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1 UNITED STATES BANKRUPTCY COURT
2 EASTERN DISTRICT OF CALIFORNIA
3 SACRAMENTO DIVISION

FILED
SEP 29 2014
UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF CALIFORNIA

4 In re:)
5)
6 DELANO RETAIL PARTNERS, LLC,)
7 Debtor.)

Case No. 11-37711-B-7

Chapter 7.

FILED
Sep 29, 2014
CLERK, U.S. DISTRICT COURT
EASTERN DISTRICT OF CALIFORNIA

8 C&S WHOLESALE GROCERS, INC.,)
9 Plaintiff.)

District Court No. 2:14-cv-2263 TLN

Adv. Pro. No. 13-2250-B

10 vs.)
11 HARLEY, DELANO, et al.,)
12 Defendants.)

REPORT AND RECOMMENDATION

13)
14)
15 This matter was deemed submitted on June 10, 2014. The
16 following constitutes the court's proposed findings of fact and
17 conclusions of law, pursuant to 28 U.S.C. § 157(c)(1) and Federal
18 Rule of Bankruptcy Procedure 7052.

19
20 **I. BACKGROUND**

21
22 Before the court is a motion for summary judgment filed by
23 defendant Joseph Neri ("Neri"). The subject matter of this
24 litigation is a transaction between the debtor and an entity
25 known as 2040 Fairfax, Inc. ("2040 FF") which occurred in and
26 around December 2008 and the effects of that transaction on the

1 debtor's financial condition. Individual defendants Harley
2 Delano and Dennis Delano were the sole members of the debtor and
3 the sole shareholders of 2040 FF. Prior to the transaction, the
4 debtor leased a property located at 2040 Sir Francis Drake
5 Boulevard, Fairfax, California (the "Fairfax Store"), at which
6 the debtor operated a grocery store. The store was one of
7 several owned and operated by the debtor at that time. In and
8 around December 2008 the debtor entered into a transaction
9 pursuant to which the debtor transferred assets to 2040 FF,
10 including the debtor's leasehold interest in the Fairfax Store.
11 Neri, as attorney for the debtor and 2040 FF, drafted the legal
12 documents which effectuated the transaction. Two years later in
13 late 2010 the debtor deposited \$560,000.00 to Neri's attorney
14 trust account and entered into an attorney-client fee agreement
15 with Neri which included a provision for a \$500,000.00 retainer.

16 The plaintiff C&S Wholesale Grocers, Inc. alleges in the
17 first amended complaint filed on December 23, 2013 (Dkt. 97) (the
18 "FAC") that the transaction between the debtor and 2040 FF and
19 the later transfer of funds to Neri were designed and carried out
20 by defendants as a means of transferring assets of the debtor to
21 2040 FF so as to put them beyond the reach of the debtor's
22 creditors, including the plaintiff. The plaintiff alleges that
23 these transfers were fraudulent. The plaintiff also alleges that
24 Neri and the Delanos breached fiduciary duties owed to the
25 debtor, that Neri committed legal malpractice in his
26 representation of the debtor and that the Delanos and Neri

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1 converted the debtor's assets. This motion is brought by Neri
2 for summary judgment on the plaintiff's claims against Neri. The
3 FAC alleges the following specific claims for relief against
4 Neri:

- 5
- 6 1.) Avoidance and recovery of intentional fraudulent
- 7 transfer, 11 U.S.C. § 548.
- 8 2.) Avoidance and recovery of constructive fraudulent
- 9 transfer, 11 U.S.C. § 548.
- 10 3.) Avoidance and recovery of intentional fraudulent
- 11 transfer, Cal. Civ. Code § 3439.04(a)(1).
- 12 4.) Avoidance and recovery of constructive fraudulent
- 13 transfer, Cal. Civ. Code §§ 3439.04(a)(2), 3439.05
- 14 5.) Breach of Fiduciary Duty
- 15 6.) Legal Malpractice
- 16 7.) Conversion
- 17

18 The plaintiff brings these claims as an assignee of the
19 chapter 7 trustee, having reached a court-approved agreement with
20 the chapter 7 trustee in the parent bankruptcy case to prosecute
21 the claims on behalf of the bankruptcy estate. Of the foregoing
22 claims, the claims for avoidance of fraudulent transfer are
23 "core" claims which arise under the Bankruptcy Code pursuant to
24 11 U.S.C. §§ 544(b) and 548, and the court may make a final
25 determination of those claims. The claims for breach of
26 fiduciary duty, legal malpractice and conversion are "non-core"

1 or "related to" claims which are before the court by way of
2 supplemental jurisdiction pursuant to 28 U.S.C. § 1367(a), and of
3 which the court lacks constitutional authority to make a final
4 determination. The court makes this report and recommendation
5 because it is recommending a final determination as to the
6 plaintiff's non-core claim of conversion against Neri.

7 For the reasons set forth herein, the motion should be
8 granted in part so that moving defendant Joseph Neri ("Neri")
9 shall have summary judgment that the plaintiff shall take nothing
10 by its claim for relief for conversion against Neri. Neri's
11 request for summary judgment in his favor on the plaintiff's
12 other claims should be denied.

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14 **II. ANALYSIS**

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16 **A.) Summary Judgment Standard**

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18 Fed. R. Bankr. P. 7056, incorporating Fed. R. Civ. P. 56,
19 provides that the court shall grant summary judgment if the
20 movant shows that there is no genuine dispute as to any material
21 fact and the movant is entitled to judgment as a matter of law.
22 The burden of proof on a motion for summary judgment is linked to
23 the burdens of the respective parties at trial:

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25 The moving party initially bears the burden of proving
26 the absence of a genuine issue of material fact.

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1 Celotex Corp. v. Catrett, 477 U.S. 317, 323, 106 S. Ct.
2 2548, 91 L. Ed. 2d 265 (1986). Where the non-moving
3 party bears the burden of proof at trial, the moving
4 party need only prove that there is an absence of
5 evidence to support the non-moving party's case. Id. at
6 325. Where the moving party meets that burden, the
7 burden then shifts to the non-moving party to designate
8 specific facts demonstrating the existence of genuine
9 issues for trial. Id. at 324. This burden is not a
10 light one. The non-moving party must show more than the
11 mere existence of a scintilla of evidence. Anderson v.
12 Liberty Lobby, Inc., 477 U.S. 242, 252, 106 S. Ct.
13 2505, 91 L. Ed. 2d 202 (1986). The nonmoving party must
14 do more than show there is some "metaphysical doubt" as
15 to the material facts at issue. Matsushita Elec. Indus.
16 Co., Ltd. v. Zenith Radio Corp., 475 U.S. 574, 586, 106
17 S. Ct. 1348, 89 L. Ed. 2d 538 (1986). In fact, the
18 non-moving party must come forth with evidence from
19 which a jury could reasonably render a verdict in the
20 non-moving party's favor. Anderson, 477 U.S. at 252. In
21 determining whether a jury could reasonably render a
22 verdict in the non-moving party's favor, all
23 justifiable inferences are to be drawn in its favor.
24 Id. at 255.

25 Dzung Chu v. Oracle Corp. (In re Oracle Corp. Sec. Litig.), 637
26 F.3d 376 (9th Cir. 2010).

1 **B.) In pari delicto defense**

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3 Neri first argues that the doctrine of in pari delicto,
4 meaning, literally, "in equal fault" applies as a bar to all of
5 the plaintiff's claims in this adversary proceeding. Neri argues
6 that the Delanos participated in the alleged wrongdoing that is
7 the subject of this action and as the sole members of the debtor
8 their actions are imputed to the debtor. Neri argues that CSWG,
9 standing in the position of the chapter 7 trustee, is subject to
10 all defenses that Neri could raise against the debtor itself, and
11 that the wrongful conduct imputed to the debtor bars recovery
12 against Neri as another participant in the wrongful conduct.

13

14 The equitable defense of in pari delicto, which
15 literally means "in equal fault," is rooted in the
16 common-law notion that a plaintiff's recovery may be
17 barred by his own wrongful conduct. [Bateman Eichler,
18 Hill Richards, Inc. v. Berner, 472 U.S. 299, 306
19 (1985)] Traditionally, the defense was limited to
20 situations where the plaintiff bore "at least
21 substantially equal responsibility for his injury,"
22 id., at 307, 105 S.Ct., at 2627, and where the parties'
23 culpability arose out of the same illegal act. 1 J.
24 Story, Equity Jurisprudence 399-400 (14th ed. 1918).
25 Contemporary courts have expanded the defense's
26 application to situations more closely analogous to

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1 those encompassed by the "unclean hands" doctrine,
2 where the plaintiff has participated "in some of the
3 same sort of wrongdoing" as the defendant. See Perma
4 Life Mufflers, Inc. v. International Parts Corp., 392
5 U.S. 134, 138, 88 S.Ct. 1981, 1984, 20 L.Ed.2d 982
6 (1968).

7
8 Pinter v. Dahl, 486 U.S. 622 (1988). The Supreme Court in Pinter
9 went on to note that the broadened construction of the doctrine
10 was not appropriate in litigation arising under federal
11 regulatory statutes, an issue not relevant to this adversary
12 proceeding.

13 CSWG does stand in the shoes of the chapter 7 trustee in
14 this matter, having reached an agreement with the trustee to
15 prosecute the claims asserted in this adversary proceeding on
16 behalf of the estate. The issue arises as to whether a party
17 suing in the position of the trustee on behalf of the bankruptcy
18 estate is subject to the doctrine of in pari delicto. This issue
19 has not been directly decided by the Ninth Circuit Court of
20 Appeals. The most oft-cited case at the circuit level on the
21 issue of the applicability of the doctrine of in pari delicto to
22 actions prosecuted on behalf of an estate in bankruptcy is
23 Official Committee of Unsecured Creditors v. R.F. Lafferty & Co.,
24 Inc., 267 F.3d 340 (3d. Cir. 2001), in which the Third Circuit
25 Court of Appeals held that a committee of unsecured creditors was
26 subject to the doctrine of in pari delicto with respect to claims

1 to which the trustee succeeded under 11 U.S.C. § 541(a)(1):

2
3 Under section 541, the bankruptcy estate includes "all
4 legal or equitable interests of the debtor in property
5 as of the commencement" of bankruptcy. 11 U.S.C. §
6 541(a) (emphasis added); see also O'Dowd v. Trueger,
7 233 F.3d 197, 202 (3d Cir.2000). These legal and
8 equitable interests include causes of action. 3 Collier
9 on Bankruptcy ¶ 323.02[1]; accord O'Dowd, 233 F.3d at
10 202-03. Given these provisions, we have held that "in
11 actions brought by the trustee as successor to the
12 debtor's interest under section 541, the 'trustee
13 stands in the shoes of the debtor and can only assert
14 those causes of action possessed by the debtor.
15 [Conversely,] [t]he trustee is, of course, subject to
16 the same defenses as could have been asserted by the
17 defendant had the action been instituted by the
18 debtor." " Hays & Co. v. Merrill Lynch, Pierce, Fenner
19 & Smith, Inc., 885 F.2d 1149, 1154 (3d Cir.1989)
20 (quoting Collier on Bankruptcy ¶ 323.02[4]).

21
22 As these authorities demonstrate, the explicit language
23 of section 541 directs courts to evaluate defenses as
24 they existed at the commencement of the bankruptcy.
25 This direction is entirely consistent with the
26 legislative history.

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3 The answer to our first question should now be
4 apparent. The Committee asks us to consider
5 post-petition events, namely, the removal of the
6 Shapiro family and their co-conspirators from the
7 Debtors' management, as well as the Committee's status
8 as an innocent successor, when weighing the equities of
9 the in pari delicto defense. The plain language of
10 section 541, however, prevents courts from taking into
11 account events that occur after the commencement of the
12 bankruptcy case. As a result, we must evaluate the in
13 pari delicto defense without regard to whether the
14 Committee is an innocent successor.

15
16 Lafferty, 267 F.3d at 356-57. It is important to note, however,
17 that Lafferty addressed only the applicability of the defense to
18 claims to which the estate succeeded pursuant to 11 U.S.C. § 541.
19 Lafferty points out that it does not address claims brought by a
20 trustee under avoiding powers given to the trustee by the
21 Bankruptcy Code. Id. at 356 (The trustee's "avoiding powers are
22 not implicated here..."). Two years after Lafferty, the Third
23 Circuit addressed the applicability of in pari delicto to a claim
24 for avoidance of fraudulent transfer pursuant to 11 U.S.C. § 548,
25 and concluded that in such a case a court could consider the
26 post-petition event of the appointment of a bankruptcy trustee

1 for the purposes of evaluating the doctrine in In re Personal and
2 Business Ins. Agency, 334 F.3d 239 (3d Cir. 2003) ("PBI"). In
3 PBI, the Third Circuit concluded that the replacement of the
4 debtor's principal with the trustee as the individual with
5 control over the debtor rendered a defendant's assertion of in
6 pari delicto based on the principal's unlawful acts to be
7 inapplicable:

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9 The Trustee argues that Lafferty cannot control our
10 decision here because the Committee in Lafferty brought
11 suit under § 541, which specifically bars consideration
12 of events that occurred after the commencement of the
13 bankruptcy, while the Trustee is bringing suit under §
14 548, which has no such language. This argument has
15 merit. The Lafferty Court made clear that its holding
16 did not extend to actions brought under Code sections
17 other than § 541, and it specifically stated that the
18 "trustee's 'avoiding' powers are not implicated here,
19 as they relate to the trustee's power to resist
20 pre-bankruptcy transfers of property."

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24 We agree that "under Pennsylvania law equitable
25 defenses such as the doctrine of imputation that may be
26 sustainable against the corporation may fail to act as

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1 a total bar to recovery when the beneficiaries of the
2 action are the corporation's innocent creditors," and
3 find that the same logic applies to suits brought under
4 § 548 of the Code, and we therefore conclude that we
5 may take the appointment of the Trustee into account
6 when evaluating his fraudulent conveyance claim. There
7 is no limiting language in § 548 similar to that in §
8 541, and without that language there is no reason not
9 to follow the better rule, under which Kesselring's
10 conduct would not be imputed to the Trustee because it
11 would lead to an inequitable result in this case.

12
13 PBI, 334 F.3d at 245-47 (citations omitted). Other courts have
14 extended PBI's analysis to include claims brought by a trustee
15 under the avoiding powers bestowed by 11 U.S.C. § 544. See In re
16 Maui Indus. Loan & Finance Co., 454 B.R. 113, 136 ("The in pari
17 delicto defense is inapplicable when a trustee brings an action
18 under sections 544(b) and 548."); In re Norvergence, Inc., 405
19 B.R. 709, 742 (Bankr.D.N.J.2009); In re Fuzion Technologies
20 Group, Inc., 332 B.R. 225, 232 (Bankr.S.D.Fla.2005).

21 Neri's argument that the doctrine of in pari delicto
22 operates as a complete bar to all of the plaintiff's claims is
23 not persuasive. In this action the plaintiff, standing in the
24 shoes of the chapter 7 trustee, alleges claims for avoidance of a
25 fraudulent transfer of \$560,000.00 from the debtor to Neri under
26 11 U.S.C. § 548(a)(1)(A) and (a)(1)(B). For the reasons stated

1 in PBI, in pari delicto is not a defense to those claims. Neri
2 cannot use alleged participation in wrongdoing by the Delanos as
3 a defense because the Delanos were replaced by the chapter 7
4 trustee, in whose shoes the plaintiff now stands.

5 The plaintiff also alleges claims for avoidance of
6 fraudulent transfer of \$560,000.00 from the debtor to Neri
7 pursuant to Cal. Civ. Code §§ 3439.04(a)(1) and (a)(2) and
8 3439.05. California law allows claims under Cal. Civ. Code §§
9 3409.04 and 3439.05 to be asserted by creditors who seek to avoid
10 fraudulent transfers by debtors to third parties. A trustee in
11 bankruptcy has standing to bring claims under Cal. Civ. Code §§
12 3439.04 and 3439.05 by virtue of 11 U.S.C. § 544(b), which gives
13 the trustee the power to avoid any transfer of an interest of the
14 debtor in property that is voidable under applicable law by a
15 creditor holding an unsecured claim that is allowable under 11
16 U.S.C. § 502. As with the plaintiff's claims under 11 U.S.C. §
17 548, in pari delicto is not applicable as a defense to the
18 trustee's claims under Cal. Civ. Code § 3439.04 and 3439.05.
19 Neri cannot use alleged participation in wrongdoing by the
20 Delanos as a defense because the Delanos were replaced by the
21 chapter 7 trustee, in whose shoes the plaintiff now stands.

22 This leaves, however, claims remaining in the FAC which are
23 not based on trustee avoiding powers under the Bankruptcy Code
24 and are instead state law claims to which the estate succeeded
25 pursuant to 11 U.S.C. § 541. Those claims include breach of
26 fiduciary duty, legal malpractice and conversion. The defense of
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1 in pari delicto is potentially applicable to those claims.

2 California law treats the in pari delicto doctrine as part
3 of the doctrine of "unclean hands."

4

5 "The [unclean hands] doctrine demands that a plaintiff
6 act fairly in the matter for which he seeks a remedy.
7 He must come into court with clean hands ... or he will
8 be denied relief, regardless of the merits of his
9 claim." (Kendall-Jackson Winery, Ltd. v. Superior
10 Court (1999) 76 Cal.App.4th 970, 978, 90 Cal.Rptr.2d
11 743.) "The doctrine of unclean hands requires
12 unconscionable, bad faith, or inequitable conduct by
13 the plaintiff in connection with the matter in
14 controversy. [Citations.] Unclean hands applies when it
15 would be inequitable to provide the plaintiff any
16 relief, and provides a complete defense to both legal
17 and equitable causes of action." (Fladeboe v. American
18 Isuzu Motors, Inc. (2007) 150 Cal.App.4th 42, 56, 58
19 Cal.Rptr.3d 225.) The plaintiff's misconduct must be of
20 such a prejudicial nature that it would be unfair to
21 grant him the relief he seeks in court. (Soon v.
22 Beckman (1965) 234 Cal.App.2d 33, 36, 44 Cal.Rptr.
23 190.) "Whether the defense applies in particular
24 circumstances depends on the analogous case law, the
25 nature of the misconduct, and the relationship of the
26 misconduct to the claimed injuries. [Citation.]" (

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1 Dickson, Carlson & Campillo v. Pole (2000) 83
2 Cal.App.4th 436, 447, 99 Cal.Rptr.2d 678.) The defense
3 applies only "where it would be inequitable to grant
4 the plaintiff any relief." (Ibid.) "The decision of
5 whether to apply the defense based on the facts is a
6 matter within the trial court's discretion." (Ibid.)

7
8 Bank of America, N.A. v. Roberts, 217 Cal.App.4th 1386, 1400
9 (2013).

10 The defense may be invoked against a corporate plaintiff if
11 under California law one or more agents of the plaintiff
12 participated in the wrongful conduct and the conduct may be
13 imputed to the corporation. The exception to the foregoing is
14 the case where the action of the agent was adverse to the
15 interest of the corporation, called the "adverse interest"
16 exception. See, e.g., Bankruptcy Services, Inc. v. Ernst &
17 Young (In re CBI Holding Co.), 247 B.R. 341, 365
18 (Bankr.S.D.N.Y.2000). There is a further exception to the
19 adverse interest exception called the "sole actor" exception
20 under which the actions of the corporation's agent may be imputed
21 to the corporation even if the agent acts adversely to the
22 interest of the corporation, if the agent and the corporation are
23 "one and the same." See, e.g., Lafferty, 267 F.3d at 359.

24 "As a general rule, application of the unclean hands
25 doctrine remains primarily a question of fact. . . . As such, it
26 is not properly determined either on a summary judgment motion or

1 by reference to collateral estoppel principles." Mattco Forge,
2 Inc. v. Arthur Young & Co., 5 Cal.App.4th 392, 407-08 (1992).
3 This is because the doctrine relies heavily on an examination of
4 intent of the plaintiff and the relative culpability of the
5 parties. See Blain v. Doctor's Co., 222 Cal.App.3d 1048, 1060-62
6 (1990).

7 The doctrine of unclean hands is an affirmative defense. At
8 trial, "the defendant generally bears the burden of proving its
9 affirmative defenses." Peregrine Funding, Inc. v. Sheppard
10 Mullin Richter & Hampton LLP, 133 Cal.App.4th 658 (2005).

11 Therefore, for the purposes of summary judgment, Neri bears the
12 initial burden of showing that the elements of his defense are
13 present, after which the burden shifts to the plaintiff to show
14 that there is a dispute of material fact as to one or more of the
15 elements of the defense.

16 In this case, the element over which the parties argue is
17 that of unconscionable, bad faith or inequitable conduct by the
18 Delanos. Neri's reply states that the evidence in support of
19 this element consists of allegations made by plaintiff in the FAC
20 which state that the Delanos , together with Neri, conspired
21 together and orchestrated a scheme by which the debtor
22 transferred assets to 2040 FF, to the detriment of the debtor and
23 for the benefit of themselves and 2040 FF and for the purpose of
24 delaying, hindering or defrauding the interests of the debtor's
25 creditors. Neri argues that these allegations are admissible
26 evidence and may serve as the basis for summary judgment because

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1 the allegations state that Neri and the Delanos engaged in
2 equally culpable bad faith conduct.

3 In response, the plaintiff has shown evidence which shows a
4 dispute of material fact regarding the Delanos' culpability
5 relative to Neri. It is for that reason that the court will not
6 grant Neri summary judgment on the plaintiff's claims for breach
7 of fiduciary duty, legal malpractice and conversion based on his
8 assertion of the in pari delicto defense.

9 The court finds that there is a material dispute of fact
10 regarding the degree to which the Delanos engaged in bad faith
11 conduct equally culpable to Neri's conduct. Specifically, the
12 plaintiff has presented evidence in the form of deposition of
13 testimony of Harley Delano and Dennis Delano that they asked Neri
14 to make sure that a new lease of the Fairfax Store under which a
15 new entity called 2040 Fairfax, Inc. ("2040 FF") would act as
16 tenant in place of the debtor would be done "legally and
17 properly" and that they did not have any intention to harm DRP in
18 connection with the transaction and that Neri proposed to them
19 scenarios which included a transfer of assets between the debtor
20 and 2040 FF. Neri does not dispute that DRP and the Delanos
21 relied on him for legal advice. The plaintiff has also presented
22 evidence in the form of deposition testimony of Neri in which
23 Neri states that he never considered whether the Delanos owed
24 fiduciary duties to the debtor, he was not familiar with the
25 fiduciary duties of members of an LLC, and that he did not advise
26 the Delanos or the debtor to obtain an independent manager or
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1 attorney to review the transaction between the debtor and 2040
2 FF. The court finds that based on this evidence a fact finder or
3 jury could reasonably render a verdict in the plaintiff's favor
4 on the issue of Neri's unclean hands defense. Therefore, there
5 is a dispute of material fact on the issue of the relative
6 culpability of the Delanos and Neri which precludes summary
7 judgment.

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9 To the extent that Neri argues that the plaintiff should be
10 estopped from arguing in oppositon to this motion that there is a
11 dispute of material fact regarding the Delano's intent and their
12 culpability relative to Neri because it contradicts the
13 plaintiff's allegations in the FAC, the argument is not
14 persuasive. The doctrine of judicial estoppel requires a party
15 to have previously prevailed on a prior inconsistent position.
16 New Hampshire v. Maine, 532 U.S. 742, 748-49 (2001). Neri shows
17 no evidence that the plaintiff has previously prevailed on the
18 prior allegedly inconsistent position.

19 Based on the foregoing, Neri is not entitled to summary
20 judgment that the defense of in pari delicto bars all of the
21 plaintiff's claims against him.

22 Having determined that the defense of in pari delicto is not
23 a complete bar to the plaintiff's claims, the court now turns to
24 his arguments regarding the individual claims alleged against him
25 in the FAC.

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1 C.) Fraudulent transfer claims under 11 U.S.C. § 548 and Cal.
2 Civ. Code §§ 3439.04 and 3439.05

3
4 Neri argues that he is entitled to summary judgment on the
5 plaintiff's claims for avoidance of fraudulent transfer pursuant
6 to 11 U.S.C. § 548 and Cal. Civ. Code §§ 3439.04 and 3439.05
7 because there is no dispute of material fact that he was not an
8 "initial transferee," as that term is used for the purposes of 11
9 U.S.C. § 550(a), of the \$560,000.00 transferred from the debtor
10 to Neri's attorney trust account in late 2010.

11 11 U.S.C. § 550(a) provides that to the extent that a
12 transfer is avoided under 11 U.S.C. §§ 544 or 548, the trustee
13 may recover "the property transferred, or, if the court so
14 orders, the value of such property from - (1) the initial
15 transferee of such transfer or the entity for whose benefit such
16 transfer was made." 11 U.S.C. § 550(a)(1) (emphasis added). The
17 plain language of the statute does not require that the initial
18 transferee benefit from the transfer.

19 In the Ninth Circuit, an initial transferee is one who has
20 "dominion" over the money. In re Incomnet, Inc., 463 F.3d 1064,
21 1069-70 (9th Cir.2006). One who has dominion has the "legal
22 authority over the money and the right to use the money however
23 [one] wishe[s]." Id. at 1070.

24 Neri presents evidence in the form of his declaration (Dkt.
25 140), the declaration of Harley Delano (Dkt. 141) and the
26 declaration of Dennis Delano (Dkt. 160) in which each states that

1 in late 2010 the Delanos authorized the debtor to make a series
2 of deposits totaling \$560,000.00 into Neri's attorney trust
3 account. The Delanos and Neri each state that the debtor
4 maintained complete control over the use of the funds while they
5 were in Neri's trust account and Neri did not establish dominion
6 over the funds or mismanage them in any way. Neri also argues
7 that of the \$560,000.00 transferred to him, all of the funds were
8 subsequently transferred to other parties "entirely in accordance
9 with [the debtor's] own wishes" including a transfer of
10 \$384,000.00 to the chapter 7 trustee and \$116,000.00 to pay
11 another attorney to represent the debtor in state court
12 litigation.

13 The burden shifts to the plaintiff to show evidence that
14 raises a dispute of material fact as to whether Neri had dominion
15 over the transferred funds. The plaintiff points to an Attorney-
16 Client Fee Agreement between Neri and the debtor, dated January
17 21, 2011, which is filed as Exhibit G to the FAC and identified
18 in paragraph 45 of the FAC. The Attorney-Client Fee Agreement is
19 also filed as Pursuant to the fee agreement, the debtor agreed to
20 pay Neri \$500,000.00 as a retainer and authorized Neri to deduct
21 his own hourly billings against the retainer and authorized him
22 to "utilize . . . the Retainer to pay co-counsel based on co-
23 counsel's written Attorney-Client Agreement with [the debtor]."
24 The plaintiff has also submitted evidence in the form of Neri's
25 deposition testimony, wherein Neri states that he had not
26 previously had any retainer agreement with the debtor during the

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1 time that the debtor was his client. The plaintiff also submits
2 the declaration of John V. Marklin, who served as a financial
3 consultant for the plaintiff from 2005 to 2012. He states that
4 in November 2010 several grocery stores operated by the debtor
5 throughout the San Francisco Bay Area were suffering substantial
6 losses of revenue and were expected to close. He states that the
7 plaintiff requested that he oversee liquidation sales at the
8 stores and he understood that the debtor had agreed to use the
9 proceeds of the liquidation to pay the debtor's creditors,
10 including the plaintiff. He states that he learned of the
11 transfer of \$560,000.00 of the proceeds of the liquidation sales
12 to Neri's attorney trust account on or about December 21, 2010,
13 after the transfer had already occurred. He also states that
14 Neri wrote to him to make it clear that Marklin was only to
15 contact Neri regarding the funds in the trust account and that no
16 representative of the debtor would respond to requests from
17 Marklin.

18 Neri argues that Marklin's declaration should be stricken in
19 its entirety because Marklin has not been previously disclosed by
20 the plaintiff as a witness, pursuant to Fed. R. Civ. P. 37(c)(1).
21 Neri's request is denied. Pursuant to Fed. R. Civ. P. 7037,
22 incorporating Fed. R. Civ. P. 37(c)(1), a party who fails to
23 provide information or identify a witness as required by Fed. R.
24 Civ. P. 26(a) or (e) is not allowed to use that information or
25 witness to supply evidence on a motion, at a hearing or at a
26 trial unless the failure was substantially justified or is

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1 harmless. Additionally, Fed R. Bankr. P. 9013 requires that a
2 request for an order, such as a request for an order striking
3 Marklin's declaration, be made by motion. Given the nature of
4 the relief sought, such a motion would be a contested matter
5 under Fed. R. Bankr. P. 9014. Neri's request that Marklin's
6 declaration be stricken, set forth in his reply to the
7 plaintiff's opposition, does not satisfy the requirement that a
8 request to strike be made by motion.

9 The court finds that the plaintiff has shown evidence
10 sufficient to establish a dispute of material fact regarding
11 Neri's dominion over the \$560,000.00 transferred to his attorney
12 trust account. The plaintiff has shown evidence that the
13 circumstances surrounding the transfer, including execution of a
14 retainer agreement which provided for a \$500,000.00 retainer
15 which Neri was allowed to utilize to pay himself and co-counsel
16 when he had previously had no retainer agreement with the debtor,
17 and Neri's response to Marklin's inquiry that no representative
18 of the debtor would respond to requests regarding the funds could
19 lead a reasonable finder of fact to conclude that Neri was more
20 than a mere conduit for the funds and exercised dominion over the
21 funds. The fact that some of the funds may have been
22 subsequently transferred to other parties does not eliminate a
23 dispute of material fact over whether Neri exercised dominion
24 over the funds at the time that the transfer was made.

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D.) Breach of fiduciary duty.

The elements of a cause of action for breach of fiduciary duty are: (1) the existence of a fiduciary duty; (2) breach of the fiduciary duty; and (3) damage proximately caused by the breach.

Stanley v. Richmond, 35 Cal.App.4th 1070, 1086 (1995).

The FAC alleges that Neri, as the debtor's attorney, owed fiduciary duties to the debtor including a duty of loyalty and a duty of care. The FAC alleges that Neri violated these duties by deliberately participating in a scheme to transfer an asset belonging to the debtor to 2040 FF and to impose obligations on the debtor for the benefit of 2040 FF without consideration and by transferring funds from the debtor to Neri. The FAC also alleges that Neri violated his duty of due care to the debtor by failing to make written disclosure to the debtor of his simultaneous representation of both the debtor and 2040 FF, by failing to obtain the debtor's written consent to the simultaneous representation, by accepting employment adverse to the debtor, by disclosing confidential and privileged information belonging to the debtor, by failing to disclose to the debtor that he did not have professional liability insurance, by failing to execute a written fee agreement with the debtor at the time he began to serve as the debtor's attorney in 2006 and by charging

1 an "unconscionable" retainer of \$500,000.00 when he did enter
2 into a written fee agreement with the debtor in January, 2011.

3 Neri argues that the plaintiff cannot show evidence to prove
4 causation of damages. In support, he submits the declarations of
5 Harley Delano (Dkt. 141) and Dennis Delano (Dkt. 160) who each
6 state that even if Neri had disclosed to the debtor and the
7 Delanos the alleged conflict in his representation of the debtor
8 and 2040 FF, had provided a written fee agreement and had
9 disclosed that he did not have professional liability insurance
10 that they would have done nothing differently and still would
11 have retained him as counsel for the debtor. Both Delanos also
12 state in their declarations that at no time did Neri make any
13 business decisions on behalf of the debtor or 2040 FF.

14 The burden shifts to the plaintiff to show a dispute of
15 material fact. With respect to Neri's failure to make various
16 disclosures regarding simultaneous representation his lack of
17 liability insurance and the absence of a written fee agreement
18 the plaintiff presents no evidence to show that if these
19 disclosures had been made and a written fee agreement provided
20 that the debtor, through the Delanos, would have taken any other
21 action. On this aspect of the plaintiff's claim for breach of
22 fiduciary duty, the plaintiff has not carried its burden.

23 However, the substance of the plaintiff's claim for breach
24 of fiduciary duty does not solely concern Neri's failure to make
25 disclosures or provide a written fee agreement. The plaintiff
26 also accuses Neri of violating a duty of loyalty and care to the
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1 debtor by participating in a scheme to transfer assets of the
2 debtor to 2040 FF without consideration. On that aspect of the
3 plaintiff's claim for breach of fiduciary duty, the court finds
4 that the plaintiff has submitted sufficient evidence to create a
5 dispute of material fact. Specifically, the plaintiff has
6 presented evidence in the form of deposition of testimony of
7 Harley Delano and Dennis Delano that they asked Neri to make sure
8 that a new lease of the Fairfax Store under which a new entity
9 called 2040 Fairfax, Inc. ("2040 FF") would act as tenant in
10 place of the debtor would be done "legally and properly" and that
11 they did not have any intention to harm DRP in connection with
12 the transaction and that Neri proposed to them scenarios which
13 included a transfer of assets between the debtor and 2040 FF.
14 Neri does not dispute that DRP and the Delanos relied on him for
15 legal advice. The plaintiff has also presented evidence in the
16 form of deposition testimony of Neri in which Neri states that he
17 never considered whether the Delanos owed fiduciary duties to the
18 debtor, he was not familiar with the fiduciary duties of members
19 of an LLC, and that he did not advise the Delanos or the debtor
20 to obtain an independent manager or attorney to review the
21 transaction between the debtor and 2040 FF. A fact finder or
22 jury could reasonably conclude from the foregoing that Neri,
23 without considering whether he owed a duty to the debtor as its
24 attorney, devised and effectuated a scheme by which the debtor
25 was divested of assets without consideration, thus causing damage
26 to the debtor.

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1 Based on the foregoing, Neri is not entitled to summary
2 judgment on the plaintiff's claim for breach of fiduciary duty.

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4 **E.) Legal malpractice**

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6 The elements of a claim for legal malpractice under
7 California law are:

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9 (1) the duty of the attorney to use such skill,
10 prudence, and diligence as members of his or her
11 profession commonly possess and exercise; (2) a breach
12 of that duty; (3) a proximate causal connection between
13 the breach and the resulting injury; and (4) actual
14 loss or damage resulting from the attorney's
15 negligence.

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17 Coscia v. McKenna & Cuneo, 25 Cal.4th 1194, 1199 (2001).

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19 The FAC alleges that as attorney for the debtor, Neri owed
20 the debtor a duty to use such skill prudence and diligence as
21 other members of his profession commonly possess and exercise.
22 The FAC alleges that Neri breached those duties by failing to
23 make written disclosure to the debtor of his simultaneous
24 representation of both the debtor and 2040 FF, by failing to
25 obtain the debtor's written consent to the simultaneous
26 representation, by accepting employment adverse to the debtor, by

1 disclosing confidential and privileged information belonging to
2 the debtor, by failing to disclose to the debtor that he did not
3 have professional liability insurance, by failing to execute a
4 written fee agreement with the debtor at the time he began to
5 serve as the debtor's attorney in 2006 and by charging an
6 "unconscionable" retainer of \$500,000.00 when he did enter into a
7 written fee agreement with the debtor in January, 2011. The FAC
8 also alleges that but for Neri's breach of his duties of care,
9 the debtor would not have entered into the transaction with 2040
10 FF whereby it transferred its assets to 2040 FF and undertook
11 obligations for the benefit of 2040 FF for no consideration.

12 As with the plaintiff's claim for breach of fiduciary duty
13 Neri argues that the plaintiff cannot show evidence to prove
14 causation of damages, again pointing to the declarations of
15 Harley Delano and Dennis Delano, who state that they would have
16 hired Neri even if he had provided them with disclosures and a
17 written fee agreement. Neri also argues that the plaintiff
18 cannot show evidence to establish what level of skill, prudence
19 and diligence Neri failed to possess in performing the legal
20 tasks required of him by the Delanos and the debtor.

21 The burden shifts to the plaintiff to show a dispute of
22 material fact. As with the claim for breach of fiduciary duty,
23 with respect to Neri's failure to make various disclosures
24 regarding simultaneous representation his lack of liability
25 insurance and the absence of a written fee agreement the
26 plaintiff presents no evidence to show that if these disclosures
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1 had been made and a written fee agreement provided that the
2 debtor, through the Delanos, would have taken any other action.
3 On this aspect of the plaintiff's claim for breach of fiduciary
4 duty, the plaintiff has not carried its burden.

5 However, the substance of the plaintiff's claim for legal
6 malpractice does not solely concern Neri's failure to make
7 disclosures or provide a written fee agreement. The plaintiff
8 also accuses Neri of violating a duty of loyalty and care to the
9 debtor by participating in a scheme to transfer assets of the
10 debtor to 2040 FF without consideration. On that aspect of the
11 plaintiff's claim for breach of fiduciary duty, the court finds
12 that the plaintiff has submitted sufficient evidence to create a
13 dispute of material fact. Specifically, the plaintiff has
14 presented evidence in the form of deposition of testimony of
15 Harley Delano and Dennis Delano that they asked Neri to make sure
16 that a new lease of the Fairfax Store under which a new entity
17 called 2040 Fairfax, Inc. ("2040 FF") would act as tenant in
18 place of the debtor would be done "legally and properly" and that
19 they did not have any intention to harm DRP in connection with
20 the transaction and that Neri proposed to them scenarios which
21 included a transfer of assets between the debtor and 2040 FF.
22 Neri does not dispute that DRP and the Delanos relied on him for
23 legal advice. The plaintiff has also presented evidence in the
24 form of deposition testimony of Neri in which Neri states that he
25 never considered whether the Delanos owed fiduciary duties to the
26 debtor, he was not familiar with the fiduciary duties of members

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1 of an LLC, and that he did not advise the Delanos or the debtor
2 to obtain an independent manager or attorney to review the
3 transaction between the debtor and 2040 FF. A fact finder or
4 jury could reasonably conclude from the foregoing that Neri
5 devised and effectuated a scheme by which the debtor was divested
6 of assets without consideration, thus breaching his duty of
7 prudence and diligence as the debtor's attorney and causing
8 damage to the debtor.

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10 **F.) Conversion**

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12 "Conversion is the wrongful exercise of dominion over
13 the property of another. The elements of a conversion
14 are the plaintiff's ownership or right to possession of
15 the property at the time of the conversion; the
16 defendant's conversion by a wrongful act or disposition
17 of property rights; and damages. It is not necessary
18 that there be a manual taking of the property; it is
19 only necessary to show an assumption of control or
20 ownership over the property, or that the alleged
21 converter has applied the property to his own use.
22 [Citations.]" (Oakdale Village Group v. Fong (1996) 43
23 Cal.App.4th 539, 543-544, 50 Cal.Rptr.2d 810.) Money
24 can be the subject of an action for conversion if a
25 specific sum capable of identification is involved. (
26 Weiss v. Marcus (1975) 51 Cal.App.3d 590, 599, 124
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1 Cal.Rptr. 297.)

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3 Farmers Ins. Exchange v. Zerlin 53 Cal.App.4th 445, 452 (1997).

4 The FAC alleges that by intentionally orchestrating a scheme
5 under which the debtor would operate the Fairfax Store for the
6 benefit of 2040 FF, and at the same time pay 2040 FF Rent and 25%
7 of the profit from the Fairfax Store, the defendants (presumably
8 including) Neri wrongfully and intentionally exercised control
9 over the debtor's property and that the debtor could not consent
10 to that control because the Delanos and Neri conspired to
11 dominate and control the debtor.

12 Neri argues that the plaintiff cannot show evidence of a
13 wrongful exercise of dominion over the property of the debtor
14 because the debtor, through the Delanos, consented to the
15 transaction between the debtor and 2040 FF and the transfer of
16 \$560,000.00 to Neri. Neri submits the declarations of Harley
17 Delano and Dennis Delano in support, who each state that they, as
18 the sole members of the debtor, authorized the transaction
19 between 2040 FF and the debtor and authorized the debtor to
20 transfer \$560,000.00 to Neri's attorney trust account.

21 The plaintiff argues in opposition that the debtor did not
22 consent because it was impossible for the Delanos to consent on
23 behalf of the debtor to a transaction in which they had an
24 interest. The plaintiff cites California Rule of Professional
25 Conduct 3-600(E) and Forrest v. Baeza, 58 Cal.App.4th 65 (1997).
26 Those authorities, however, concern the dual representation by an
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1 attorney of a organization and a director, officer, employee,
2 member, shareholder or other constituent of the organization.
3 Those authorities have nothing to do with whether the debtor's
4 consent through the Delanos was ineffective because the Delanos
5 had an interest in the transaction. The court finds that the
6 plaintiff has not carried its burden of showing that there is a
7 dispute of material fact with respect to the debtor's consent to
8 the transfer of funds to Neri. Neri is entitled to summary
9 judgment that the plaintiffs shall take nothing by their claim
10 for conversion against Neri.

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12 **III. RECOMMENDATION**

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14 For all of the above reasons, IT IS HEREBY RECOMMENDED that
15 Neri's motion for summary judgment be granted in part such that
16 Neri shall have summary judgment that the plaintiff shall take
17 nothing by its claim for relief for conversion, and that it be
18 denied as to Neri's request for summary judgment on the
19 plaintiff's claims for avoidance of fraudulent transfer, breach
20 of fiduciary duty and legal malpractice.

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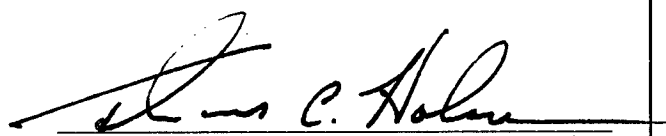
22 These findings and recommendations are submitted to the
23 United States District Judge assigned to the case, pursuant to
24 the provisions of 28 U.S.C. § 157(c)(1). Although section
25 157(c)(1) does not contain the procedural provisions found in 28
26 U.S.C. § 626(b)(1), the court recommends utilizing the same
27 procedure. Accordingly, within fourteen days after being served

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1 with these findings and recommendations, any party may file
2 written objections with the court and serve a copy on all
3 parties. Such a document should be captioned "Objections to
4 Bankruptcy Judge's Report and Recommendation." Failure to file
5 objections within the specified time may waive the right to
6 appeal the District Court's order. Turner v. Duncan, 158 F.3d
7 449, 455 (9th Cir. 1998); Martinez v. Ylst, 951 F.2d 1153 (9th
8 Cir. 1991).

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10 Dated: September 29, 2014



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12 Thomas C. Holman
13 United States Bankruptcy Judge
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