both Natomas and Solorio is not required, nor  
3 necessary. Deane contends that strong public policy concerns  
4 dictate that Barth be disqualified because allowing him to remain  
5 as counsel for either party would permit it to profit from  
6 unethical conduct, in representing adverse interests. Deane's  
7 concern lacks foundation and support. If Barth is disqualified  
8 from representing Natomas, the adverse interests will still be  
9 present between Natomas and Solorio, but Barth will no longer be  
10 representing adverse parties. More importantly, Barth will no  
11 longer be assisting Natomas in bringing a derivative claim  
12 against a client he has an interest in protecting. Further,  
13 because any distinction between Natomas and its major  
14 shareholders is fictional, it would not be improper for Barth to  
15 represent Solorio in either action. Gong v. RFG Oil, Inc., 166  
16 Cal. App. 4th 209, 217 (2008) (citing Forrest, 58 Cal. App. 4th  
17 at 76).

18           Indeed, permitting Barth to continue representing Solorio is  
19 "consistent with federal authority in the precise circumstance of  
20 attorney disqualification in shareholder derivative litigation,  
21 which holds that while dual representation of a corporation and  
22 its directors is impermissible (at least if the directors are  
23 charged with fraud), the attorney who formerly represented both  
24 clients may continue to represent the individual ones." Forrest,  
25 58 Cal. App. 4th at 81 (citing Musheno v. Gensemer, 897 F. Supp.  
26 at 838); Lewis, 218 F. Supp. at 239. Based on these authorities,  
27 the court finds that while Barth's disqualification from  
28 representing Natomas is mandated, Barth can continue to represent

1 Solorio in the State Court Action or in this action, if Solorio  
2 wishes to have Barth substitute in as his counsel in this matter.

3 **IV. Future Representation of Natomas**

4 Having determined that Barth must be disqualified from  
5 representing Natomas in this action, lastly, the court considers  
6 who may represent Natomas in the future. Pursuant to the Local  
7 Rules of this court, Natomas, as a limited liability company,  
8 cannot appear in this action *pro per*; it must be represented by  
9 counsel. E.D. Cal. L.R. 83-183. Thus, the court will stay all  
10 proceedings in this case for 60 days to permit Natomas to find  
11 substitute counsel.<sup>9</sup>

12 Case law makes clear that said counsel for the corporation  
13 in a derivative action must be "independent counsel" who has had  
14 no previous connection with the corporation or its individual  
15 directors or shareholders. In re Oracle Sec. Litig., 829 F.  
16 Supp. at 1189; Lewis, 218 F. Supp. at 240 (holding "it would be  
17 wise for the corporation to retain independent counsel, who have  
18 had no previous connection with the corporation, to advise it as  
19 to the position which it should take in [the] controversy");  
20 Messing, 439 F. Supp. at 782 (recognizing that only  
21 "[i]ndependent counsel for the corporation, unshackled by any  
22 ties to the directors, [is] in the unique position of having only  
23 the corporation's interest at stake"). Thus, the court directs  
24 Natomas to retain independent counsel that has no prior ties to  
25 the company or any party to this case.

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28 <sup>9</sup> All other pending motions in the case will be continued  
by separate minute order of the court.

1 **CONCLUSION**

2 For the foregoing reasons, the court GRANTS in part and  
3 DENIES in part Deane's motion to disqualify Barth from  
4 representing Natomas and Solorio. Barth is hereby disqualified  
5 from representing Natomas in this action; however, Barth may  
6 continue to represent Solorio in the related State Court Action  
7 or may substitute in as Solorio's counsel in this action.  
8 Natomas is directed to retain independent counsel having no prior  
9 relationship with the company or the individual defendants in  
10 this action. The court stays all proceedings in the case for 60  
11 days to permit Natomas to find substitute counsel.

12 IT IS SO ORDERED.

13 DATED: September 14, 2009

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16 FRANK C. DAMRELL, JR.  
17 UNITED STATES DISTRICT JUDGE  
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