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3 UNITED STATES DISTRICT COURT
4 FOR THE NORTHERN DISTRICT OF CALIFORNIA
5 OAKLAND DIVISION

6 In re:

7 600 ALABAMA LLC, A CORPORATION,
8

Case No: C 09-4378-SBA

Bk. No. 08-31434 DM
Chapter 11

9 **ORDER**

10
11 MARIN MORTGAGE BANKERS CORP
12 (“MMB”), as servicing agent for CHARLES
13 J. FLYNN AND/OR MIK P. FLYNN, OR
14 THEIR SUCCESSORS IN TRUST, UNDER
15 THE FLYNN FAMILY LIVING TRUST,
DATED MAY 7, 1999, AND ANY
AMENDMENTS THERETO ET AL AS
TO AN UNDIVIDIED \$1,270,000
INTEREST,

16 Appellant,

17 vs.

18 DAVID BRADLOW,

19 Appellee.
20

21 This matter comes before the Court on Appellant Marin Mortgage Bankers Corp’s
22 (“MMB”) appeal of the bankruptcy court’s order denying its motion to disqualify David
23 Bradlow (“Bradlow”) as the Chapter 11 Trustee. The Court has jurisdiction pursuant to 28
24 U.S.C. § 158 and Federal Rule of Bankruptcy Procedure 8001. Having read and considered
25 the briefs filed in connection with this matter and having reviewed the record as a whole,
26 the Court reverses the Order and remands the case to the bankruptcy court for the reasons
27 set forth below. The Court, in its discretion, finds this matter suitable for resolution without
28 oral argument. See Fed.R.Civ.P. 78(b); B.L.R. 8010-1(b).

1 **I. BACKGROUND**

2 **A. OVERVIEW**

3 The Debtor, 600 Alabama Street Partners, LLC (“Debtor” or “600 Alabama”), filed
4 a Chapter 11 bankruptcy petition on August 1, 2008. The Debtor’s Estate consists of two
5 primary assets: (1) real property and improvements located at 600 Alabama Street, San
6 Francisco, California (the “Alabama Property”); and (2) a claim in the approximate amount
7 of \$1,000,000 asserted against a related entity, 2712 Mission Partners, L.P. (“Mission
8 Partners”), which subsequently filed for bankruptcy.

9 The Alabama Property is leased to a veterinarian clinic (the “Tenant”), and is
10 encumbered by the multiple liens, as follows: (1) a first lien held by American California
11 Bank (“ACB”) in the approximate amount of \$2,100,000; (2) a second trust deed held by
12 Appellant MMB in the amount of \$520,000; (3) a third trust deed held by Ken Miller
13 (“Miller”) for \$150,000; (4) a fourth trust deed for \$131,000 held by Loanvest V, LLC
14 (“Loanvest”), whose principal was George Cresson; (5) and a fifth trust deed for \$523,000
15 asserted by Lilly Chiang (“Chiang”). Appellant’s Opening Brief (“AOB”) 2.¹ Chiang’s
16 husband, attorney John Sullivan (“Sullivan”), was a manager of Loanvest and also had a
17 business relationship with Miller. He also worked as an attorney for the firm representing
18 Mission Partners. Sullivan’s relationship to the lien holders, the claim against Mission
19 Partners, and his interactions with the bankruptcy trustee, are the center of this appeal.

20 **B. FACTS RELATING TO TRUSTEE**

21 On October 30, 2008, Appellee Bradlow was appointed Chapter 11 Trustee of the
22 Debtor’s Estate per Chiang’s request. AOB 7. Bradlow opined that, “[t]he most important
23 issue in the case relates to the amount of rent that is to be paid per month” by the Tenant on
24 the Alabama Property. Excerpts of Record in Supp. of Appellee’s Opening Brief (“ER”) 3,
25 Dkt. 16. After reaching a rental agreement with the Tenant, Bradlow believed that there

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27 ¹ Although the third, fourth and fifth deeds were placed against the Alabama
28 Property, those deeds actually secured loans made to entities *other than* 600 Alabama. On
that basis, MMB contends that the claims made by those particular lienors have no value.
See AOB 6-7.

1 would be little equity remaining for lien holders junior to ACB (the first lienholder).
2 Appellee’s Response Brief (“RB”) 5, Dkt. 14. Bradlow thus believed that it would not be
3 worthwhile for him to take further action on behalf of the Estate unless he could find a
4 party willing to commit the time and resources to pursue the claim against Mission
5 Partners. Id. at 5-6.

6 In early 2009, counsel for Chiang/Sullivan engaged Bradlow in discussions
7 regarding a purported strategy with respect to the claim against Mission Partners. In an
8 email, dated January 29, 2009, their counsel told Bradlow: “We are trying to get a win-win
9 situation, which, frankly, rescues you from a lot of high-risk, unpaid litigation
10 responsibilities while giving our clients a chance on some recovery on their loans to the
11 debtor.” Certificate of Record (“COA”) Pt. I at 83, Dkt. 3. Under the terms of the
12 proposed deal, Chiang/Sullivan would obtain an unsecured claim in place of their otherwise
13 worthless secured claim. Id. at 84.²

14 On or about February 2, 2009, Bradlow reached a Litigation Agreement with
15 Chiang/Sullivan allowing them to pursue an adversary claim on Bradlow’s behalf in the
16 Mission Partners bankruptcy action. ER 26-30. That agreement also allowed
17 Chiang/Sullivan to pursue actions to avoid the liens of the second, third and fourth trust
18 deed holders (in the 600 Alabama bankruptcy) under 11 U.S.C. § 544(b)(2). ER 26-27. In
19 exchange, Chiang/Sullivan agreed to prosecute all such claims at their own expense. Id. If
20 successful, Chiang/Sullivan would be reimbursed by the Estate for all attorneys’ fees and
21 expenses, with the net recovery split equally between themselves and the Estate. ER 28.

22 MMB opposed the Litigation Agreement because of its potential to undermine their
23 positions as secured lien holders in the bankruptcy. ER 31-39. According to MMB, there
24 was no equity in the Alabama Property, and as such, the only way for Bradlow to “create
25 equity” was to “team up” with junior lienors Chiang/Sullivan and allow them to challenge
26

27 ² The secured claim was valueless because there was insufficient equity in Alabama
28 Property. As an unsecured creditor, however, they would have access to monies recovered
from the adversary action against Mission Partners. See 11 U.S.C. § 506(a)(1).

1 the validity of other senior secured creditors. ER 32. This, MMB claimed, would
2 effectively allow the junior lienors and unsecured creditors to benefit at the expense of
3 secured creditors, such as itself. Id.

4 The bankruptcy court issued an order approving the Litigation Agreement on March
5 4, 2009, and thereafter, Chiang/Sullivan, through their attorney Merle Meyers, sought to
6 avoid the MMB lien. ER 50-57; AOB 2. In addition, on March 16, 2009, Bradlow,
7 through counsel, signed off on a proposed agreement with Chiang/Sullivan and Loanvest,
8 purporting to settle Loanvest's fourth position lien by granting Loanvest an unsecured
9 claim for \$131,000. COA, Pt. 6 at 17-21, Dkt. 3-5.³ Notably, up until January 26, 2009,
10 slightly less than two weeks prior to the motion to approve the Litigation Agreement,
11 Sullivan was the manager of Loanvest. Id., Pt. 13 at 58, Dkt. 3-12.

12 Sullivan and Chiang pursued the adversary action against Mission Partners, as
13 permitted under the Litigation Agreement. During the course of that action, Mission
14 Partner's counsel Scott McNutt ("McNutt") became aware of a potential conflict between
15 Sullivan and Mission Partners. In a supplemental declaration filed with the court on May 6,
16 2009, McNutt disclosed that Sullivan had been working as an attorney for the McNutt Law
17 Group, which was counsel for Mission Partners. AOB 3. McNutt terminated the firm's ties
18 with Sullivan after the bankruptcy court issued its order allowing Chiang/Sullivan to
19 prosecute the claim against McNutt's client Mission Partners. Id. In addition, McNutt
20 presented emails showing that Sullivan had preexisting business relationships with Miller
21 and Loanvest, the third and fourth lienholders, respectively, of the Alabama Property. Id.
22 The bankruptcy court was not advised of any of these potential conflicts when it initially
23 approved the Litigation Agreement. Id. at 3.

24 MMB filed a motion to vacate the Litigation Agreement and to remove Bradlow as
25 trustee in both the adversary proceeding, as well as in the 600 Alabama bankruptcy

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27 ³ There was no equity in the Alabama Property to cover the third, fourth and fifth
28 lienors, converting to unsecured creditor status gave Loanvest the possibility of recovery
from the net proceeds, if any, from the adversary action that Chiang/Sullivan were pursuing
against Mission Partners.

1 proceeding. Id. At a motion hearing on August 20, 2009, the bankruptcy court granted
2 MMB’s motion to vacate the Litigation Agreement, but denied the request to remove
3 Bradlow. With regard to Bradlow, the court focused on its view that no actual harm
4 resulted from the apparent conflict:

5 Well, I mean, let’s concede that point, that if Mr. Bradlow had –
6 or anyone – had come and said, let’s approve the settlement and
7 allow Loanvest [the fourth position lienholder] or anyone else a
8 claim in the amount of some amount of dollars, without
9 disclosing things, maybe that would have been inappropriate.
But it still didn’t happen. In other words, I guess I’ve
hammered on this with you before. *How can I fault someone
for someone for something that didn’t happen?*

10 Tr. 10, Aug. 20, 2009 (emphasis added); see also id. 116-17. As noted, however, Bradlow,
11 through counsel, had, in fact, signed an agreement allowing Loanvest’s \$131,000 worthless
12 claim. Id. at 9. The claim ultimately was not approved by Bradlow due to MMB’s efforts
13 to set aside the Litigation Agreement and request to disqualify him as trustee. Id.

14 Appellant now appeals the Order denying the motion to remove Bradlow as trustee
15 on the ground that the bankruptcy court abused its discretion by applying an erroneous legal
16 standard in deciding whether to remove Bradlow as trustee. The matter has been fully
17 briefed and is now ripe for decision.⁴

18 **II. LEGAL STANDARD**

19 A bankruptcy court’s decision on a request to remove a trustee under 11 U.S.C.
20 § 324 is reviewed for abuse of discretion. In re AFI Holding, Inc., 355 B.R. 139, 147 (9th
21 Cir. BAP 2006) (“AFI I”). “A bankruptcy court necessarily abuses its discretion if it bases
22 its decision on an erroneous view of the law or on clearly erroneous factual findings.” Id.
23 It also abuses its discretion if it applies an incorrect legal rule. Id.

24 **III. DISCUSSION**

25 Appellant argues that Bradlow should be removed as trustee, pursuant to 11 U.S.C.
26 § 324, based on an appearance of impropriety. AOB 16. Section 324 provides that “[t]he

27 ⁴ In light of the Court’s analysis, the Court does not reach the merits of MMB’s
28 remaining arguments.

1 court, after notice and a hearing, may remove a trustee, other than the United States trustee,
2 or an examiner, *for cause*.” 11 U.S.C. § 324(a) (emphasis added). At issue here is whether
3 the bankruptcy court applied the proper standard when evaluating “cause” for a trustee’s
4 removal. MMB contends that the bankruptcy court abused its discretion by applying what
5 it contends was tantamount to an “actual harm” standard. More specifically, MMB asserts
6 that the bankruptcy court erroneously concluded that its decision to invalidate the Litigation
7 Agreement and the fact that the trustee ultimately did seek approval of Loanvest’s claim
8 obviated the need to remove Bradlow as trustee, since no actual harm resulted from
9 Bradlow’s apparent conflict of interest. AOB 16-17. Rather, MMB argues that the
10 bankruptcy court should have considered whether Bradlow involvement as trustee created
11 an appearance of impropriety.

12 In assessing whether to remove a trustee for a conflict of interest under § 324, the
13 bankruptcy court must consider whether the trustee is “disinterested.” In re AFI Holding,
14 Inc., 530 F.3d 832, 837-38 (9th Cir. 2008) (“AFI II”).⁵ “A trustee/fiduciary must be free
15 from any hint of bias.” Id. at 850. “[D]isinterestedness covers not only actual impropriety,
16 but the appearance of impropriety as well.” Id. (internal quotations omitted). The
17 bankruptcy court’s consideration of whether to remove a trustee under § 324 “is determined
18 on a case-by-case, totality-of-circumstances approach[.]” Id. In that regard, a court should
19 consider whether: (1) the trustee has “some interest or relationship that would even faintly
20 color the independence and impartial attitude required by the Code”; (2) the “conflict is
21 sufficiently materially adverse to the estate to find a lack of disinterestedness”; and (3) “a
22 trustee’s past affiliations with insiders and an appearance of impropriety that may create a
23 potential for a materially adverse effect on the estate.” Id. at 838 (citing AFI I, 355 B.R. at
24 151).

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27 ⁵ While the AFI dealt with a Chapter 7 trustee and the instant case deals with a
28 Chapter 11 trustee, both require that the trustee be disinterested making the holding
applicable. See AFI II, 530 F.3d at 852 n.16; 11 U.S.C § 702(a)(1); 11 U.S.C § 1104(b) and
(d).

1 Here, the bankruptcy court did not consider whether the trustee was disinterested or
2 whether his prior affiliations created an appearance of impropriety. Rather, the court
3 predicated its decision on the conclusion that no harm occurred because it rescinded its
4 approval of the Litigation Agreement and because Bradlow never sought judicial approval
5 of the Loanvest claim. In other words, the bankruptcy court focused entirely on the issue of
6 actual harm. As discussed above, however, the Ninth Circuit has not adopted such an
7 approach. Insofar as the bankruptcy court did not analyze MMB's motion to disqualify
8 Bradlow based on the considerations set forth in AFI II and instead required a showing of
9 actual harm, the bankruptcy court abused its discretion by applying the incorrect legal
10 standard. See AFI I, 355 B.R. at 147. On remand, the bankruptcy court should reconsider
11 MMB's request to remove Bradlow as trustee, consistent with the standards as set forth
12 above.

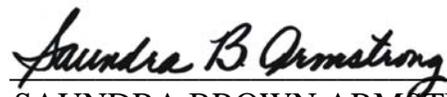
13 **IV. CONCLUSION**

14 For the reasons stated above,

15 IT IS HEREBY ORDERED THAT that Bankruptcy Court's Order is REVERSED
16 and the case REMANDED in accordance with this opinion.

17 IT IS SO ORDERED.

18 Dated: September 28, 2010

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20 SAUNDRA BROWN ARMSTRONG
21 United States District Judge
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1 UNITED STATES DISTRICT COURT
2 FOR THE
3 NORTHERN DISTRICT OF CALIFORNIA

4 IN RE: 600 ALABAMA LLC,
5
6 Plaintiff,

7 v.

8 IN RE: 600 ALABAMA LLC et al,
9
10 Defendant.

11 _____/

Case Number: CV09-04378 SBA

CERTIFICATE OF SERVICE

12 I, the undersigned, hereby certify that I am an employee in the Office of the Clerk, U.S. District
13 Court, Northern District of California.

14 That on September 28, 2010, I SERVED a true and correct copy(ies) of the attached, by placing
15 said copy(ies) in a postage paid envelope addressed to the person(s) hereinafter listed, by
16 depositing said envelope in the U.S. Mail, or by placing said copy(ies) into an inter-office delivery
17 receptacle located in the Clerk's office.

18 U.S. Bankruptcy Court, No. District of CA (San Francisco)
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20 235 Pine Street
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22 San Francisco, CA 94120-7341

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24 US Bankruptcy Court
25 Northern District of California
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28 San Francisco, CA 94120-7341

Dated: September 28, 2010

Richard W. Wieking, Clerk

By: LISA R CLARK, Deputy Clerk