### Effective Oral Argument: a Live Demonstration

### Panelists:

The Honorable Margaret M. Mann Kay Catherwood, Esq. Michael O'Halloran, Esq.

- 1. *In re Zarate*, 567 B.R. 176 (2017)
- 2. *In the Matter of Walldesign, Inc.*, 872 F.3d 954 (2017)
- 3. Jared K. Carter; Lauren Bishop, Oral Argument and Advocacy: Practice Ready Tips, 42 Vt. B.J. 30 (2016)
- 4. Kathryn E. Kasper, Transforming a Skillfully Crafted Brief into an Effective Oral Argument, 20 Woman Advoc. 25 (2015)
- 5. Margaret Grignon, Oral Argument: Facing the Challenge and Embracing the Opportunity, 19 Woman Advoc. 22 (2014)

567 B.R. 176
United States Bankruptcy Court,
N.D. California,
Oakland Division.

IN RE Floro T. ZARATE and Patricia G. Zarate, Debtors. Joseph and Juliana Taburaza, et al., Plaintiffs,

Floro T. Zarate and Patricia G. Zarate, Defendants.

Case No. 14–42250 RLE

|
Adversary Proceeding No. 14–4119

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Signed February 2, 2017

#### **Synopsis**

**Background:** After judgment creditors, who had entered into a prepetition asset purchase agreement by which Chapter 7 debtors agreed to sell two skilled nursing facilities to them, obtained a stipulated judgment in their adversary proceeding against debtors stating that debtors owed them a nondischargeable debt of \$831,018.31, judgment creditors filed motion for award of "prevailing party" attorney fees and costs. Debtors opposed motion.

**Holdings:** The Bankruptcy Court, Roger L. Efremsky, J., held that:

- [1] under California law, this adversary proceeding was not one to enforce the terms of the parties' asset purchase agreement or to collect monies due thereunder, and so judgment creditors were not entitled to an award of attorney fees under the agreement's attorney fees provision;
- [2] the adversary proceeding was not an "action on a contract" and so judgment creditors were not entitled to an award of attorney fees pursuant to California statute providing for award of attorney fees to prevailing party in action on a contract if contract provides for award of fees to one of parties in action to enforce contract;
- [3] even if the language of the asset purchase agreement's indemnity provision were broad enough to cover a tort claim such as this nondischargeability proceeding, it did

not apply in litigation between the parties but, rather, was merely a third party indemnity provision; and

[4] the court would exercise its discretion to decline to award costs.

Motion denied.

West Headnotes (22)

#### [1] Bankruptcy

Prevailing party

Under the American Rule, the prevailing party is ordinarily not entitled to collect reasonable attorney fees from the loser.

Cases that cite this headnote

#### [2] Bankruptcy

Prevailing party

American Rule, that the prevailing party is ordinarily not entitled to collect reasonable attorney fees from the loser, is a default rule that can be overcome by statute and by contract.

Cases that cite this headnote

#### [3] Costs

Contracts

Under California law, parties may agree that the prevailing party in litigation may recover attorney fees, whether the litigation sounds in contract or in tort. Cal. Civ. Proc. Code § 1021.

Cases that cite this headnote

#### [4] Costs

Contracts

Under California law, attorney fees are included in costs when authorized by contract. Cal. Civ. Proc. Code §§ 1032, 1033.5.

Cases that cite this headnote

#### [5] Costs

#### Contracts

California statute providing for award of attorney fees to prevailing party in action on a contract if contract provides for award of fees to one of parties in action to enforce contract does not apply to tort claims; statute determines which party, if any, is entitled to attorney fees on a contract claim. Cal. Civ. Code § 1717.

Cases that cite this headnote

#### [6] Bankruptcy

# Dischargeability determinations; consumer debt issues

Under California law, judgment creditors' nondischargeability proceeding against Chapter 7 debtors, in which they sought damages for fraud, was not one to enforce the terms of the parties' prepetition asset purchase agreement or to collect monies due thereunder, and so judgment creditors were not entitled to an award of attorney fees under the agreement's attorney fees provision. 11 U.S.C.A. § 523(a)(2)(A).

Cases that cite this headnote

#### [7] Contracts

#### ← Intention of Parties

Under California law, the basic goal in contract interpretation is to give effect to the parties' mutual intent at the time of contracting.

Cases that cite this headnote

#### [8] Contracts

#### Language of contract

Under California law, when a contract is reduced to writing, the parties' intention is determined from the writing alone, if possible. Cal. Civ. Code § 1639.

Cases that cite this headnote

#### [9] Contracts

#### ← Language of Instrument

Under California law, the words of a contract are to be understood in their ordinary and popular sense. Cal. Civ. Code § 1644.

Cases that cite this headnote

#### [10] Bankruptcy

# Dischargeability determinations; consumer debt issues

Under California law, judgment creditors' nondischargeability proceeding against Chapter 7 debtors was not an "action on a contract," and so judgment creditors were not entitled to award of "prevailing party" attorney fees pursuant to California statute providing for award of attorney fees to prevailing party in action on a contract if contract provides for award of fees to one of parties in action to enforce contract; the dischargeability of a debt resolves a tort claim, a tort claim does not "enforce" a contract, and whether the parties' underlying asset purchase agreement was enforceable was never in question. 11 U.S.C.A. § 523(a)(2)(A); Cal. Civ. Code § 1717.

Cases that cite this headnote

#### [11] **Costs**

#### Contracts

Under California law, a tort claim does not "enforce" a contract and so is not an "action on a contract" within meaning of statute authorizing an award of attorney fees in an action on a contract. Cal. Civ. Code § 1717.

Cases that cite this headnote

#### [12] Bankruptcy

#### Fraud

Dischargeability of a debt, under the discharge exception for debts obtained by false pretenses, a false representation, or actual fraud, resolves a tort claim. 11 U.S.C.A. § 523(a)(2)(A).

#### Cases that cite this headnote

#### [13] Bankruptcy

Fraud

To prevail on a theory under the discharge exception for debts obtained by false pretenses, a false representation, or actual fraud, and the analogous common law fraud theory, plaintiff must prove: (1) debtor made a misrepresentation or fraudulent omission, (2) with knowledge of its falsity, (3) with the intention of deceiving creditor, (4) creditor relied on the representation, and (5) creditor sustained damage as a proximate result. 11 U.S.C.A. § 523(a)(2)(A).

Cases that cite this headnote

#### [14] Bankruptcy

Dischargeability determinations;
 consumer debt issues

#### **Indemnity**

Subject-matter in general

#### **Indemnity**

Attorney fees

Under California law, even if language of indemnity provision contained in prepetition asset purchase agreement executed by judgment creditors and Chapter 7 debtors were broad enough to cover a tort claim such as judgment creditors' nondischargeability proceeding against debtors, it did not apply in litigation between the parties but, rather, was merely a third party indemnity provision; agreement contained a specific attorney fees clause and interpreting the indemnity provision as another attorney fees provision that was implicated in a dispute between the parties would have rendered the other clause surplusage, provision contained "shall indemnify and hold harmless" language, and review of all three sub-parts of provision showed that it was, in its entirety, a third party indemnification provision. 11 U.S.C.A. § 523(a)(2)(A).

Cases that cite this headnote

#### [15] Indemnity

#### Construction and Operation of Contracts

Under California law, indemnity agreements are construed under the same rules governing the interpretation of other contracts.

Cases that cite this headnote

#### [16] Contracts

Construction as a whole

Under California law, a written contract must be read as a whole and every part interpreted with reference to the whole.

Cases that cite this headnote

#### [17] Contracts

Construction as a whole

Under California law, court must give effect to every word or term employed by the parties in a contract and reject none as meaningless or surplusage.

Cases that cite this headnote

#### [18] Contracts

Construction as a whole

Under California law, courts must interpret a contract in a manner that gives full meaning and effect to all of the contract's provisions and avoid a construction of the contract that focuses only on a single provision.

Cases that cite this headnote

#### [19] **Costs**

Contracts

Including attorney fees as an item of loss in a third party indemnity provision generally does not constitute a provision for the award of attorney fees in an action on the contract itself, as required to trigger California statute providing for award of attorney fees to prevailing party in action on a contract if contract provides for award of fees to one of parties in action to enforce contract. Cal. Civ. Code § 1717.

#### Cases that cite this headnote

#### [20] **Costs**

Contracts

#### **Indemnity**

Subject-matter in general

#### **Indemnity**

Attorney fees

Under California law, key indicator in distinguishing third party indemnification provisions from provisions for the award of attorney fees incurred in litigation between the parties to the contract is an express reference to indemnification; clause that contains the words "indemnify" and "hold harmless" generally obligates the indemnitor to reimburse the indemnitee for any damages the indemnitee becomes obligated to pay third persons, that is, it relates to third party claims, not attorney fees incurred in a breach of contract action between the parties to the indemnity agreement itself.

#### Cases that cite this headnote

#### **[21]** Costs

Contracts

#### **Indemnity**

Attorney fees

Under California law, in distinguishing third party indemnification provisions from provisions for the award of attorney fees incurred in litigation between the parties to the contract, courts examine the context in which the language appears; if the surrounding provisions describe third party liability, the clause will be construed as a standard third party indemnification provision.

#### Cases that cite this headnote

#### [22] Bankruptcy

Dischargeability determinations;
 consumer debt issues

Bankruptcy court would exercise its discretion to decline to award costs to

judgment creditors, as "prevailing parties" in their nondischargeability proceeding against Chapter 7 debtors, where judgment creditors' request for costs did not include a bill of costs or otherwise provide the documentation required by local rule, nor did judgment creditors comply with substantive limitations set forth in the federal statute governing taxation of costs. 11 U.S.C.A. § 523(a)(2)(A); 28 U.S.C.A. § 1920.

Cases that cite this headnote

#### **Attorneys and Law Firms**

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R. Kenneth Bauer, Law Offices of R. Kenneth Bauer, Walnut Creek, CA, for Defendants.

# Memorandum Decision on Plaintiffs' Motion for Attorney's Fees and Costs and Order Thereon

Roger L. Efremsky, U.S. Bankruptcy Judge

#### I. Introduction

On September 15, 2016, the court entered a stipulated judgment in favor of plaintiffs Joseph and Juliana Taburaza. The judgment states that defendants owe a non-dischargeable debt of \$831,018.31 to plaintiffs. October 13, 2016, plaintiffs filed this motion for an award of attorney's fees and costs as the prevailing party in the adversary proceeding. Defendants opposed this motion. The matter has been fully briefed and argued. This is the court's findings of fact and conclusions of law as required by Fed. R. Bankr. P. 7052. <sup>1</sup>

#### II. Background

#### a. The 2005 Asset Purchase Agreement

In June 2005, the parties entered into an Asset Purchase Agreement (the "APA") by which defendants agreed to sell two skilled nursing facilities (the "Facilities") to plaintiffs. Defendants operated the Facilities through Tru–Care, Inc., a California corporation. Defendants owned a 60% interest, and plaintiffs owned a 40% interest,

in the Tru-Care shares and in the two pieces of real property (known as "Milpitas" and "Wisteria") on which the Facilities operated. APA, Recital A.

The transaction contemplated by the APA was a transfer to plaintiffs of defendants' Tru–Care shares or the Tru–Care assets, and of defendants' 60% interest in Milpitas and Wisteria. At closing, plaintiffs were to pay the secured debt on Milpitas and Wisteria and assume certain obligations of the business including certain tax debts. APA, § 2.1–2.4.

Relevant to this dispute, Recital C of the APA described what plaintiffs agreed to pay as the "major obligations" and "estimated balances" related to Milpitas, Wisteria, and Tru–Care: two secured loans on Milpitas totaling \$1,275,791; two secured loans on Wisteria totaling \$812,188; \$28,000 owed under a settlement agreement; \$100,000 owed to an individual named Vicki Gaceta Smith; and estimated employment tax obligations of \$400,000. APA, Recital C.

The closing was to take place 90 days after execution of the APA. APA, § 6.1. The defendants were to manage the Facilities until plaintiffs obtained the required regulatory approvals to operate the Facilities. APA, § 3.1. Section 3.1 stated that defendants would not incur any new liabilities except in the ordinary course of business during this interim period. Article 4 described defendants' representations and warranties. Defendants represented that \*180 there were no unpaid tax debts other than the \$400,000 disclosed in Recital C, and that their representations were true and did not omit anything material. APA, § 4.1(d) and § 4.1(t).

If plaintiffs were unable to obtain the regulatory approvals by the contemplated 90–day closing date, plaintiffs could extend the closing date by 6 months. APA, § 8.1(a)(i). In addition, if the regulatory approvals were not obtained in the extended 6 month period, plaintiffs could either proceed or elect not to proceed with the purchase. APA, § 8.1(a)(ii).

Article 11, entitled Post Closing Covenants, contained the following provision:

11.6(a) Sellers agree to defend, indemnify and hold Buyers ... harmless from and against any and all loss, damage, liability, action

or proceeding, including without limitation, attorney's fees, ("Loss") resulting from or arising out of (i) any inaccuracy in or breach of any representation, warranty, covenant, or obligation made or incurred by Sellers herein or in any other agreement.

Section 11.6(b) provided the same protection to Sellers. Section 11.6(c) described the procedures to be followed "[i]f any legal proceedings shall be instituted or any claim is asserted by any third party in respect of which any Party may be entitled to indemnity hereunder." APA, § 11.6(c).

Article 12, entitled Miscellaneous, contained the following provision:

§ 12.9 Attorneys Fees. In event suit is brought or an attorney is retained by any party to this Agreement to enforce the terms of this Agreement or to collect any moneys due hereunder, the prevailing party shall be entitled to recover reimbursement for reasonable attorneys' fees, court costs, costs of investigation and other related expenses incurred in connection therewith.

# b. The 2009 Amendment to the Asset Purchase Agreement

For reasons that are not entirely clear, the closing did not take place as described in the APA and it may never have taken place. However, in 2009, the parties executed the First Amendment to Purchase Agreement and Assignment and Assumption Agreement (the "2009 Agreement"). The 2009 Agreement incorporated the provisions quoted above. It also stated that the parties had entered into a management agreement and a lease of the Milpitas and Wisteria real properties effective as of April 1, 2009 or the date plaintiffs received regulatory approval.

According to Recital C of the 2009 Agreement, the APA was amended to allow plaintiffs to waive their due diligence closing conditions, amend the closing date, amend certain representations and warranties in connection with the management agreement, and update

the outstanding financial obligations relating to Milpitas and Wisteria and the business. 2009 Agreement, Recital C.

Section 6 of the 2009 Agreement, entitled Amended Financial Obligations, provided that Recital C of the APA was replaced with a new listing of the "major obligations" and their "estimated balances" as of April 1, 2009. The new list included the two secured loans on Milpitas with slightly lower balances totaling \$1,193,437, and the two secured loans on Wisteria with slightly lower balances totaling \$753,080; the same \$100,000 owed to the individual named Vicki Gaceta Smith, and the same \$400,000 estimated employment tax obligation. 2009 Agreement, § 6.

Plaintiffs later discovered defendants had failed to disclose significant liabilities. This prompted plaintiffs to sue defendants in state court for breach of contract and obtain a \$1.34 million default judgment.

#### \*181 c. The Complaint and Answer

Soon after defendants filed their bankruptcy case, plaintiffs initiated this adversary proceeding. AP Docket no. 1. The first claim for relief was based on a theory of fraud in the inducement under § 523(a)(2)(A). The essential allegations were that defendants had, with intent to deceive, "misrepresented facts, concealed and failed to disclose" material facts in order to induce plaintiffs to enter into the 2009 Agreement, resulting in damage of \$1.34 million. In the prayer, plaintiffs sought judgment for the amount of this debt plus pre-judgment interest, contractual attorneys fees, costs, and disbursements. <sup>2</sup>

Defendants answered the complaint, generally denying its essential allegations. AP docket no. 8.

#### d. The Summary Judgment Rulings

In July 2015, plaintiffs filed a motion for summary judgment. AP docket nos. 20–24, 26. In response, defendants admitted they had failed to disclose multiple material obligations and admitted that a debt of some amount was non-dischargeable but that plaintiffs had not established the amount of the damages resulting from the defendants' non-disclosures. AP docket nos. 27–28.

Plaintiffs filed supplemental declarations in an effort to establish the amount of their damages. AP Docket nos. 37, 39. Defendants responded that the plaintiffs had again

failed to prove their damages. AP docket no. 38. At the hearing held on January 7, 2016, the court found that plaintiffs had failed to establish their damages with any precision and summary judgment was denied except as to \$32,468 for certain unpaid medical insurance premiums.

At this point, the parties agreed to attend judicial mediation. However, this mediation was ultimately unsuccessful and in May 2016, the court set a trial date of August 25, 2016.

#### e. The Stipulated Judgment

At the beginning of the trial on August 25, 2016, the parties announced that they had reached a settlement by which defendants agreed that \$831,018.31 was a non-dischargeable debt. On September 15, 2016, the court entered the judgment. AP docket no. 71.

#### f. The Motion for Attorney's Fees

On October 13, 2016, plaintiffs filed this motion for an award of attorney's fees and costs. AP docket nos. 73–75. The motion seeks an award of \$316,887.00 in attorney's fees pursuant to Rule 7054, California Code of Civil Procedure § 1021 and § 1032, and California Civil Code § 1717, and \$11,748.25 in costs pursuant to 28 U.S.C. § 1920. (Plaintiffs' motion repeatedly refers to "California Code of Civil Procedure § 1717" which is obviously incorrect. The section is California Civil Code § 1717.)

Defendants' opposition argues that the motion is untimely because Civil Rule 54(d)(2)(B), applicable here by Rule 7054(b)(2), requires such a motion to be filed no later than 14 days after the entry of judgment. The opposition also argues that fees are not allowed under California law because this was not an action on a contract; it was a tort action based on a fraud in the inducement theory. Finally, defendants argue that the requested fees and costs are excessive because the request includes fees and costs incurred in the state court litigation. AP docket no. 82.

#### \*182 III. Discussion

#### a. Timeliness of the Motion

The court will first dispose of the defendants' timeliness argument. It is true that the motion was not filed within 14 days of entry of the judgment as required by Rule 7054(b) (2) which makes Civil Rule 54(d)(2)(B)(i) applicable here.

It is also true, as defendants point out, that neither defendants nor the court agreed to any extension of time. However, the discussion on the record on August 25, 2016, when the parties announced their settlement, may have led plaintiffs to believe that filing this motion within 30 days was acceptable.

The court does not necessarily agree with this interpretation. Nevertheless, if plaintiffs had sought an order extending their time under Rule 9006 and the relevant excusable neglect analysis under Pioneer Investment Services Co. v. Brunswick Assoc. Limited Partnership, 507 U.S. 380, 113 S.Ct. 1489, 123 L.Ed.2d 74 (1993), the court would have exercised its discretion to grant it. To the extent necessary, the court grants such an extension now. For these reasons, the court will consider the motion timely and deal with it on its merits.

#### b. Statutory Framework for Attorney's Fees

[1] [2] Under the American Rule, the prevailing party is ordinarily not entitled to collect a reasonable attorney's fee from the loser. Alyeska Pipeline Serv. Co. v. Wilderness Soc'y, 421 U.S. 240, 247, 95 S.Ct. 1612, 44 L.Ed.2d 141 (1975). This default rule can be overcome by statute and by contract. Travelers Cas. and Sur. Co. of America v. Pacific Gas and Elec. Co., 549 U.S. 443, 448, 127 S.Ct. 1199, 167 L.Ed.2d 178 (2007).

[3] California follows the American Rule. California Code of Civil Procedure § 1021 says "[e]xcept as attorney's fees are specifically provided for by statute, the measure and mode of compensation of attorneys ... is left to the agreement, express or implied, of the parties." Section 1021 allows the parties to agree that the prevailing party in litigation may recover attorney's fees, whether the litigation sounds in contract or in tort. 3250 Wilshire Blvd. Bldg. v. W.R. Grace & Co., 990 F.2d 487, 489 (9th Cir. 1993) (language of agreement determines whether party entitled to fees or costs; agreement covered tort claims because it covered suits with "respect to subject matter or enforcement" of agreement); Xuereb v. Marcus & Millichap, Inc., 3 Cal.App.4th 1338, 1341, 5 Cal.Rptr.2d 154 (1992) (agreement providing for fees and costs in any "lawsuit or other legal proceeding" to which the "agreement gives rise" was broad enough to cover contract and tort claims).

[4] Code of Civil Procedure § 1032(b) says "except as otherwise expressly provided by statute, a prevailing party

is entitled as a matter of right to recover costs in any action or proceeding." Code of Civil Procedure § 1033.5 lists the items that are allowable as costs under § 1032. Attorney's fees are included in costs "when authorized by contract." Code Civ. Proc. § 1033.5(a)(10)(A).

Under California Civil Code § 1717(a), "in any action on a contract, where the contract specifically provides that attorney's fees and costs which are incurred to enforce that contract, shall be awarded either to one of the parties or to the prevailing party, then the party who is determined to be the party prevailing on the contract, whether he or she is the party specified in the contract or not, shall be entitled to reasonable attorney's fees in addition to other costs."

[5] \*183 Civil Code § 1717 does not apply to tort claims; it determines which party, if any, is entitled to attorney's fees on a contract claim. Stout v. Turney, 22 Cal.3d 718, 730, 150 Cal.Rptr. 637, 586 P.2d 1228 (1978) (action for fraud arising out of a contract to sell real property was not an action on a contract within the meaning of Civil Code § 1717); Santisas v. Goodin, 17 Cal.4th 599, 615, 71 Cal.Rptr.2d 830, 951 P.2d 399 (1998) (complaint alleging failure to disclose defects in sales transaction sounded in tort and was entirely outside the scope of Civil Code § 1717).

Against this background, the questions are whether this § 523(a)(2)(A) case was an "action on a contract," and, if not, whether the attorney's fee provisions in the APA are broad enough to cover a tort claim.

### c. Code of Civil Procedure § 1021—Language of the Agreement

[6] The attorney's fee provision in § 12.9 of the APA provided:

In event suit is brought or an attorney is retained by any party to this Agreement to enforce the terms of this Agreement or to collect any moneys due hereunder, the prevailing party shall be entitled to recover reimbursement for reasonable attorneys' fees, court costs, costs of investigation and other related expenses incurred in connection therewith.

[7] [8] [9] The basic goal in contract interpretation to give effect to the parties' mutual intent at the time of contracting. When a contract is reduced to writing, the parties' intention is determined from the writing alone, if possible. Cal. Civ. Code § 1639. The words of a contract are to be understood in their ordinary and popular sense. Cal. Civ. Code § 1644.

While the case law in this area is not a model of clarity, there are several cases that guide the court in interpreting an attorney's fee provision such as this one. In short, provisions such as § 12.9—by its terms limited to enforcement of the terms or collection of what is owed-have been held not to extend to fees incurred in litigating tort claims. Exxess Electronixx v. Heger Realty Corp., 64 Cal.App.4th 698, 707-708, 75 Cal.Rptr.2d 376 (1998) (an action or proceeding to "enforce the terms or declare rights" under a lease did not cover fraud claims); Sharma v. Salcido (In re Sharma), 2013 WL 1987351, \*18 (9th Cir. B.A.P. 2013) (suit to "enforce or interpret" a settlement agreement did not cover fees in a § 523(a)(2)(A) case involving fraud in inducement of settlement agreement). In contrast, provisions with broader language—suits arising from or with respect to the subject matter or enforcement of a contract—have been held to extend to fees incurred in litigating tort claims. 3250 Wilshire Blvd. Building v. W.R. Grace & Co., 990 F.2d 487, 489 (9th Cir. 1993) (contract providing for fees for any suit with respect to "the subject matter or enforcement" of contract covered tort claims); Santisas v. Goodin, 17 Cal.4th 599, 608, 71 Cal.Rptr.2d 830, 951 P.2d 399 (1998) (agreement for fees for any "litigation arising out of the execution" of agreement or sale of property covered tort claims); Xuereb v. Marcus & Millichap, Inc., 3 Cal.App.4th 1338, 1341, 5 Cal.Rptr.2d 154 (1992) (agreement providing for prevailing party fees in "any lawsuit or other legal proceeding to which it gives rise" covered tort claims including events that occurred prior to agreement's formation).

Plaintiffs argue that their intention was to have the attorney's fee provision in § 12.9 of the APA cover this litigation. While their subjective intention is not relevant here, if that was in fact their intention, the language they chose—enforce or collect—did not convey that meaning. The court will not rewrite the APA for them at \*184 this point. Plaintiffs are not entitled to an award of attorney's fees under this provision of the APA. They did not seek to

enforce the APA or the 2009 Agreement by this adversary [9] The basic goal in contract interpretation is proceeding; they sought damages for fraud based on § to the parties' mutual intent at the time of 523(a)(2)(A).

#### d. Civil Code § 1717—Action on a Contract

[10] Plaintiffs argue that their § 523(a)(2)(A) claim was an "action on a contract" because fraudulent misrepresentations or omissions were made in the representations and warranties in the 2009 Agreement which induced plaintiffs to proceed with the transaction. Defendants counter that it was instead a tort case relying on a theory of fraud in the inducement regarding the 2009 Agreement.

The Ninth Circuit instructs this court to look to California law to determine whether this was an action "to enforce or avoid enforcement" of a contract to determine whether Civil Code § 1717 applies. Penrod v. AmeriCredit Financial Services, Inc. (In re Penrod), 802 F.3d 1084 (9th Cir. 2015).

[11] First, under established California law, a tort claim does not "enforce" a contract. Stout v. Turney, 22 Cal.3d 718, 730, 150 Cal.Rptr. 637, 586 P.2d 1228 (1978); Santisas v. Goodin, 17 Cal.4th 599, 615, 71 Cal.Rptr.2d 830, 951 P.2d 399 (1998).

[13] Second, the dischargeability of a debt under § [12] 523(a)(2)(A) resolves a tort claim. Candland v. Ins. Co. of N. Am. (In re Candland), 90 F.3d 1466, 1470 (9th Cir. 1996) (discussing elements of § 523(a)(2)(B) case). To prevail on a § 523(a)(2)(A) theory, and the analogous common law fraud theory, a plaintiff must prove (1) the debtor made a misrepresentation or fraudulent omission; (2) with knowledge of its falsity; (3) with the intention of deceiving the creditor; (4) that the creditor relied on the representation; and (5) the creditor sustained damage as a proximate result. Turtle Rock Meadows Homeowners Ass'n v. Slyman (In re Slyman), 234 F.3d 1081, 1085 (9th Cir. 2000) (all five elements of common law fraud under California law must be proven to support nondischargeability under § 523(a)(2)(A)).

The court does not find plaintiffs' analysis of this issue persuasive. Plaintiffs cite Heritage Ford v. Baroff (In re Baroff), 105 F.3d 439, 443 (9th Cir. 1997) for the general idea that courts interpret liberally whether an action is on a contract. Plaintiffs then cite Bos v. Board of Trustees, 818 F.3d 486, 489 (9th Cir. 2016) for the uncontroversial

proposition that three conditions must be satisfied for an action to be considered on a contract: the contract must contain a provision regarding the award of fees to one of the parties; the action in which the fees are incurred must be on a contract, the party seeking fees must have prevailed. From this point, plaintiffs leap to three broad statements: an action is on a contract if it (1) "involves" a contract (citing In re Tobacco Cases I, 193 Cal.App.4th 1591, 1601, 124 Cal.Rptr.3d 352 (2011)); (2) seeks to enforce a contract (citing Penrod, 802 F.3d at 1088); or (3) seeks to determine rights or duties under a contract (citing Exxess Electronixx v. Heger Realty Corp., 64 Cal.App.4th 698, 707, 75 Cal.Rptr.2d 376 (1998)).

In In re Tobacco Cases I, after acknowledging that California courts liberally interpret the phrase on a contact, the court held that litigation involving the enforcement of a consent decree was an action on a contract for purposes of \*185 Civil Code § 1717. In re Tobacco Cases I, at 1600-1601, 124 Cal.Rptr.3d 352. This case sheds no light on the issue before the court. In Penrod, the Ninth Circuit held that a creditor's objection to confirmation of a chapter 13 plan was an action on a contract because the source of the right asserted in the objection was a provision of the contract and resolution required interpretation of the contract. Penrod, at 1088. Penrod provides no support for plaintiffs' argument; whether that contested matter involved a tort claim was not an issue. In Exxess Electronixx, after stating that tort claims for breach of fiduciary duty and constructive fraud did not enforce the terms of a lease, the court did say a declaratory relief action sounded in contract. Exxess, at 710, 75 Cal.Rptr.2d 376. This adversary proceeding is not a declaratory relief action and Exxess provides no support for plaintiffs' claim that Civil Code § 1717 applies here.

While plaintiffs cite <u>Bos v. Board of Trustees</u>, 818 F.3d 486, 489 (9th Cir. 2016) as supporting their argument, in fact it does no such thing. In <u>Bos</u>, the Ninth Circuit held that the § 523(a)(4) case before it was not within the ambit of Civil Code § 1717. Relevant to plaintiffs' contention, the Ninth Circuit pointed out that:

<u>Santisas</u> and relevant Ninth Circuit cases establish not just a rule of inclusion, but also a rule of exclusion: that if the bankruptcy court did not need to determine whether the contract was enforceable, then the dischargeability claim is not an action on the contract within the meaning of [Civil Code] § 1717.

Bos, at 489, (citing Redwood Theaters, Inc. v. Davison (In re Davison), 289 B.R. 716, 723 (9th Cir. BAP 2003).

Here, whether the APA or the 2009 Agreement were enforceable was never a question and the interpretation of these agreements was never an issue. Based on the above, this was not an action on a contract. The APA and the 2009 Agreement provided the context out of which this dispute arose, but this was not an action on a contract. Civil Code § 1717 does not provide a basis to award attorney's fees.

#### e. The APA's Indemnity Provision

[14] In § 11.6(a) of the APA, defendants, as sellers, agreed to "defend, indemnify and hold" plaintiffs, as buyers, "harmless from and against any and all loss, damage, liability, action or proceeding, including, without limitation, attorney's fees resulting from or arising out of (i) any inaccuracy in or breach of any representation, warranty, covenant, or obligation made or incurred by sellers" in the APA or related agreements.

Plaintiffs contend that § 11.6(a) entitles them to indemnification from defendants for all loss in this litigation, including attorney's fees. They then claim that § 11.6(c) is a third party indemnification provision that entitles them to indemnification from defendants for all losses, including attorney's fees, if plaintiffs are embroiled in litigation with third parties.

Assuming (only for the sake of argument) that the language of § 11.6(a) is broad enough to cover a tort claim such as this one, the question is whether it applies in litigation between the parties to the APA. For several reasons, the court finds that § 11.6(a) does not operate as plaintiffs contend and § 11.6 is merely a third party indemnity provision.

[15] Indemnity agreements are construed under the same rules governing the interpretation of other contracts. \*186 Myers Building Industries, Ltd. v. Interface Technology, Inc., 13 Cal.App.4th 949, 969, 17 Cal.Rptr.2d 242 (1993). 4

[16] [17] [18] As the Ninth Circuit has explained:

A written contract must be read as a whole and every part

interpreted with reference to the whole. Furthermore, a court must give effect to every word or term employed by the parties and reject none as meaningless or surplusage. Therefore, we must interpret the contract in a manner that gives full meaning and effect to all of the contract's provisions and avoid a construction of the contract that focuses only on a single provision.

In re Crystal Props., Ltd., L.P., 268 F.3d 743, 748 (9th Cir. 2001) (quotation marks and internal citations omitted); See also Natural Resources Defense Council, Inc. v. County of Los Angeles, 725 F.3d 1194, 1206 (9th Cir. 2013) (rejecting strained and unreasonable interpretation of contract); Mastrobuono v. Shearson Lehman Hutton, Inc., 514 U.S. 52, 63, 115 S.Ct. 1212, 131 L.Ed.2d 76 (1995) (it is a cardinal principle of contract construction that a document should be read to give effect to all of its provisions and to render them consistent with each other).

First, § 12.9 of the APA contains a specific attorney's fee clause. Interpreting § 11.6(a) as another attorney's fee provision that is implicated in a dispute between the parties to the APA renders § 12.9 surplusage. Section 11.6(a) may arguably be a more expansive fee provision because it uses the phrase "resulting from or arising out of" any breach of any warranty. However, plaintiffs' interpretation is precluded by the authorities described above; it would make § 12.9 surplusage and is therefore an unreasonable interpretation of the APA.

[19] Second, beyond that threshold point, a significant body of California case law supports a finding that § 11.6, in its entirety, is a third party indemnification provision and does not work as a prevailing party attorney's fee provision. The general rule is that including attorney's fees as an item of loss in a third party indemnity provision does not constitute a provision for the award of attorney's fees in an action on the contract itself which is required to trigger Civil Code § 1717. Carr Business Enterprises, Inc. v. City of Chowchilla, 166 Cal.App.4th 14, 20, 82 Cal.Rptr.3d 128 (2008) (citing Myers Building Industries, Ltd. v. Interface Technology, Inc., 13 Cal.App.4th 949, 969, 17 Cal.Rptr.2d 242 (1993)).

[20] In Alki Partners, LP v. DB Fund Services, LLC, 4 Cal.App.5th 574, 209 Cal.Rptr.3d 151 (2016), the

court explained how courts distinguish third party indemnification provisions from provisions for the award of attorney's fees incurred in litigation between the parties to the contract. First, the "key indicator is an express reference to indemnification. A clause that contains the words 'indemnify' and 'hold harmless' generally obligates the indemnitor to reimburse the indemnitee for any damages the indemnitee becomes obligated to pay third persons—that is, it relates to third party claims, not attorney fees incurred in a breach of contract action between the parties to the indemnity agreement itself." \*187 Id., at 600, 209 Cal.Rptr.3d 151 (citing Carr Business Enterprises, Inc. v. City of Chowchilla, 166 Cal.App.4th 14, 20, 82 Cal.Rptr.3d 128 (2008). The indemnification provision in § 11.6(a) uses this "shall indemnify and hold harmless" language which is a strong indication it was only intended to cover third party claims.

[21] Second, courts examine the context in which the language appears. <u>Id.</u>, at 600, 209 Cal.Rptr.3d 151. If the surrounding provisions describe third party liability, the clause will be construed as a standard third party indemnification provision. <u>Id.</u> (citing <u>Myers Building Industries</u>, Ltd. v. Interface Technology, Inc., 13 Cal.App.4th 949, 970, 17 Cal.Rptr.2d 242 (1993)(contract clause by which one party promised to indemnify the other from "any, all and every claim which arises out of the performance" of the contract dealt only with third party claims).

A review of all three sub-parts of § 11.6 shows this is a third party indemnity provision. In § 11.6(a), defendants, as sellers, agree to indemnify plaintiffs, as buyers; in § 11.6(b), plaintiffs, as buyers agree to indemnify sellers. In § 11.6(c), the mechanics of addressing a third party indemnity claim are explained. Section 11.6(c) begins by saying if "any legal proceedings shall be instituted or any claim is asserted by any third party in respect of which any Party may be entitled to indemnity," then proceeds to describe the obligation to give notice and the ability to participate in or control such an indemnity action. Read together, these three sub-parts of § 11.6 show that this is a third party indemnification provision and does not, for this additional reason, support an award of attorney's fees here.

#### f. Costs

[22] Plaintiffs seek an award of \$11,748.25 in costs, citing Rule 7054(b) and 28 U.S.C. § 1920 as the basis for

awarding costs. Rule 7054(b)(1) provides that the court may allow costs to the prevailing party and costs may be taxed by the clerk on 14 days' notice. Although the request for costs is technically untimely, for the reasons previously discussed, the court will consider it on its merits.

Plaintiffs' request for costs does not provide the documentation required by Civil Local Rule 54–1(a) or comply with substantive limitations in 28 U.S.C. § 1920. Civil Local Rule 54–1(a), applicable here by Bankruptcy Local Rule 1001–2, requires a prevailing party claiming taxable costs to serve and file a bill of costs. The bill of costs must state separately and specifically each item of taxable costs claimed and must be supported by an affidavit pursuant to 28 U.S.C. § 1924 that the costs are correctly stated, were necessarily incurred, and are allowable by law. In addition, appropriate documentation must be attached to the bill of costs.

Plaintiffs did not file a bill of costs, and did not provide any evidentiary support for their costs. In addition, plaintiffs' \$11,748 total includes (1) many items that are not within the categories stated in § 1920(1)–(6); (2) many items that pre-date the filing of this bankruptcy case; and (3) many items that appear to involve the defendants'

main case rather than this adversary proceeding. At the hearing on this motion, plaintiffs' counsel conceded that the requested costs were not in line with § 1920 and offered no authority for including costs incurred in other proceedings.

For these reasons, the court exercises its discretion to decline to award costs.

#### **IV. Conclusion**

For the foregoing reasons, the motion for attorney's fees and costs is denied.

### \*188 V. Order

Based on the above, plaintiffs' motion is denied. Each side shall bear their own costs in this adversary proceeding. The clerk's office is directed to close this adversary proceeding following docketing of the Memorandum Decision and Order.

#### **All Citations**

567 B.R. 176, 63 Bankr.Ct.Dec. 174

#### Footnotes

- Unless specified otherwise, all chapter and section references are to the Bankruptcy Code, 11 U.S.C. § 101–1532; all "Rule" references are to the Federal Rules of Bankruptcy Procedure, Fed. R. Bankr. P. 1001–1037; all "Civil Rule" references are to the Federal Rules of Civil Procedure, Fed. R. Civ. P. 1–86.
- All other claims for relief in the complaint were abandoned prior to trial.
- 3 There is no question that the first and third conditions are satisfied. The only issue here is whether this adversary proceeding was an action on a contract.
- 4 California Civil Code § 2772 provides that "[i]ndemnity is a contract by which one engages to save another from a legal consequence of the conduct of one of the parties, or of some other person." Civil Code § 2778(1)–(7) is a set of rules to be applied in interpreting an indemnity contract. Civil Code § 2778(3) provides that an indemnity against claims, or demands, or liability embraces the costs of defense against such claims. That is, attorney's fees are included by statute.

**End of Document** 

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KeyCite Blue Flag – Appeal Notification
Petition for Certiorari Docketed by LISA ANNE HENRY, ET AL.
v. OFFICIAL COMMITTEE OF UNSECURED CREDITORS OF
WALLDESIGN, INC., U.S., March 1, 2018

872 F.3d 954 United States Court of Appeals, Ninth Circuit.

In the MATTER OF WALLDESIGN, INC., a subchapter S. Corporation, Debtor, Lisa Anne Henry, DBA Henry West Designs, Appellant,

v.

Official Committee of Unsecured Creditors of Walldesign, Inc., Appellee. In the Matter of Walldesign, Inc., a subchapter S. Corporation, Debtor, Donald F. Buresh, an individual; Sharon J. Phillips, an individual, Appellants,

v.

Official Committee of Unsecured Creditors of Walldesign, Inc., Appellee.

> No. 15-56220, No. 15-56221 | Argued and Submitted March 10, 2017 Pasadena, California | Filed October 2, 2017

#### **Synopsis**

Background: Unsecured creditors committee brought adversary proceedings to recover payments that transferor, an individual who was Chapter 11 debtor's sole shareholder, director, and president, made from secret bank account that he had created to fraudulently siphon money away from debtor and use for his personal expenses, seeking to recover \$220,350.00 from sellers of real property used by transferor for a tasting room for his vineyard and \$232,948.16 from interior design firm whose services were provided for property owned by transferor. The United States Bankruptcy Court for the Central District of California entered orders granting defendants' motions for partial summary judgment, and committee appealed. The District Court, Virginia A. Phillips, J., 2015 WL 4399843, reversed and remanded. Defendants appealed.

**Holdings:** The Court of Appeals, Algenon L. Marbley, District Judge, sitting by designation, held that:

- [1] the court would apply the "one-step transaction" approach to the dominion test used in determining whether a transferee is an "initial transferee" within meaning of the Bankruptcy Code, whereby a principal of a corporate debtor who misappropriates company funds to satisfy personal obligations is not an initial transferee;
- [2] under the dominion test, defendants qualified as "initial transferees" of the payments and, thus, were not entitled to statutory "safe harbor" for subsequent transferees, but remained strictly liable to committee; and
- [3] transferor did not qualify as an "initial transferee" under the dominion test, notwithstanding his level of de facto control over debtor.

District court's judgments affirmed and cases remanded with directions.

Nguyen, Circuit Judge, filed dissenting opinion.

West Headnotes (34)

#### [1] Bankruptcy

Preferences and fraudulent conveyances; avoided transfers

#### **Bankruptcy**

← Trustee as representative of debtor or creditors

Bankruptcy Code empowers liquidating trustee to enlarge debtor's estate by invalidating fraudulent transfers of property, including money, thereby making the property part of debtor's estate again. 11 U.S.C.A. §§ 544, 548.

Cases that cite this headnote

#### [2] Bankruptcy

Conclusions of law; de novo review

Court of Appeals reviews district court's decision on appeal from bankruptcy court de novo.

Cases that cite this headnote

#### [3] Bankruptcy

Scope of review in general

Where appeal from district court's decision on appeal from bankruptcy court stems from the grant of summary judgment, Court of Appeals must determine whether pleadings and supporting documents show that there is no genuine dispute as to a material fact and that the moving parties are entitled to judgment as a matter of law.

Cases that cite this headnote

#### [4] Bankruptcy

Avoidance rights and limits thereon, in general

Bankruptcy Code draws critical distinction between initial and subsequent transferees when it comes to recovery of fraudulent transfers. 11 U.S.C.A. §§ 550(a), 550(b)(1).

Cases that cite this headnote

#### [5] Bankruptcy

Avoidance rights and limits thereon, in general

In recovering fraudulent transfers, bankruptcy trustees have absolute right of recovery against "initial transferee" and any entity for whose benefit such transfer was made. 11 U.S.C.A. § 550(a).

Cases that cite this headnote

### [6] Bankruptcy

Avoidance rights and limits thereon, in general

While bankruptcy trustees theoretically can recover a fraudulent transfer from subsequent transferees as well as initial transferees, subsequent transferees who accepted the property for value, in good faith, and without knowledge of the voidability of the transfer may avail themselves of the Bankruptcy Code's "good faith" defense. 11 U.S.C.A. §§ 550(a), 550(b).

Cases that cite this headnote

#### [7] Bankruptcy

Avoidance rights and limits thereon, in general

Courts look first to statutory text to determine whether defendants qualify as "initial transferees" within meaning of the section of the Bankruptcy Code governing liability of transferees of avoided transfers. 11 U.S.C.A. § 550(a).

Cases that cite this headnote

#### [8] Statutes

Plain Language; Plain, Ordinary, or Common Meaning

#### **Statutes**

Relation to plain, literal, or clear meaning; ambiguity

If statute's text is plain, courts must enforce it according to its terms, so long as the result is not absurd.

Cases that cite this headnote

#### [9] Bankruptcy

Avoidance rights and limits thereon, in general

Any reliance on the meaning of "transfer" in the Bankruptcy Code's definitions section is misplaced in connection with determining whether transferees qualify as "initial transferees" under the section of the Code governing liability of transferees of avoided transfers. 11 U.S.C.A. §§ 101(54)(D), 550(a).

Cases that cite this headnote

#### [10] Bankruptcy

Avoidance rights and limits thereon, in general

Under the dominion test used to determine whether party is initial transferee on avoided transfer, a "transferee" is one who has dominion over the money or other asset, or, in other words, one with the right to put the money to one's own purposes. 11 U.S.C.A. § 550(a)(1).

Cases that cite this headnote

#### [11] Bankruptcy

Avoidance rights and limits thereon, in general

Keys to the dominion test used to determine whether party is initial transferee on avoided transfer are whether the recipient of funds has legal title to them and whether the recipient has the ability to use the funds as he sees fit. 11 U.S.C.A. § 550(a)(1).

Cases that cite this headnote

#### [12] Bankruptcy

Avoidance rights and limits thereon, in general

Under the dominion test used to determine whether party is initial transferee on avoided transfer, the first party to establish dominion over the funds after they leave the transferor is the "initial transferee"; other transferees are "subsequent transferees." 11 U.S.C.A. § 550(a)(1).

Cases that cite this headnote

#### [13] Bankruptcy

Avoidance rights and limits thereon, in general

While the dominion test used to determine whether party is initial transferee on avoided transfer focuses on who had legal authority over the money, the more lenient control test involves a more gestalt analysis and requires courts to view the entire transaction as a whole to determine who truly had control of the money. 11 U.S.C.A. § 550(a)(1).

Cases that cite this headnote

#### [14] Bankruptcy

Avoidance rights and limits thereon, in general

Under the "one-step transaction" approach to applying, in corporate misappropriation cases, the dominion test used to determine whether party is initial transferee on avoided transfer, principal of a corporate debtor who misappropriates company funds to satisfy personal obligations is not an initial transferee, as, it is reasoned, the mere power of a principal to direct the allocation of corporate resources does not amount to legal dominion and control, which is required for initial-transferee status. 11 U.S.C.A. § 550(a) (1).

Cases that cite this headnote

#### [15] Bankruptcy

Avoidance rights and limits thereon, in general

Under the "one-step transaction" approach to applying, in corporate misappropriation cases, the dominion test used to determine whether party is initial transferee on avoided transfer, principal's control over debtor's business operations does not, in itself, compel a finding that principal had dominion over funds transferred from debtor to a third party. 11 U.S.C.A. § 550(a)(1).

Cases that cite this headnote

#### [16] Bankruptcy

Avoidance rights and limits thereon, in general

In corporate misappropriation cases, the "one-step transaction" approach applies to the dominion test used to determine whether party is initial transferee on avoided transfer, whereby principal of corporate debtor who misappropriates company funds to satisfy personal obligations is not an initial transferee; under text of statute, determining initial transferee is a temporal inquiry, as there must be transfer and receipt of transferred property before there can be a transferee,

structure of statute indicates that principal does not become initial transferee simply by using his or her control over corporate assets to effect a fraudulent transfer, and policy concerns underlying statute counsel in favor of treating beneficiaries, initial transferees, and subsequent transferees separately and requiring "legal control" over funds as opposed to mere "de facto" control for initial-transferee status. 11 U.S.C.A. § 550(a)(1).

Cases that cite this headnote

#### [17] Bankruptcy

# Avoidance rights and limits thereon, in general

In applying, in corporate misappropriation cases, the "one-step transaction" approach to the dominion test used to determine whether party is initial transferee on avoided transfer, the extent to which debtor's principal has de facto control over debtor before funds are transferred from debtor, and the extent to which principal uses this control for his or her own benefit in causing debtor to make a transfer, are not relevant considerations in determining the initial transferee. 11 U.S.C.A. § 550(a)(1).

Cases that cite this headnote

#### [18] Bankruptcy

### Avoidance rights and limits thereon, in general

In applying, in corporate misappropriation cases, the "one-step transaction" approach to the dominion test used to determine whether party is initial transferee on avoided transfer, the "flow of funds" matters, and receipt of the transferred property is a necessary element for that entity to be a transferee. 11 U.S.C.A. § 550(a)(1).

Cases that cite this headnote

#### [19] Bankruptcy

Avoidance rights and limits thereon, in general

In applying, in corporate misappropriation cases, the "one-step transaction" approach to the dominion test used to determine whether party is initial transferee on avoided transfer, simply directing a transfer, such as directing a debtor to transfer funds, is not enough to constitute dominion. 11 U.S.C.A. § 550(a)(1).

Cases that cite this headnote

#### [20] Bankruptcy

### Avoidance rights and limits thereon, in general

Under the "one-step transaction" approach to applying, in corporate misappropriation cases, the dominion test used to determine whether party is initial transferee on avoided transfer, debtor's principal may establish dominion by first directing a transfer into his or her personal bank account and then making the payment from his personal account to the creditor; principal, however, does not establish dominion by misdirecting company funds directly to a third party for personal gain, as in that situation, principal is not a transferee at all but, rather, is the party for whose benefit the transfer was made. 11 U.S.C.A. § 550(a)(1).

Cases that cite this headnote

#### [21] Bankruptcy

## Avoidance rights and limits thereon, in general

Under the "one-step transaction" approach to applying, in corporate misappropriation cases, the dominion test used to determine whether party is initial transferee on avoided transfer, principal does not become initial transferee simply by using his or her control over corporate assets to effect a fraudulent transfer. 11 U.S.C.A. § 550(a)(1).

Cases that cite this headnote

#### [22] Bankruptcy

Avoidance rights and limits thereon, in general

Bankruptcy Code imposes strict liability on both initial transferees and any beneficiaries of the fraudulent transfers. 11 U.S.C.A. § 550(a)(1).

Cases that cite this headnote

#### [23] Bankruptcy

Avoidance rights and limits thereon, in general

As a general rule, beneficiaries and initial transferees are separate parties to a fraudulent transfer. 11 U.S.C.A. § 550(a)(1).

Cases that cite this headnote

#### [24] Bankruptcy

Avoidance rights and limits thereon, in general

Corporate principal, whether a shareholder, director, officer, or other insider, who effects a transfer of company funds in his or her representative capacity does not have dominion over those funds in his or her personal capacity, and such a principal does not qualify as an "initial transferee" under the section of the Bankruptcy Code governing liability of transferees of avoided transfers. 11 U.S.C.A. § 550(a)(1).

Cases that cite this headnote

#### [25] Bankruptcy

Avoidance rights and limits thereon, in general

Under the dominion test, individuals who, respectively, sold real property to Chapter 11 debtor's principal and provided interior design services for him, and were paid from secret bank account that principal created in debtor's name to fraudulently siphon money away from it and use for his personal expenses, qualified as "initial transferees" of payments and, thus, were not entitled to statutory "safe harbor" for subsequent transferees, but remained strictly liable to unsecured creditors committee for avoided transfers; principal was not initial transferee

of funds because he lacked dominion over them, as he did not possess legal title to funds and ability to freely appropriate them but, instead, abused his power as principal to direct company funds to third parties for his own benefit, such that this was classic "one-step transaction" with legal control over funds passing directly from debtor to the individuals in question on behalf of principal. 11 U.S.C.A. §§ 550(a)(1), 550(b)(1).

Cases that cite this headnote

#### [26] Bankruptcy

Avoidance rights and limits thereon, in general

Section of the Bankruptcy Code governing liability of transferees of avoided transfers expressly allows trustee to recover from either initial transferee or party for whose benefit the transfers were made, indicating that, as a matter of policy, the option should be preserved where possible. 11 U.S.C.A. §§ 550, 550(a)(1).

Cases that cite this headnote

#### [27] Courts

Number of judges concurring in opinion, and opinion by divided court

Court of Appeals cannot overrule a prior panel's decision without intervening Supreme Court, or en banc, precedent.

Cases that cite this headnote

#### [28] Bankruptcy

Avoidance rights and limits thereon, in general

In the vast majority of cases, possessing legal title to funds will equate to having "dominion" over them, for purposes of determining whether party is initial transferee on avoided transfer. 11 U.S.C.A. § 550(a)(1).

Cases that cite this headnote

#### [29] Bankruptcy

# Avoidance rights and limits thereon, in general

In determining whether party is initial transferee on avoided transfer, legal title is the starting point to the dominion inquiry, not an afterthought. 11 U.S.C.A. § 550(a)(1).

Cases that cite this headnote

#### [30] Bankruptcy

### Avoidance rights and limits thereon, in general

Under the dominion test, principal of Chapter 11 debtor did not qualify as an "initial transferee" of payments that he made from secret bank account that he created in debtor's name to fraudulently siphon money away from debtor and use for his personal expenses, notwithstanding his level of de facto control over debtor, his domination of company to use secret account as his own "personal piggy bank," or fact that he made his wife a signatory on the secret account. 11 U.S.C.A. § 550(a)(1).

Cases that cite this headnote

#### [31] Corporations and Business Organizations

#### ← Officers in general

California law imputes to a corporation any knowledge of an officer of that corporation within the scope of his duties, even when an owner/officer of a debtor corporation defrauds the company.

Cases that cite this headnote

#### [32] Bankruptcy

# Avoidance rights and limits thereon, in general

Though a principal of a corporation who utterly dominates the corporation may be forced to assume the corporation's liabilities under an alter ego theory, or may be otherwise liable for breach of fiduciary duty, principal does not, simply by virtue of such domination, become an initial transferee under the section of the Bankruptcy Code governing liability of

transferes of avoided transfers. 11 U.S.C.A. § 550(a)(1).

Cases that cite this headnote

#### [33] Banks and Banking

#### Depositors' passbooks and accounts

Under California law, corporation's act of adding non-employees like accountants, spouses, or other closely associated individuals as signatories to its bank account, alone, does not change legal ownership over the depository account. Cal. Com. Code § 4104(a)(5).

1 Cases that cite this headnote

#### [34] Courts

Particular questions or subject matter

Decisions of the Bankruptcy Appellate Panel (BAP) are not binding on the Court of Appeals; rather, it is the other way around.

Cases that cite this headnote

\*958 Appeals from the United States District Court for the Central District of California, Virginia A. Phillips, District Judge, Presiding, D.C. Nos. 8:14-cv-01725-VAP, 8:15-cv-00167-VAP

#### **Attorneys and Law Firms**

Steven J. Katzman (argued) and Anthony Bisconti, Bienert Miller & Katzman PLC, San Clemente, California, for Appellants.

John P. Reitman (argued) and Jack A. Reitman, Landau Gottfried & Berger LLP, Los Angeles, California, for Appellees.

Before: A. Wallace Tashima and Jacqueline H. Nguyen, Circuit Judges and Algenon L. Marbley, \* District Judge.

Dissent by Judge Nguyen

#### \*959 OPINION

#### MARBLEY, District Judge:

It is said that bad facts make bad law. These appeals test that maxim against the often esoteric backdrop of the Bankruptcy Code. More specifically, the court must decide who is liable for voidable payments in bankruptcy proceedings when a debtor corporation's sole shareholder, director, and president misappropriates company funds to fuel his own version of "lifestyles of the rich and famous."

The bankruptcy court held that the Committee of Unsecured Creditors ("the Committee") could recover the fraudulently transferred funds *solely* from the corporate cheat, because the appellants were subsequent transferees who accepted the payments for value, in good faith, and without knowledge of their voidability. *See* 11 U.S.C. § 550(b)(1) (the "safe-harbor" provision).

The district court reversed, concluding that the appellants were initial transferees under § 550(a)(1) and, therefore, *not* entitled to the safe harbor under § 550(b)(1) for subsequent transferees. Under the district court's view, the Committee could recover the funds from both the corporate cheat *and* those parties to whom he first made payments from the corporate account.

Although the equities seem harsh at first glance, our reading of the statute and the case law persuades us that the district court was correct. By enacting 11 U.S.C. § 550, Congress assigned liability for repaying voidable transfers to both the "good guys" (initial transferees, like the appellants) and the "bad guys" (those for whose benefit the transfer was made, like corporate cheats), because "good guys" who are party to those transfers generally stand in a better position to guard against corporate fraud than do unsuspecting creditors. We therefore **AFFIRM** the judgments of the district court in favor of the Committee <sup>1</sup> and **REMAND** these cases to the bankruptcy court for further proceedings.

#### I. BACKGROUND

[1] Sections 544 and 548 of the Bankruptcy Code empower a liquidating trustee to enlarge the debtor's estate by invalidating fraudulent transfers of property,

including money, thereby making the property a part of the debtor's estate again. 11 U.S.C. §§ 544(b)(1), 548(a)(1) (B).

Section 550, in turn, dictates who must reimburse the trustee and, through the trustee, the debtor's creditors, for those fraudulent and "avoided" transfers. *Id.* § 550. These appeals hinge on § 550 and determining whether the appellants were *initial* transferees of fraudulent payments under § 550(a)(1), and thus strictly liable to the Committee, or *subsequent* transferees, who may avail themselves of the safe-harbor provision of § 550(b)(1).

#### A. Factual Background

Michael Bello served as the sole shareholder, director, and president of Walldesign, Inc., a California corporation that installed drywall, acoustical material, and plaster in construction projects in California, Nevada, and Arizona. Bello oversaw \*960 Walldesign's day-to-day business operations, as well as the company's finances.

Walldesign maintained its primary bank account at Comerica Bank in El Segundo, California. Walldesign generally deposited its accounts receivable in and paid its expenses from this primary account. The primary account was disclosed in the general ledger and other books and records of Walldesign. And, when Bello signed the Schedules and Statement of Financial Affairs in Walldesign's bankruptcy case, he disclosed the company's primary account in those filings.

In 2002, Bello opened a different bank account in Walldesign's name at Preferred Bank in Irvine, California. When he opened this account, Bello used Walldesign's Federal Tax I.D. Number, a Statement by Domestic Stock Corporation, Walldesign's Articles of Incorporation, a Unanimous Consent of Shareholder of Walldesign to Corporate Action, and a signature card granting him authority as an agent of Walldesign to open the account. That said, Bello used his home as the secondary account's address; he did not disclose the account in Walldesign's general ledger or other records; and he later made his wife —who was not a Walldesign employee—a signatory to the account. Bello, moreover, tried to conceal the secondary account during Walldesign's bankruptcy proceedings.

Although most of Walldesign's income and expenses flowed through its primary account, Bello devised a system whereby rebates from the company's suppliers were deposited into the secondary account instead. Rather than deduct the rebates from Walldesign's invoice, suppliers issued checks to Walldesign for the difference. Bello then deposited the rebate checks into Walldesign's secondary account, without disclosing the deposits to the company's management, its creditors, or even the bankruptcy court. Bello channeled nearly \$8 million of Walldesign funds into the secondary account in the ten years he operated it.

Bello then used the funds in Walldesign's secondary account to support his own lavish lifestyle rather than for legitimate business purposes. You name it, Bello spent it, including paying for the following: (1) to operate Bello's family vineyards; (2) to operate Bello's horseracing stable; (3) to operate other unrelated business entities Bello controlled; (4) Bello's Las Vegas casino bills; (5) Bello's personal expenses charged on his American Express credit card; (6) Bello's homeowners association and country club fees for two private golf courses; and (7) to pay for a "tasting room" property purchased by RU Investments, one of Bello's other business ventures. In total, Bello paid nearly \$8 million from the secondary account to roughly 130 individuals and entities. All of the payments that Bello caused Walldesign to make from this secondary account were for his personal expenses and not for the benefit of the company or its creditors.

Bello's actions ultimately impacted the appellants, Donald Buresh and Sharon Phillips ("the Bureshes") and Lisa Anne Henry. The Bureshes are a married couple who owned real property in St. Helena, California ("the Property"). In 2009, they sold the Property to a Bello-controlled entity, RU Investments, for roughly \$220,000. The Bureshes sold the Property for a fair value and at arms' length. Over the next two years, Bello made payments to the Bureshes from checks drawn on Walldesign's secondary account. These checks all bore the name "WALLDESIGN INCORPORATED." Ultimately, Bello located a Bello Family Vineyard "tasting room" on the Property. Aside from the sale of the Property, the Bureshes had no pre-existing relationship and have no ongoing \*961 relationship with Bello, his family, or any of his businesses.

Ms. Henry is the owner of Henry West Design, a small interior design firm. She met Bello through a client, who referred her to Bello for design services on a building he (not Walldesign) owned. She provided design- and construction-related services for Bello over nine years, always at her standard rates, in arms' length transactions. Bello did not personally pay for these services; instead, he drew checks from Walldesign's secondary account, as well as from other businesses he operated. In total, Bello spent over \$230,000 on Ms. Henry's design services. Aside from providing these services, Ms. Henry had no pre-existing or ongoing relationship with Bello, his family, or any of his businesses.

#### **B.** Procedural Background

Walldesign petitioned for bankruptcy on January 4, 2012. The Committee was appointed to represent creditors' interests a few days later. The Committee eventually brought ninety-six separate adversary proceedings to recover payments Bello made from the secondary account, including the payments to the Bureshes and Ms. Henry. All told, the Committee sought to recover \$220,350.00 from the Bureshes and \$232,948.16 from Ms. Henry.

The Committee also filed a complaint against Bello, his wife, and various other Bello-related individuals and entities—seeking to recover an amount equal to all identified payments made from the secondary account, including the payments made to the Bureshes and Ms. Henry.

In June 2014, the Bureshes and Ms. Henry filed motions for partial summary judgment against the Committee. The Bureshes and Ms. Henry argued that they were not liable to the Committee for any fraudulent transfers because they were not "initial transferees" under 11 U.S.C. § 550(a)(1) but, rather, were subsequent transferees entitled to the safe harbor under § 550(b)(1). The bankruptcy court granted the motions for partial summary judgment, first in an oral order on July 31, 2014, and later issued brief written orders in both cases. The Committee then appealed both orders to the district court.

On July 17, 2015, the district court reversed the decision of the bankruptcy court in the Bureshes' case (the lead case). *In re Walldesign, Inc.*, No. SACV 15-00167-VAP, 2015 WL 4399843 (C.D. Cal. July 17, 2015). The district

court found the Bureshes strictly liable to the Committee because they qualified as "initial transferees" of the fraudulent payments that Bello made from Walldesign's secondary account under § 550(a)(1). *Id.* at \*7. In the same order, the court administratively closed Ms. Henry's appeal for the same reason, thereby remanding both cases to the bankruptcy court for further proceedings. *Id.* 

The Bureshes and Ms. Henry timely filed their notices of appeal of the district court orders.

#### II. STANDARD OF REVIEW

[2] [3] We review the district court's decision on an appeal from a bankruptcy court de novo. *Barclay v. Mackenzie (In re AFI Holding, Inc.)*, 525 F.3d 700, 702 (9th Cir. 2008). Because these appeals stem from the grant of summary judgment, we must determine whether the pleadings and supporting documents show that there is no genuine dispute as to a material fact and that the moving parties are entitled to judgment as a matter of law. *Id.* 

#### III. ANALYSIS

### A. Statutory Scheme: The Bankruptcy Code Draws a Critical Distinction Between Initial and Subsequent Transferees.

[4] The Bankruptcy Code draws a critical distinction between initial and subsequent \*962 transferees when it comes to the recovery of fraudulent transfers. When a trustee has proven the avoidability of a fraudulent transfer, the trustee may recover the property (or its value) from "(1) the initial transferee of such transfer or the entity for whose benefit such transfer was made; or (2) any [subsequent] transferee of such initial transferee." 11 U.S.C. § 550(a). The trustee, however, may not recover the property or its value from a subsequent transferee if that transferee accepted the property "for value ..., in good faith, and without knowledge of the voidability of the transfer." *Id.* § 550(b)(1).

[5] [6] This distinction between initial and subsequent transferees is "critical." *Schafer v. Las Vegas Hilton Corp.* (*In re Video Depot, Ltd.*), 127 F.3d 1195, 1197 (9th Cir. 1997). Trustees have an absolute right of recovery

against the "initial transferee" and any "entity for whose benefit such transfer was made." *Danning v. Miller (In re Bullion Reserve of N. Am.)*, 922 F.2d 544, 547 (9th Cir. 1991). While trustees "[t]heoretically" can recover from subsequent transferees as well, subsequent transferees who accepted the property "for value, in good faith, and without knowledge" of the voidability of the transfer may avail themselves of the "good faith' defense of section 550(b)." *Id.*; accord In re Video Depot, 127 F.3d at 1198.

#### B. Statutory Text: Who is an "Initial Transferee."

[7] [8] We look first to the statutory text to determine whether the Bureshes and Ms. Henry qualify as initial transferees. *Lamie v. U.S. Tr.*, 540 U.S. 526, 534, 124 S.Ct. 1023, 157 L.Ed.2d 1024 (2004). If the statute's text "is plain," we must "enforce it according to its terms," so long as the result is not absurd. *Id.* (quotation omitted).

In a leading case on § 550, the Seventh Circuit explained that "'[t]ransferee' is not a self-defining term; it must mean something different from 'possessor' or 'holder' or 'agent.' " Bonded Fin. Servs., Inc. v. European Am. Bank, 838 F.2d 890, 894 (7th Cir. 1988). The court noted that treating "anyone who touches the money" as a "transferee" could lead to "absurd results" and require "useless [analytical] steps." Id. To avoid this result, the court opted to "slice these [steps] off with Occam's Razor and leave a more functional rule" in their place. Id. Under that more functional rule, the "minimum requirement [for] status as a 'transferee' is dominion over the money or other asset," i.e., "the right to put the money to one's own purposes." Id. at 893 (emphasis added).

Our court followed suit in *Universal Service Administrative*Co. v. Post-Confirmation Committee of Unsecured
Creditors (In re Incomnet), 463 F.3d 1064 (9th Cir.
2006). There, we first noted that "Section 550(a) does
not define the phrase 'initial transferee.' " Id. at 1069.
But rather than relying on an over-simplistic syllogism
from the meaning of "transfer," as the Bureshes and
Ms. Henry propose, we joined the Seventh Circuit in
adopting the "dominion test." Id. at 1069–71 (describing
Bonded Financial Services as "[t]he leading case" on
§ 550 and adopting its formulation of the "dominion
test" to determine initial-transferee status). Moreover, we
adopted the dominion test despite some "concerns that,
by focusing on whether a party had dominion over funds,

courts may lose track of the original question proposed by the statute—namely, whether a party is a transferee." *Id.* at 1073 n.11. In 2014, our court again held that "[i]n the absence of a statutory definition, we apply the so-called 'dominion test' to determine whether a party is the initial transferee." \*963 *Mano-Y & M, Ltd. v. Field (In re Mortg. Store, Inc.)*, 773 F.3d 990, 995 (9th Cir. 2014). There, we confirmed that "[t]he proper standard is the *In re Incomnet* dominion test" and that under that test, "the touchstones ... for initial transferee status are legal title and the ability of the transferee to freely appropriate the transferred funds." *Id.* at 996.

[9] Thus, any reliance on the meaning of "transfer" in 11 U.S.C. § 101(54)(D) is misplaced in connection with the inquiry at hand: determining whether the Bureshes and Ms. Henry qualify as "initial *transferees*" under § 550(a) (1).

# C. Under the Dominion Test, the Bureshes and Ms. Henry Qualify as "Initial Transferees."

As explained below, the Bureshes and Ms. Henry qualify as the "initial transferees" of payments made from Walldesign's secondary account under the dominion test. As such, they remain strictly liable to the Committee.

#### 1. The Dominion Test Explained

[11] [12] Under the dominion test, "a transferee is one who ... has dominion over the money or other asset,"—in other words, one with "the right to put the money to one's own purposes." In re Mortg. Store, 773 F.3d at 995 (quoting *In re Incomnet*, 463 F.3d at 1070). The "key[s]" to this test are " 'whether the recipient of funds has legal title to them' and whether the recipient has 'the ability to use [the funds] as he sees fit.' " *Id.* (quoting In re Incomnet, 463 F.3d at 1071). We further explained that, "an individual will have dominion over a transfer if, for example, he is 'free to invest the whole [amount] in lottery tickets or uranium stocks." Id. (quoting Bonded Fin. Servs., 838 F.2d at 894). "The first party to establish dominion over the funds after they leave the transferor is the initial transferee; other transferees are subsequent transferees." Id. (citations omitted).

In adopting the "more restrictive 'dominion test' " from *Bonded Financial Services*, our court stressed that the test "focuses on whether the recipient of funds has *legal title to them*"; that "dominion ... *strongly correlates with legal title*"; and that "dominion ... [is] akin to *legal control*." *In re Incomnet*, 463 F.3d at 1071, 1073 (emphasis added) (quotation omitted); *In re Mortg. Store*, 773 F.3d at 996 ("[T]he touchstones ... for initial transferee status are *legal title* and the ability of the transferee to freely appropriate the transferred funds." (emphasis added)).

[13] Indeed, in adopting the dominion test, we took care both to distinguish it from the often-conflated "control test," and to reject that more lenient standard for determining initial-transferee status. In re Incomnet, 463 F.3d at 1069–71 (explaining that "the 'dominion test' and the 'control test,' as originally stated, are not merely different names for the same inquiry"). While the dominion test focuses on who had "legal authority over the money," the control test involves a more gestalt analysis and requires courts to "view the entire transaction as a whole to determine who truly had control of the money." Id. at 1070 (emphasis added) (citations omitted). After noting that some courts "combined these tests" or their names, we held that the tests are distinguishable. Id. at 1071. We then adopted the "more restrictive 'dominion test' " and rejected the "more lenient 'control test.' " Id. (quotations omitted); see also In re Mortg. Store, 773 F.3d at 995–96 (adhering to "the pure dominion test").

2. Application of the Dominion Test in Corporate Misappropriation Cases: A One-Step or Two-Step Transaction?

With these considerations in mind, courts have taken two approaches when \*964 applying § 550 to fraudulent transfers involving the misappropriation of corporate funds by company directors, officers, or other insiders.

#### a. The Majority Approach

[14] Under the majority approach, or "one-step transaction" approach, courts hold that a principal of a debtor corporation who misappropriates company funds to satisfy personal obligations is *not* an initial transferee. *In re Video Depot*, 127 F.3d at 1198–99 (collecting cases); *Sklar v. Susquehanna Bank (In re Global Prot.)*, 546 B.R.

586, 622–23 (Bankr. D. N.J. 2016) (same). These courts reason that "[t]he mere power of a principal to direct the allocation of corporate resources does not amount to *legal* dominion and control," which is required for initial-transferee status. *In re Video Depot*, 127 F.3d at 1199 (emphasis added).

[15] As the Tenth Circuit has explained, "[m]any principals presumably exercise *de facto* control over the funds of the corporations they manage" and "can choose to cause their corporations to use those funds appropriately or inappropriately." *Id.* (quoting *Rupp v. Markgraf*, 95 F.3d 936, 941 (10th Cir. 1996)). But "[this] distinction is only relevant to the question whether the principal's conduct amounted to a breach of duty to the corporation." *Id.* (quotation omitted). The distinction is not relevant to whether the principal qualifies as an initial transferee. *Id.* Thus, a principal's control over the business operations of a corporation "does not, in itself, compel a finding that [the principal] had dominion ... over the funds transferred from [the corporation] to [a third party]." *Id.* at 1200.

[16] [17] Three reasons support the majority approach and viewing direct corporate misappropriations as "single-step transactions." *First*, the text of § 550(a)(1) compels this result:

Determining the *initial transferee* of a transaction is necessarily a temporal inquiry; there must be a transfer before there can be a transferee. The extent to which a principal has de facto control over the debtor before the funds are transferred from the debtor, and the extent to which the principal uses this control for his or her own benefit in causing the debtor to make a transfer, are not relevant considerations in determining the initial transferee under § 550.

See Rupp, 95 F.3d at 941.

[18] [19] In other words, the "flow of funds" matters, and "receipt of the transferred property is a necessary element for that entity to be a transferee under § 550." Id. at 942 (emphasis added) (quotation omitted). But "[s]imply directing a transfer, i.e., such as directing a

debtor to transfer funds, is not enough." *Id.* (emphasis added) (quotation omitted).

[20] A principal, therefore, may establish dominion "by first directing a transfer into his or her personal bank account and then making the payment from his personal account to the creditor." See In re Video Depot, 127 F.3d at 1199. But a principal does not establish dominion by misdirecting company funds directly to a third party for personal gain. See id. In that situation, the principal is not a transferee at all but, rather, is the party for whose benefit the transfer was made. In re Global Prot., 546 B.R. at 624.

[21] [22] [23] Second, the structure of § 550(a)(1) indicates that a principal does not become an initial transferee simply by using his or her control over corporate assets to effect a fraudulent transfer. See Gen. Elec. Capital Auto Lease, Inc. v. Broach (In re Lucas Dallas), 185 B.R. 801, 809–10 (B.A.P. 9th Cir. 1995); \*965 In re Global Prot., 546 B.R. at 624; In re Red Dot Scenic, Inc., 293 B.R. 116, 121 (Bankr. S.D.N.Y. 2003), aff'd, 351 F.3d 57 (2d Cir. 2003). Section 550 imposes strict liability on both initial transferees and any beneficiaries of the fraudulent transfers. 11 U.S.C. § 550(a)(1). From that starting point, the Ninth Circuit Bankruptcy Appellate Panel ("BAP") has reasoned:

[I]f the distinction between an initial and a subsequent transferee turns on whether the party benefitting from the transfer "forced" the debtor to make the transfer, then the scope of liability under section 550 is unduly narrowed. Section 550(a)(1) subjects to strict liability not only the initial transferee, but also "the entity for whose benefit such transfer was made." 11 U.S.C. § 550(a)(1). The party who forces a debtor to make a transfer is almost always "the entity for whose benefit such transfer was made," and thus is generally always subject to strict liability. Yet Congress intended to make initial transferees also strictly liable.... "The implication is that the entity for whose benefit the transfer was made is different from a transferee, immediate or otherwise." Bullion Reserve, 922 F.2d at 548. Consideration of whether the beneficiary of the transfer "forced" the debtor to make the transfer would collapse the two prongs of strict liability into a single party.... There is nothing in the statute or otherwise to justify this result.

*In re Lucas Dallas*, 185 B.R. at 809–10. This distinction between the beneficiaries of a transfer and initial transferees "thus strongly indicates that, as a general rule,

beneficiaries and initial transferees are separate parties to a fraudulent transfer." *In re Red Dot*, 293 B.R. at 121.

Third, the policy concerns underlying § 550 counsel in favor of treating beneficiaries, initial transferees, and subsequent transferees separately and requiring "legal control" over the funds as opposed to mere "de facto" control for initial-transferee status. In re Mortg. Store, 773 F.3d at 997–98 & n.1; In re Video Depot, 127 F.3d at 1199. The alternative approach—by which "every agent or principal of a corporation [is] deemed the initial transferee when he or she effected a transfer of property in his or her representative capacity"-both misallocates the monitoring costs that § 550 sought to impose and deprives the trustee of a potential source of recovery for creditors. See In re Video Depot, 127 F.3d at 1199; In re Red Dot, 293 B.R. at 121. After all, foxes (like corporate cheats) rarely guard henhouses (like corporate treasuries) with much success. In re Mortg. Store, 773 F.3d at 998 n.1. And Congress likely decided that "recovery from [an] embezzling principal would be difficult, thus it also made the first recipient of those funds liable to returning them." See In re Global Prot., 546 B.R. at 625.

[24] As these cases demonstrate, a corporate principal (whether a shareholder, director, officer, or other insider) who effects a transfer of company funds in his or her representative capacity does not have dominion over those funds in his or her personal capacity. Therefore, such a principal does not qualify as an initial transferee under § 550(a)(1) of the Bankruptcy Code.

#### b. The Minority Approach

To be sure, a minority of courts view misappropriation cases differently and reason that corporate principals may be strictly liable as initial transferees when they misuse company funds for personal gain. See, e.g., Internal Revenue Serv. v. Nordic Vill., Inc. (In re Nordic Vill., Inc.), 915 F.2d 1049, 1055 (6th Cir. 1990), rev'd on other grounds, United States v. Nordic Vill., Inc., 503 U.S. 30, 112 S.Ct. 1011, 117 L.Ed.2d 181 (1992).

\*966 Under this "two-step transaction" approach, the debtor company is *deemed* to have made the initial transfer to the corporate principal, thus making him or her strictly liable as the initial transferee. *See In re Nordic Vill.*, 915 F.2d at 1055 ("If Lah is viewed as having taken money

illegally from Nordic, he is the 'initial transferee' and the delivery of the cashier's check to the IRS makes the IRS '[a subsequent] transferee....' "); see id. ("If the IRS is considered as an 'immediate transferee' of Lah, the IRS can prevail if ... it took for value, in good faith, and without knowledge of the voidability of the transfer.").

#### c. The Ninth Circuit Follows the Majority Approach

Because the minority approach suffers from several flaws, our court has rejected it. *In re Video Depot*, 127 F.3d at 1198–1200; *see In re Mortg. Store*, 773 F.3d at 995–96. For starters, the minority approach draws largely on equitable principles and a concern that seemingly "innocent" third parties will be held liable for fraudulent transfers unless corporate principals are deemed the initial transferees. *In re Global Prot.*, 546 B.R. at 624. But our court has noted that these types of "equitable considerations fit much more comfortably under the control test," which we repeatedly have rejected. *See In re Mortg. Store*, 773 F.3d at 996.

The minority approach also predates *Bonded Financial Services*, on which we have relied so heavily in adopting the dominion test, and focuses instead on the separate definition of "transfer" from 11 U.S.C. § 101(50). *E.g.*, *In re Nordic Vill.*, 915 F.2d at 1055 & n.3 (citing a pair of pre-*Bonded* district court cases for the proposition that "[t]here is substantial support for the conclusion that when a corporate officer takes checks drawn from corporate funds to pay personal debts, the corporate officer, and not the payee on the check[,] is the initial transferee").

Due to these shortcomings (and others), we have declined to follow the minority approach. In fact, in *In re Video Depot*, we acknowledged that although "the Sixth Circuit has expressed tentative support for [the minority approach], ... no circuit has based a decision on it," and, therefore, we expressly "decline[d] to depart from the considered judgment of the other circuits." 127 F.3d at 1199 (citing *In re Nordic Vill.*, 915 F.2d at 1049). In the process, we also rejected both lower-court decisions on which the Sixth Circuit based its reasoning. *Id.* at 1198 (declining to follow both *In re Auto-Pak, Inc.*, 73 B.R. 52 (D.D.C. 1987), and *In re Jorges Carpet Mills, Inc.*, 50 B.R. 84 (Bankr. E.D. Tenn. 1985)); *see In re Nordic Vill.*, 915 F.2d at 1055 n.3 (citing *In re Auto-Pak* and *In re Jorges Carpet Mills*).

In recent years, we have moved even further away from the equitable concerns that drive the minority approach in favor of strict application of "the pure dominion test" and its focus on legal control. *See In re Mortg. Store*, 773 F.3d at 996–98 & n.1.

#### 3. Application of the Majority Approach in These Cases

[25] Here, application of the majority approach proves straight-forward: Bello was *not* the initial transferee of the funds in the secondary account because he lacked dominion over them. Rather than possessing legal title to the funds and the ability to freely appropriate them, Bello abused his power as a principal to direct *company* funds to third parties for his own benefit. Because "[l]egal control over the funds ... passed directly from [Walldesign] to [the Bureshes and Ms. Henry]," Bello is not the initial transferee. *See In re Video Depot*, 127 F.3d at 1199.

\*967 Recall the facts, which are not in dispute. Bello, acting as an agent for Walldesign, established a bank account in the company's name using Walldesign's Federal Tax I.D. Number, a Statement by Domestic Stock Corporation, Walldesign's Articles of Incorporation, a Unanimous Consent of Shareholder of Walldesign to Corporate Action, and a signature card granting him signing authority as Walldesign's agent to open the secondary account. As all parties necessarily agree, the secondary account belonged to Walldesign—not to Bello. Bello then deposited Walldesign funds (and Walldesign funds alone) into the secondary account.<sup>2</sup> Bello later misdirected those company funds directly to third parties like the Bureshes and Ms. Henry, by way of company checks clearly emblazoned "WALLDESIGN INCORPORATED," without ever depositing them in his own personal account or otherwise taking legal control of them.

This was a classic "one-step transaction"—with funds moving *from* Walldesign (the transferor) *to* the Bureshes and Ms. Henry (the initial transferees), *on behalf of* Bello (the party for whose benefit the transfers were made). Bello may have exercised de facto control over those funds as a corporate principal, but he never exercised *legal* control over them, as required for initial-transferee status. *See, e.g., In re Video Depot*, 127 F.3d at 1199 (suggesting that "a principal may establish legal control and dominion

by first directing a transfer into his or her personal bank account and then making the payment from his personal account to the creditor," but holding that a principal does not establish dominion simply by misdirecting corporate funds "directly from [the company] to [a third party]"); Rupp, 95 F.3d at 941–42 (rejecting argument that "a principal who directs and benefits from a fraudulent transfer of funds from a debtor to a third party is ipso facto the initial transferee" where "the debtor's funds moved directly to the third party" (quotation omitted)); see also 5 Collier on Bankruptcy ¶ 555.02[4] [a] at 550–18 (15th ed. 1996) (explaining that although "[t]he Code does not define the term [ ] 'initial transferee' ... [g]enerally, the party who receives a transfer of property directly from the debtor is the initial transferee" (emphasis added)).

Thus, Bello is strictly liable as the party for whose benefit such transfers were made, while the Bureshes and Ms. Henry are strictly liable as initial transferees. Several cases bear this out. In *In re Global Protection*, for example, the bankruptcy court held that a corporate principal was not the initial transferee where he misdirected company funds directly to a bank to pay his personal debts because "[t]he money never passed through [his] hands." 546 B.R. at 623. The court instead held that the bank, as recipient of the funds, was the initial transferee, but that both the bank and the principal were strictly liable under § 550(a)(1). Id. at 625. Likewise, in In re Red Dot, the court held that a corporate principal was "the party for whose benefit the transfer was made," and not an initial transferee, where he "caused the debtor ... to transfer money direct[ly] to a personal creditor" without any "intermediary step between the Debtor's issuance of the check and the [creditor's] receipt of the funds." 293 B.R. at 122 (quotation omitted). There again, the court held both parties strictly liable under § 550(a)(1). Id.

\*968 Although this result may "elevate[] form over substance," as the Bureshes and Ms. Henry suggest, form matters a great deal in fraudulent-transfer cases due to the policy concerns underlying § 550. *In re Video Depot*, 127 F.3d at 1199; *Richardson v. U.S. Internal Revenue Serv.* (*In re Anton Noll, Inc.*), 277 B.R. 875, 882 (B.A.P. 1st Cir. 2002) ("[D]ifferentiating between a one step and a two step transaction has real legal significance—it is not merely an act of upholding form over substance.").

The majority approach, which we employ, allocates the monitoring costs and risks of repayment among the

parties as Congress intended. In re Video Depot, 127 F.3d at 1199. It would undermine § 550 to declare Bello the initial transferee because it is "unreasonable to assume" that an insider who misappropriates company funds "ha[s] the proper incentives to monitor [the company] for fraud." See In re Mortg. Store, 773 F.3d at 998 n.1. Appellant suggested at oral argument that Bello's wife, who also was a signatory to the secondary account, had the ability and incentive to monitor the company for fraud. This suggestion assumes facts not in the record—namely, that Bello's wife was an innocent signatory on the account, and not acting in cahoots with her husband. In truth, we have no indication what role, if any, Bello's wife played as a signatory on the account. It seems equally likely that Bello's wife knew what her husband was doing but turned a blind eye anyway.

Likewise, it is fair to view the Bureshes and Ms. Henry as the initial transferees since they "receive[d] funds directly from [the] debtor," and thus, their "capacity [and burden] to monitor ... [were] at [their] greatest." In re Video Depot, 127 F.3d at 1199. Although the Bureshes and Ms. Henry suggest that they lacked the ability to monitor for fraud, the record shows otherwise. It is undisputed that the Bureshes sold their Property to a Bello-controlled entity called "RU Investments." Yet they received all payments for that sale from checks bearing the name "WALLDESIGN INCORPORATED"—providing at least some indication that something was amiss. Likewise, Ms. Henry performed all services for Bello in his individual capacity. Yet she received all payments from checks bearing the name "WALLDESIGN INCORPORATED" or from one of Bello's other businesses—again, providing at least some indication of an irregularity in the payments. As between Walldesign's creditors, who had no idea of the fraudulent transfers, and the Bureshes and Ms. Henry, who had some indication of these irregularities, the Bureshes and Ms. Henry stood in a better position to monitor for fraud. See In re Mortg. Store, 773 F.3d at 997.

[26] Finally, viewing the Bureshes and Ms. Henry as the initial transferees, while viewing Bello as the party for whose benefit the transfers were made, allows the Committee to recover from *all* parties under § 550(a)(1), as Congress intended. After all, "Section 550 expressly allows the trustee to recover from either party, indicating that, as a matter of policy, the option should be preserved where possible." *Rupp*, 95 F.3d at 943; *see also In re* 

Global Prot., 546 B.R. at 624–25 (recognizing importance of permitting recovery from "good guys" and "bad guys" alike, because "recover [ing] from the embezzling principal would be difficult"); In re Red Dot, 293 B.R. at 122 (noting that "[a]n alternative result would be inconsistent with the Bonded [Financial Services] framework and would contravene the structure and purpose of section 550(a)").

## 4. The Bureshes' and Ms. Henry's Arguments to the Contrary Lack Merit

[27] The Bureshes and Ms. Henry offer several rejoinders, but they all lack \*969 merit. First, they argue that we should scrap the dominion test from In re Incomnet in favor of the control test that the Eleventh Circuit employs. See In re Chase & Sanborn Corp., 848 F.2d 1196, 1199 (11th Cir. 1988). We have been down this road twice before, and both times, we explicitly declined similar invitations. In re Mortg. Store, 773 F.3d at 996 ("[I]n In re *Incomnet*, we explicitly rejected the control test's flexible, equitable approach and embraced the pure dominion test."); In re Incomnet, 463 F.3d at 1071 ("[W]e take care not to apply the more lenient 'control test' put forth in In re Chase & Sanborn Corp."). Because we cannot overrule a prior panel's decision without intervening Supreme Court (or en banc) precedent, this argument is a non-starter. Koerner v. Grigas, 328 F.3d 1039, 1050 (9th Cir. 2003) (citing Hart v. Massanari, 266 F.3d 1155, 1171–72 (9th Cir. 2001)). For better or worse, we must employ "the pure dominion test" in these cases. In re Mortg. Store, 773 F.3d at 996.

Second, they suggest that we should "clarify" the dominion test by confining it to cases involving "mere conduits," like banks operating under the express direction of a depositor or trustees who direct the disbursement of the funds in a trust account they manage. See In re Incomnet, 463 F.3d at 1073–74 (outlining two mere-conduit scenarios where dominion test is especially useful). This argument is wrong twice over.

[28] [29] For one thing, our decision in *In re Incomnet* began with the proposition that "[t]he dominion test we have crafted *strongly correlates with legal title*," and is "akin to *legal control*." 463 F.3d at 1073 (emphasis added) (quotation omitted). Thus, "[i]n the vast majority of cases, possessing legal title to funds will equate to having dominion over them." *Id.* Only after establishing

this baseline understanding, which runs directly counter to the Bureshes' and Ms. Henry's position in these appeals, did we acknowledge that in "unusual situations" involving mere conduits, "legal title to funds and the right to put those funds to use" may be separated and, thus, "[t]he focus on 'dominion' " may be especially useful. Id. at 1073-74. We therefore recognized that while "conduit cases" seem "most likely to fall into the narrow set of circumstances where the identity of the transferee is sufficiently unclear as to require the application of the dominion test," that test applies with equal force in all transfer cases and "is not limited to the context of 'conduit cases.' "Id. at 1073 n.11. Later, of course, we applied the dominion test in *In re Mortgage Store*, which itself was not a mere conduit case. 773 F.3d at 996. Here again, a pair of prior panel decisions forecloses the Bureshes' and Ms. Henry's argument. Legal title is the starting point to the dominion inquiry, not an afterthought. Id. ("[T]he touchstones in this circuit for initial transferee status are legal title and the ability of the transferee to freely appropriate the transferred funds." (emphasis added)).

After arguing that we should *not* apply the dominion test because these cases did not involve a conduit scenario, the Bureshes and Ms. Henry turn around and try to force the facts in these cases into *both* of the two "unusual [conduit] situations" we identified "in which legal title to funds and the right to put those funds to use have been separated." *See In re Incomnet*, 463 F.3d at 1073–74. This attempt fails on every level. Walldesign was not akin to a bank, operating at the direction of a depositor, because the funds belonged to Walldesign (not Bello), and there was no legal obligation for Walldesign to follow Bello's instructions. *See In re Incomnet*, 463 F.3d at 1074 (outlining first example). Bello may have had de facto control over \*970 the funds, but he lacked *legal* control over them. *See Rupp*, 95 F.3d at 941.

Likewise, Bello was not akin to a trustee, "who is able to direct the disbursement of the funds in a trust account he manages, even though he does not own them." See In re Incomnet, 463 F.3d at 1074 (outlining second example). This argument again conflates "control" with "dominion." Corporate principals simply do not have unfettered legal authority to do as they wish with company funds, the way that trustees have nearly unfettered legal authority over trust funds. See In re Ferrall's Estate, 41 Cal. 2d 166, 176–77, 258 P.2d 1009 (1953) (noting that trustees generally have "absolute or unlimited

or uncontrolled discretion" over disbursement of trust funds). Corporate principals have, at most, de facto control over company funds.

[30] Third, the Bureshes and Ms. Henry argue that Bello qualifies as the initial transferee, even under the dominion test from *In re Incomnet*. They note that Bello kept the secondary account "secret" from Walldesign, that he dominated the company to use the secondary account as his own "personal piggy bank," and that he made his wife a signatory on the account, thus meeting the requisite level of "dominion" for initial-transferee status.

Make no mistake: Bello did his best to conceal the secondary account from Walldesign's books and ledgers, its employees, and even the bankruptcy court. Bello, through his oversized role at Walldesign and spendthrift ways, likewise served as a poster boy for dominating a corporation and its assets solely for personal gain. And he did make his wife a signatory on the secondary account.

[31] But the Bureshes and Ms. Henry do not explain why these facts change the outcome under the dominion test. As for the secrecy of the secondary account, California law imputes to a corporation any "[k]nowledge of an officer of [that] corporation within the scope of his duties." Peregrine Funding, Inc. v. Sheppard Mullin Richter & Hampton LLP, 133 Cal.App.4th 658, 35 Cal.Rptr.3d 31, 46 (2005). This rule applies even when an owner/officer of a debtor corporation defrauds the company. *Id.* at 46–47 (collecting cases). Because Bello was the sole shareholder, director, and president of Walldesign, he acted within the scope of his duties in opening a corporate bank account —thereby imputing knowledge of the secondary account to Walldesign. See Mem'l Hosp. Ass'n v. Pac. Grape Prods. Co., 45 Cal. 2d 634, 637, 290 P.2d 481 (1955) ("Where the president of a corporation is also its general manager ... he has implied authority to make any contract or do any other act appropriate in the ordinary course of its business."). In any event, the Bureshes and Ms. Henry point to no authority holding that company knowledge is the sine qua non for initial-transferee status in corporate misappropriation cases. Presumably, secrecy will remain a hallmark of these types of cases—whether it be secrecy in individual transactions that skim from a company account or secrecy in the underlying account itself. See Bowers v. Atlanta Motor Speedway, Inc. (In re Se. Hotel Props. Ltd. *P'ship*), 99 F.3d 151, 152–53 (4th Cir. 1996) (explaining how corporate principal "caused an employee ... to create

certain false documents to reflect the disbursement of \$22,500 as refunds of guests' deposits for group tours booked with [debtor hotel]" to hide skimming for personal gain).

[32] Likewise, Bello's level of de facto control, while troubling, does not amount to "dominion" and initialtransferee status. A principal who "utterly dominates a corporation ... may be forced to assume a corporation's liabilities under an alter ego theory or he may be otherwise liable for \*971 breach of fiduciary duty." In re Red Dot, 293 B.R. at 124. But "he does not, simply by virtue of such domination, become an initial transferee." Id. As the Tenth Circuit explained, "[t]he extent to which a principal has de facto control over the debtor ... and the extent to which the principal uses this control for his or her own benefit in causing the debtor to make a transfer, are not relevant considerations in determining the initial transferee under § 550." Rupp, 95 F.3d at 941; accord In re Se. Hotel Props., 99 F.3d at 156 (following Rupp's analysis); In re Global Prot., 546 B.R. at 591, 623 (concluding that corporate principal who was "100% owner of the Debtor" nevertheless failed to qualify for initial-transferee status).

[33] And while Bello made his wife a signatory to Walldesign's secondary account, the Bureshes and Ms. Henry did not cite any authority for the proposition that by so doing, he transformed the company's bank account into his own personal account or otherwise became an initial transferee. See Cal. Com. Code § 4104(a)(5) ("[Bank] 'Customer' means a person having an account with a bank or for whom a bank has agreed to collect items...."); Rodriguez, 75 Cal.Rptr.3d at 547 (rejecting argument that "the name on the signature card determines the identity of the [bank] customer"). Corporations, churches, associations, and other entities are free to structure their banking needs as they see fit (within the bounds of applicable banking laws), and they often add non-employees like accountants, spouses, or other closely associated individuals as signatories to their accounts. This act alone, however, does not change legal ownership over the depository account.

Relying on California law, the dissent argues that Bello's opening of the sham account should not be imputed to Walldesign because, by acting adversely to the corporation in opening the account, he did so in his personal capacity rather than as an officer of the company.

See Diss. Op. at 974-75. According to the dissent, under Software Design & Application, Ltd. v. Hoefer & Arnett, Inc., 49 Cal.App.4th 472, 56 Cal.Rptr.2d 756 (1996) and Rodriguez v. Bank of the West, 162 Cal.App.4th 454, 75 Cal.Rptr.3d 543 (2008), Bello acted in his personal capacity despite "using his ostensible authority as Walldesign's president in opening the account." Diss. Op. at 975. While the dissent is correct that here, "[als in both Software Design and Rodriguez, the rogue agent opened a secret bank account, purportedly on behalf of the principal, for the agent's own nefarious ends," id. at 975, Software Design and Rodriguez are distinguishable. In Software Design, the sham accounts were set up in the name of a fictitious entity, not the name of the corporation. Software Design, 56 Cal.Rptr.2d at 476-77. And in *Rodriguez*, the law firm's office manager opened the sham accounts and forged the principal's signature on checks drawn on the accounts to steal client money. Rodriguez, 76 Cal. Rptr.3d at 545. Here, by contrast, Bello opened the sham account in Walldesign's name, using Walldesign's documents, and a signature card granting Bello authority as Walldesign's agent to open the account. Thus, Bello's actions, while certainly fraudulent, do not transform the sham account into his personal account.<sup>3</sup>

[34] \*972 Fourth, the Bureshes and Ms. Henry argue that we should follow the BAP decisions in *Poonja v*. Charles Schwab & Co. (In re Dominion Corp.), 199 B.R. 410, 415 (B.A.P. 9th Cir. 1996) and Ross v. John Mitchell, Inc. (In re Deitz), 94 B.R. 637, 642–43 (B.A.P. 9th Cir. 1988) by declaring this a two-step transaction. As the district court properly held, however, decisions of the BAP are not binding on this court; rather, it's the other way around. In re Mortg. Store, 773 F.3d at 995-96 ("Although we treat the BAP's decisions as persuasive authority, we are not bound by its decisions. In fact, as the BAP has recognized, our decisions are binding precedent that the BAP must follow." (quotation omitted)). The BAP decisions cited not only predate our opinion in *In re* Video Depot; they conflict with it. See In re Video Depot, 127 F.3d at 1199. Accordingly, *In re Video Depot* controls, and this remains a one-step transaction because the funds "passed directly from [Walldesign] to [the Bureshes and Ms. Henry]," without Bello assuming legal dominion or control of them. Id.

Finally—and at bottom, what all of their other arguments boil down to—the Bureshes and Ms. Henry suggest that Bello was the initial transferee because any other holding

would be inequitable to them. That may be so. But in any event, "[w]e need not weigh the merits of th[e] trade-off" between assigning responsibility to seemingly innocent initial transferees, like the Bureshes and Ms. Henry, and creditors, like the Committee, because Congress already performed that task for us. In re Mortg. Store, 773 F.3d at 997. Here, as in *In re Mortgage Store* and other cases, "[i]t would be inappropriate for us to second-guess Congress' considered judgment on this matter of policy." Id. at 997– 98. Moreover, it's not as if by holding the Bureshes and Ms. Henry strictly liable we somehow are allowing Bello to escape scot-free. Instead, Bello remains strictly liable too as the party for whose benefit the fraudulent transfers were made. See id. at 994. And the Committee is limited to seeking "a single satisfaction" from Bello, the Bureshes, and Ms. Henry. 11 U.S.C. § 550(d).

In sum, we agree that the Bureshes and Ms. Henry (as opposed to Bello) qualify as initial transferees under this Circuit's dominion test. This was a classic one-step transaction.

#### IV. CONCLUSION

The Bureshes and Ms. Henry are strictly liable to the Committee as initial transferees. 11 U.S.C. § 550(a)(1). Bello is strictly liable to the Committee as the party for whose benefit the transfers were made. *Id.* And the Committee may seek a "single satisfaction" from all three parties, jointly and severally. *Id.* § 550(d).

We **AFFIRM** the judgments of the district court in favor of the Committee and **REMAND** both cases to the district court with directions to in turn remand these cases to the bankruptcy court for further proceedings consistent with this opinion.

#### NGUYEN, Circuit Judge, dissenting:

Bankruptcy courts "are courts of equity" that "appl[y] the principles and rules of \*973 equity jurisprudence." *Young v. United States*, 535 U.S. 43, 50, 122 S.Ct. 1036, 152 L.Ed.2d 79 (2002) (quoting *Pepper v. Litton*, 308 U.S. 295, 304, 60 S.Ct. 238, 84 L.Ed. 281 (1939)). There is nothing equitable about today's decision.

Donald Buresh, Sharon Phillips, and Lisa Henry are not Michael Bello's family members, friends, or even close associates. They are a married couple who sold their property to Bello to fund their retirement and a small business owner who performed design and construction services for him. Unbeknownst to them, the checks with which Bello paid them, which bore the name of his company, were in fact drawn from a sham bank account that he created to fraudulently siphon money away from his company and use for his personal expenses. Their dealings with Bello were legitimate, arms-length transactions. Yet they each now owe Bello's creditors hundreds of thousands of dollars—a ruinous sum for most retirees and small businesses. I strongly disagree with this result.

I.

For many years, "we employed a hybrid 'dominion and control' test to identify initial transferees." *In re Mortg. Store, Inc.*, 773 F.3d 990, 996 (9th Cir. 2014) (citing *In re Video Depot, Ltd.*, 127 F.3d 1195, 1199–1200 (9th Cir. 1997)). Because the hybrid test incorporated the "pragmatic" control test used in other circuits, *id.*, it would have produced the correct result here without fuss and held Bello personally liable for his fraudulent acts as the initial transferee.

Unfortunately, in *In re Incomnet, Inc.*, 463 F.3d 1064 (9th Cir. 2006), "we explicitly rejected the control test's flexible, equitable approach and embraced the pure dominion test." *Mortg. Store*, 773 F.3d at 996. There was no reason to do so. *Incomnet* 's "resolution ... [did] not turn on the question of which of the[] two standards governs in this circuit." *Incomnet*, 463 F.3d at 1069–70.

Here, while I disagree with the majority that the Bureshes and Henry were the initial transferees under the dominion test, the very fact of our disagreement shows how difficult it can be to determine who had legal control over funds in situations where practical control is clear. We should consider ditching the dominion test and adopting the control test used successfully by other circuits. At the very least, we should return to a hybrid approach that allows us "to step back and evaluate a transaction in its entirety to make sure that [our] conclusions are logical and equitable." *Mortg. Store*, 773 F.3d at 996 (quoting *In re Chase & Sanborn Corp.*, 848 F.2d 1196, 1199 (11th Cir. 1988)).

II.

Even applying the dominion test, as we must, the Bureshes and Henry were not the initial transferees. The majority concludes that Bello didn't possess legal title to the misappropriated funds or the ability to freely appropriate them because the sham bank account actually belonged to Walldesign. According to the majority, Bello merely "abused his power as a principal to direct *company* funds to third parties for his own benefit." Maj. Op. at 966. I disagree. Under the dominion test, the sham account never belonged to Walldesign.

As the majority acknowledges, in a one-step transaction, "a principal who directs a debtor corporation ... to pay for a personal debt is not an initial transferee" because "[t]he mere power of a principal to direct the allocation of corporate resources does not amount to legal dominion and control." *Video Depot*, 127 F.3d at 1199 (citing \*974 *In re S.E. Hotel Props. LP*, 99 F.3d 151, 155–56 (4th Cir. 1996); *Rupp v. Markgraf*, 95 F.3d 936, 941 (10th Cir. 1996)). Therefore, had Bello paid the Bureshes and Henry directly from Walldesign's account at Comerica Bank, the transactions unquestionably would have taken place in one step.

In a two-step transaction, "a principal may establish legal control and dominion by first directing a transfer into his or her personal bank account and then making the payment from his personal account to the creditor." *Id.* (citing *Rupp*, 95 F.3d at 939). The question here then is whether the second account, which Bello secretly used as his "personal piggy bank" in stealing money from Walldesign, Maj. Op. at 970, should be treated as Bello's personal account or imputed to the company. In that regard, "[s]tate law ... determines the nature and extent of a debtor's interest in property." *In re Cohen*, 300 F.3d 1097, 1104 (9th Cir. 2002) (quoting *In re Richmond Produce Co.*, 151 B.R. 1012, 1016 (Bankr. N.D. Cal. 1993)).

The majority says that "California law imputes to a corporation any '[k]nowledge of an officer of [that] corporation within the scope of his duties,' " and Bello "acted within the scope of his duties in opening a corporate bank account." Maj. Op. at 970 (quoting Peregrine Funding, Inc. v. Sheppard Mullin Richter & Hampton LLP, 133 Cal.App.4th 658, 35 Cal.Rptr.3d 31,

46 (2005)). But "in order to have authority [to act on behalf of a corporation] which is implied in fact the agent, be he president or general manager of a corporation, or both, must be performing an act which is 'appropriate in the ordinary course of its business.' " *Meyer v. Glenmoor Homes, Inc.*, 246 Cal.App.2d 242, 54 Cal.Rptr. 786, 794 (1966) (quoting *Mem'l Hosp. Ass'n of Stanislaus Cnty. v. Pac. Grape Prods. Co.*, 45 Cal.2d 634, 290 P.2d 481, 483 (1955)).

Meyer clearly rejected the majority's conclusion that a corporate officer's fraudulent transaction should be imputed to the company merely because the officer had authority to perform that type of transaction in other circumstances. In Meyer, the general manager had authority to buy land on the corporation's behalf and had previously done so by taking title in the name of individuals, and such transactions were sometimes signed by only one officer and did not always appear in the corporate minutes. Id. at 795. In the transaction at issue, the general manager secretly purchased land for himself in exchange for a promissory note purportedly obligating the corporation.

The court held that the transaction could not be imputed to the corporation because the corporation "[n]ever engaged in transactions where it became obligated to pay for land ... which was conveyed to another for the use and benefit of that grantee as distinguished from the use and benefit of the corporation." Id. (emphasis added). "The knowledge acquired by the agent who is acting adversely to his principal will not be attributed to the principal." Id. at 801 (citing People v. Parker, 235 Cal.App.2d 86, 44 Cal.Rptr. 900, 905–06 (1965); Commercial Lumber Co. v. Ukiah Lumber Mills, 94 Cal.App.2d 215, 210 P.2d 276, 279 (1949)); see also Peregrine Funding, 35 Cal.Rptr.3d at 47 ("Nor is a corporation chargeable with the knowledge of an officer who collaborates with outsiders to defraud the corporation." (citing Meyer, 54 Cal.Rptr. at 801)). 1

\*975 The circumstances here are the same. No one disputes that Bello had authority generally to open a bank account on Walldesign's behalf. But Bello's authority to do so didn't extend to opening a secret account solely for his own personal benefit at the company's expense. He owed Walldesign a fiduciary duty to act in good faith in the company's best interests. See, e.g., Sheley v. Harrop, 9 Cal.App.5th 1147, 215 Cal.Rptr.3d 606, 624 (2017). Because Bello was acting adversely to Walldesign

in opening the sham account, he did so in his personal capacity, not as an officer of the company.

That Bello used his ostensible authority as Walldesign's president in opening the account makes no difference. For example, in *Software Design & Application, Ltd. v. Hoefer & Arnett, Inc.*, 49 Cal.App.4th 472, 56 Cal.Rptr.2d 756 (1996), a financial consultant with authority to handle a corporation's investment funds placed the funds into a brokerage account in the name of a fictitious partnership with the same name as the corporation. He never reported the brokerage accounts to the corporation and had the monthly statements sent to a post office box that he falsely represented as the partnership's. *Id.* at 759. The court held that at the time of these deposits, the consultant "had *already stolen money and securities from [the owners]*, having wrested control of these funds by placing them in bogus accounts." *Id.* at 763.

Similarly in Rodriguez v. Bank of the West, 162 Cal.App.4th 454, 75 Cal.Rptr.3d 543 (2008), the office manager of a law firm opened two sham bank accounts in the lawyer's name and forged his signature on numerous checks that she used to steal client money from the law firm. Id. at 544-45. In rejecting the lawyer's negligence claims against the banks, the court explained that the banks had no duty to the lawyer because, despite being the named accountholder, he was not their customer: "he did not consent to the creation of any of the accounts and, indeed, did not even know of their existence until after [the office manager's] wrongful acts were completed." *Id.* at 546. Instead, the office manager was the banks' true customer because she "opened accounts at banks at which [the lawyer] had no existing relationship, then converted the money to her own use." Id. at 548. The court found these facts "indistinguishable" from Software Design. Id.

Here too, the putative accountholder, Walldesign, was not the true owner of Bello's sham bank account. As in both *Software Design* and *Rodriguez*, the rogue agent opened a secret bank account, purportedly on behalf of the principal, for the agent's own nefarious ends. As in *Rodriguez*, Walldesign had no relationship with the bank. As in *Software Design*, the account address of record—Bello's home—was one belonging to him personally rather than to Walldesign.

This was a classic two-step transaction. First, Bello converted corporate funds by transferring them into his personal account, making him the initial transferee. Then, he transferred the funds to others, including the Bureshes and Henry, who were subsequent transferees.

#### III.

In arguing that Bello wasn't in the best position to monitor the fraud, the majority quips that "foxes (like corporate cheats) rarely guard henhouses (like corporate treasuries) with much success." Maj. Op. at 965 (citing *Mortg. Store*, 773 F.3d at 998 n.1). But allowing a corporate cheat to easily shift liability for his wrongdoing \*976 onto innocent third parties simply by signing the corporation's name on a secret bank account instead of his own only encourages this kind of embezzlement. As the majority notes, the Committee is entitled to a single satisfaction from Bello, on the one hand, and the Bureshes and Henry on the other. *Id.* at 973 (citing 11 U.S.C. § 550(d)). Every dollar the Committee is able to recover from the Bureshes and Henry is a dollar for which Bello is off the hook.

The majority admits that its holding "may be" inequitable, Maj. Op. at 972, but suggests that the Bureshes and Henry nonetheless should have monitored for fraud, since they "had some indication of ... irregularities" because Bello's checks bore Walldesign's name. *Id.* at 968-69. I disagree. Businesses often pay for their executives' personal expenses, and it's not unusual for individuals to structure their transactions through corporations for tax reasons. I don't see anything inherently suspicious about Bello paying his personal debts from the account of a closely-held corporation. Recipients of such payments, like the Bureshes and Henry, are generally not well placed to question the legitimacy of a reputable organization's bank account.

I respectfully dissent.

#### **All Citations**

872 F.3d 954, 64 Bankr.Ct.Dec. 195, Bankr. L. Rep. P 83,163, 17 Cal. Daily Op. Serv. 9744, 2017 Daily Journal D.A.R. 9605

#### Footnotes

- \* The Honorable Algenon L. Marbley, United States District Court Judge for the Southern District of Ohio, sitting by designation.
- Although the trustee of the liquidation trust established by Walldesign's confirmed Chapter 11 plan has replaced the Committee as the real party in interest in these cases, all lower court proceedings and the parties' briefing on appeal still refer to the appellee as the Official Committee of Unsecured Creditors of Walldesign, Inc. For ease of reference and consistency with the record, our opinion will refer to the appellee in these cases as "the Committee" as well.
- The fact that Bello later decided to use the checks made payable to Walldesign for his own personal gain does not negate that the money legally belonged to Walldesign. See Cal. Com. Code § 3110(a) ("The person to whom an instrument is initially payable is determined by the intent of the person ... signing as ... the issuer of the instrument.").
- The dissent also asserts that "Meyer [v. Glenmoor Homes, Inc., 246 Cal.App.2d 242, 54 Cal.Rptr. 786, 794 (1966)] clearly rejected the majority's conclusion that a corporate officer's fraudulent transaction should be imputed to the company merely because the officer had authority to perform that type of transaction in other circumstances." Diss. Op. at 974. A close reading of Meyer, however, does not support this assertion. On the issue of authority, the court stated "the uncontradicted testimony shows that the directors of the corporation plaintiff never sold or authorized a sale of, the two blocks in controversy, nor did its president ever agree to sell them, and that the deed, when signed, was a blank, and was never acknowledged. Under these circumstances, the deed was ... absolutely void...." Meyer, 54 Cal.Rptr. at 794. Moreover, in Meyer, authority was a contested issue at trial. Here, Bello's authority is uncontroverted. As the dissent admits, [n]o one disputes that Bello had authority generally to open a bank account on Walldesign's behalf." Diss. Op. at 975.
- The majority speculates that Bello's wife, who was a signatory to the sham account despite not having any affiliation with Walldesign, could have been "acting in cahoots with her husband." Maj. Op. at 968. If so, then the sham account was not attributable to Walldesign because Bello was collaborating with an outsider to defraud it. At a minimum, this is a factual issue that should be resolved by the bankruptcy court before we decide as a matter of law that the account belonged to the corporation.

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# **Oral Argument and Advocacy:**

### **Practice Ready Tips**

Oral arguments happen every day in Vermont courts. Yet, because many of us have busy schedules, families, and client commitments, we rarely have time to contemplate general strategies and approaches to good oral advocacy. But if we embrace the opportunity that oral advocacy provides us to engage with the court, the experience can be both enjoyable and productive. When we do have to go before a court to argue our case we can best serve our client's interests if we consider how best to engage in effective oral advocacy. The practical tips this article presents are not meant to be all encompassing or to be adopted in their entirety. Rather, the purpose is to provide practitioners with a few techniques and strategies that will make their time before a court more effective.

The Vermont Supreme Court typically grants oral argument where a party requests it; however, it sometimes directs that cases be decided on the briefs alone. Where the Court has determined that a case will be heard by a three-justice panel, oral arguments are limited to five minutes per side. When the full Court hears the case, each side typically is allotted fifteen minutes for oral argument. Regardless of forum, time is of the essence and preparation is therefore key to any oral argument.

Oral arguments are meant to supplement the briefs; thus, judges typically read the parties' briefs prior to oral argument, and use those briefs to frame questions to ask counsel at oral argument. In cases on appeal, oral argument should be limited to the issues on appeal rather than comprising a recitation of the facts of the entire case. The court will be familiar with the factual background of the case already. Also, because judges usually ask several questions during oral argument, you should construct your argument to allow for interruption. An oral argument should feel like a collegial dialogue between the court and counsel, not a speech or monologue from the advocate to the bench.4 Your job is to educate, advise, and most of all persuade the court5—not to talk at it.

#### Prepare, Prepare, Prepare

In order to not be caught off-guard by the court's questioning, you should practice your oral argument a handful of times before giving it in court. Practice cuts down on the risk of getting flustered and thrownoff during your argument, which can cause your argument to spiral out of control and may result in your client not being granted the relief that they deserve.

Show up to oral argument knowing the record and relevant law like the back of your hand. This means knowing the law on your side and also the law on your opponent's side. Go through and read all of the briefs (and the trial court's ruling) in the case while you prepare for your oral argument,<sup>6</sup> because you will likely need to refresh your memory if a substantial amount of time has passed since you last worked on this case. You will have to be able to anticipate the strong and weak points in both your case and opposing counsel's, which will in turn help you anticipate the court's line of questioning.

#### **Prepping for Questions**

Part of preparing for oral argument is thinking about the questions the court will have for you during argument. This will likely be pretty easy, as both you and the court will already know what the weak points of your case are before oral arguments even begin. Another good way to prepare for questioning is by talking with a friend or colleague.7 Discussion will help unearth weak points in your case that you would have missed on your own. Ultimately, questions should be viewed as an opportunity to engage the court in a conversation about the case. The court's questions may prove difficult, but if you embrace the mindset of engaging the court in a dialog about your case before you walk into the courtroom, you can alleviate some of the usual nervousness that practitioners feel prior to argument.

#### **Outline**

One of the best ways to make sure you use every minute of your time effectively is to have a good outline prepared for your oral argument. It should begin with an introduction addressing the court and telling the court what the case is about (your theme), stating your conclusion (what judgment you seek), and then briefly the reasons for that conclusion. Stating the reasons for your conclusion is best done in numbered bullets, for example that x judgment should be [whatever relief you seek] for one to three reasons—after which you would succinctly state those reasons.

This approach gives the court a road-

map of your argument, which is helpful in the event that you do not have time to get to all of the points in your outline that you were prepared to make (due to interruption, poor timing, etc.). This approach also gives you a chance to calm down a bit and set forth a roadmap for yourself, which should make it harder for you to get "lost" during your argument.

Your outline should also include the major cases and other legal authority you rely on in your argument.<sup>8</sup> While you should already have the relevant law memorized, it is helpful to jot down some quick reminders about a case in your outline so you know when to discuss it during your argument, and how you can weave it into your answers to the court. This should also help cut down on any courtroom jitters you may have. Moreover, you may want to write down questions you anticipate the court will ask of you.

Because time tends to run short at oral argument, put your best foot forward by making your strongest arguments first, and leave the weak ones out. Since you will not have time to make all of your arguments, you should only make your most pertinent and ironclad points to the court.

Lawyers sometimes linger on the introduction of their argument, getting stuck on reciting the facts of the case. Avoid that mistake—get to the point as quickly as you can. The idea is to get to the issues presented right away. If the court has already read the facts in your brief, then you should not waste your precious limited time briefing the facts during your oral argument.

Arguing a case on appeal means you need to know and understand the standard of review. This should generally be part of your outline. The standard of review is very important to any appellate court. It determines how much deference the appeals court should give to the trial court. Typically, if you are the appellant you'll want a less deferential standard of review because you are arguing for the trial court's decision to be overturned. Appellees, on the other hand, want to have the lower court's ruling upheld and so will usually want the appeals court to apply a more deferential standard of review. Either way, you should be prepared to explain the proper standard of review to the court and cite authority if the standard of review is controversial.<sup>10</sup>

Finally, your outline for argument should be exactly that—an outline. Most experienced oral advocates bring only a manila folder to the podium with their outline written directly on the folder itself. Of course, you should decide what works best for you; however, this simple approach helps avoid arguing from a "script" and eliminates wasted time spent flipping through pages in a binder. The less you need to rifle through pages during your argument, the more you can focus on your substantive points. Leave the large case file at the counsel table. If you need to go back to it to find materials to answer a particularly detailed question the court asks, that's fine. But carrying hundreds of pages to the podium is not a good idea. If you feel you need a binder worth of material at hand in order to properly argue your case, you should probably go back and spend some time getting familiar with the case.

#### Allocate Your Time Wisely

Proper time allocation is a central aspect of "winning" at oral argument. As in all lawyering, time management is crucial to success here. Be aware of how much time you have to give your argument, and how much time is left throughout various points of your argument. Practicing your argument ahead of time is key here, as is knowing ahead of time whether you will be reserving time for rebuttal. While most courts have timekeepers, many experienced oral advocates bring a wrist watch to the podium so that they can easily determine how much time is remaining. Limiting the number of key points you will make at oral argument is critical. You will not have time to argue all of the points you made it your brief—so it is always best to focus on a few of your strongest arguments.

#### Rebuttal?

To rebut, or not to rebut? Whether to reserve time for rebuttal is a matter of personal preference. We believe the best practice is always to reserve time for rebuttal if you have the opportunity to do so. Typically, you'll want that time to respond to major problems with substantive arguments that the opposing counsel has made. However, do not use your rebuttal time just to "have the last word."

There is a school of thought that says, "The best rebuttal is no rebuttal at all." Not needing to rebut the other side can signal to the court that you are not concerned by opposing counsel's argument because it did not damage your case. If this is true for you, "Your Honor, I have nothing further to add" may be the best route to take. You should ultimately only rebut if you believe opposing counsel has stated something in their argument that must be answered. For example, you should rebut your opponent's argument if you believe that they

have materially misstated law or facts, or if they have made an argument that you can refute in a strong, clear, and concise manner. If you choose to offer a rebuttal, keep it simple—one to three points is usually best. Do not use the time to repeat your argument, and do not feel like you need to respond to every single point that your opponent has made.

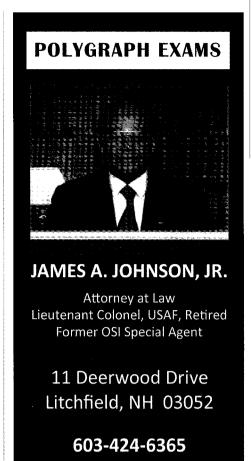
#### Pay Attention

Pay attention to the court. Pay attention to verbal and nonverbal cues from the judge or panel because they will clue you in as to what the court finds important and what it does not. So, if the court indicates that it is not interested in the issue that you are presently discussing, move on to the issues that matter to the court. This signals to the court that you understand your case and that you recognize how important it is not to waste the court's time. Make the best use of your limited time to educate and persuade the court. So be sure to take a hint.

Remember that when the court asks you questions, it is signaling what it thinks is important. Welcome the court's questions, because they allow you to see what the court is thinking and where it needs to be persuaded. Use the questions to direct your argument toward what the court is interested in, because that issue may ultimately be dispositive. Again, you want to be open to and anticipate questioning and direction from the court. Be flexible. You will be interrupted, and the court will probably find something to be more important to the matter at issue than you did. On the other hand, the court might decide that the issue you thought was central to the case and spent hours in prepping is actually hardly relevant at all. In that event, your job is to go with it and persuade the court.

#### Answer the Question

Be as direct as possible when you answer the court's questions, and start by answering "Yes, your Honor," or "No, your Honor," if possible. However, if you truly do not know the answer—just say "I don't know"—don't try to make up an answer you are not sure about.<sup>11</sup> Do not assume that every question is a challenging question. Courts often use questions to communicate points to other judges or justices on the bench. Resist your instinct to panic if the court asks you a question that you cannot immediately answer. Take a deep breath, collect your thoughts, and answer as fully and as honestly as you can. You should not worry if you need to take a few seconds to collect your thoughts before answering. This pause is not an awkward silence, and the court will appreciate that



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you tried to answer as best as you could rather than making something up or blurting out the first thing that came to mind.

#### Know When to Correct Opposing Counsel

The rule of thumb here is similar to that for when to give a rebuttal. You should clearly respond to the other side's statements during oral argument if you believe that they have misstated facts or law material to the case. When you draw the court's attention to the misstatement, you should also explain to the court why the misstatement is material to the issue being decided.<sup>12</sup>

#### **Practical Tips**

### Don't Read From or Get Buried in Your Outline

You should come to court knowing your argument well enough that you do not need to constantly refer back to your outline. Prepare as much as possible before your oral argument so you can avoid making this common mistake.

#### Be Respectful

Be formal in court: do not speak when the judge is talking, and stop talking when the court begins to speak. Your argument should not be a speech or long, uninterrupted diatribe. It should allow for interruption, questioning, and flexibility. Additionally, avoid making flippant remarks. Unless encouraged by the court, jokes are never a good idea during oral argument because they will likely fail and are never necessary.<sup>13</sup> This should go without saying; however many attorneys still miss the rule: do not make personal attacks. If your opponent engages in personal attacks, you should take the high road and not dignify their attack with a response. Judges do not take well to personal attacks, and, in essence, you should simply let opposing

counsel "dig his/her own grave" without personally stepping in should they decide to engage in personal attacks against you or your client.

#### Concede vs. Don't Concede

Many attorneys think they should never concede. That isn't true—instead, you should concede when necessary. 14 However, do not concede where you do not need to, because you risk losing credibility (which you, of course, always want to maintain with the court). As a general rule, most effective advocates are willing to concede anything they need to concede that will not result in losing their case. Conceding a point that you can concede and still win does not show weakness, it shows that you are a reasonable attorney.

#### Be Yourself

Credibility matters, so you shouldn't try to act like someone you're not. For example, if you're usually a shy, quiet person, don't try to be loud and brash in court. Courts respect authenticity.

#### Ditch the Drama

Televisionesque fist-pounding, flamboyance, and theatrics really should not be used in oral advocacy. It probably will not work in your favor, and is simply too risky to be worth trying out in court. Leave the acting on screen where it belongs.

#### Be Clear About What You Want

Be clear in telling the court what relief you are seeking on behalf of your client. <sup>15</sup> Unless you explicitly state it, you probably won't get it. Courts will commonly ask what rule you think applies, or what outcome you want. Many advocates are prepared to answer this question; they know they want to win, but they haven't thought through exactly what relief would look like. Be ready to directly answer that question in the context of telling the court the result you seek.

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#### Remember Your Purpose

Your purpose at oral argument is to inform the court. Do not lose sight of that. The best oral argument should feel like a collegial discussion of ideas.

Most attorneys get nervous when it comes to oral argument. That's normal. A practitioner's guide to oral argument will not eliminate nerves. But, through diligent preparation, responsiveness and authenticity, you can make what feels like a nervewracking experience an effective and perhaps even enjoyable aspect of being an attorney.

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<sup>&</sup>lt;sup>15</sup> See Dimitri, supra note 6, at 90.



Vermont Supreme Court Oral Arguments, STATE OF VERMONT JUDICIARY, https://www.vermontjudiciary.org/LC/audioarguments.aspx (last visited April 6, 2016).

<sup>- 1</sup>a.

<sup>3</sup> Id.

<sup>&</sup>lt;sup>4</sup> James D. Dimitri, Stepping Up to the Podium with Confidence: A Primer for Law Students on Preparing and Delivering an Appellate Oral Argument, 38 STETSON L. REV. 75, 77 (2008).

<sup>&</sup>lt;sup>5</sup> Kimberly Atkins, *Top Supreme Court Litigators Give Tips on Arguing Appeals*, LegalNews (Aug. 9, 2011), http://www.legalnews.com/detroit/1028908.

<sup>&</sup>lt;sup>6</sup> Robert J. Stumpf, Jr., Karin Vogel & Guylyn Cummins, Your Skills: Top 10 Tips to Prepare for Oral Argument, RECORDER, Aug. 2, 2013, available at http://www.sheppardmullin.com/media/article/1208\_The%20Recorder %20-%20 Your%20Skills%20-%20Top%2010%20Tips%20 to%20Prepare%20for%20Oral%20Argument. pdf

<sup>&</sup>lt;sup>7</sup> See Dimitri, supra note 6, at 87-88.

<sup>8</sup> See id. at 77.

<sup>&</sup>lt;sup>9</sup> See Sylvia Walbolt, Twenty Tips From a Battered and Bruised Oral-Advocate Veteran, LITIGATION, Winter 2011, at 1.

<sup>&</sup>lt;sup>10</sup> See Dimitri, supra note 6, at 84.

<sup>&</sup>lt;sup>1</sup> See Walbolt, supra note 11, at 3.

<sup>12</sup> Id

<sup>&</sup>lt;sup>13</sup> See Atkins, supra note 7.

<sup>&</sup>lt;sup>14</sup> See Walbolt, supra note 11, at 2.



# Transforming a Skillfully Crafted Brief into an Effective Oral Argument

By Kathryn E. Kasper – August 27, 2015

Picture a litigator. The first thought that comes to mind is an attorney standing before a jury, delivering a passionate opening or closing argument. And while this scenario certainly does reflect a slice of life as a litigator, it's a very narrow slice for most—and not reflective of the role for many. What the vast majority, if not all, of litigators will experience with some frequency during their careers is motions practice—the dual-pronged art divided between drafting a skillfully crafted brief and presenting the court with an eloquent argument based on that brief.

For a new attorney, it often seems that there is not much to do between brief writing and argument preparation. Once the brief is completed, the nuances of the arguments are already before the court. It should be a simple task to explain to the judge what he or she will find in the brief. And while it is ill-advised to approach the podium with the plan of simply reading one's brief, it also is a bad idea to distill the contents of that brief into a bullet-pointed list of the most important sentences found in it. Yet this is a trap into which young attorneys often fall.

But time in the courtroom will teach the young litigator that transforming a carefully constructed brief into an effective oral argument is an art in and of itself. And it is an art that can be mastered if you keep a handful of guidelines in mind.

### **Carefully Select the Arguments to Present**

Unless you are in a jurisdiction with fairly strict page-limit requirements, the odds are good that you were able to present all of your arguments on the issue before the court in your brief. Oral argument rarely allows that same luxury. This means that the order in which you chose to present your arguments in your brief might not be the best order at oral argument. First, carefully consider which of your arguments would result in the greatest success should you prevail. For example, is there one argument that would result in the dismissal of the entire complaint, while the others might result in the dismissal of only a handful of counts? Next, consider which arguments are your most persuasive, given the facts and the law you must apply. Your goal is to walk away from the podium knowing that the judge has at least had the opportunity to hear your very strongest points and to resolve any questions he or she may have about those arguments. If time runs out, the judge will have the opportunity to read your other arguments in your brief.

#### Pay Equal Mind to the Cases You Choose to Address

While case law can provide compelling support for arguments made in motions practice, to prepare for oral argument you must closely scrutinize which of the (likely many) cases cited in briefs are worthy of being addressed from the podium. Oral argument is not a law school classroom, and the judge generally is not interested in hearing counsel orally brief case after case. While this does not mean cases should be ignored, string cites should be left to the brief.

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Identify the one or two cases cited in your briefing that are most closely analogous to the scenario before the court, or that provide the clearest summary of the law in your jurisdiction. These cases would be worthy of a few minutes of discussion—highlighting for the court why they are of particular use in reaching a holding in your case.

For case law from the court where the argument is being heard, recognize that the judge will likely be familiar with the holding well before you bring it to his or her attention. So it is especially important to ensure you are familiar with the nuances of that opinion—and that you have confirmed it has not been overturned or superseded in some way. Of course, you confirmed this before you cited the case in your brief, but make sure nothing has changed between the time your brief was filed and the date of your oral argument. Misrepresenting what a case held—even inadvertently—can be deadly to your credibility with the judge (and to your case).

#### **Consider Your Choice of Language**

That intricately worded line from your memorandum that you are so pleased with? Chances are good it will sound a whole lot less elegant when read aloud. A common mistake made by new litigators is to attempt to select the best lines from their written briefs and use them at oral argument. The result is an awkward, overly formal recitation of exactly what the judge has already read (or will read following your argument).

As clichéd as it sounds, it is important to remember that oral argument is your opportunity to have a conversation with the judge about the strengths and weaknesses of your arguments (and those of your opponent). And while the judge's position of authority demands respect, it does not demand the type of formal language best left for the written word. When you prepare for the podium, consider how you can take the point you made in those well-polished sentences, and make the same point using conversational language. How would you present your argument to a senior partner at your firm? Take a similar approach with the judge.

#### **Be Prepared to Respond to Questions**

This point seems so simple, but in many ways it can be the most challenging for a new litigator to master. First—and most obvious—it is nearly impossible to predict what the judge will ask you, or if he or she will ask anything at all. How do you prepare for that?

The answer is not likely to be found in your well-crafted brief. But it may be found in the well-crafted brief of your opponent—particularly your opponent's reply brief. Look closely at the issues raised in your opponent's briefs and identify anything that might raise a question for the judge. Is there a case that contradicts those you cited? How can it be distinguished? Has your opponent raised a policy argument? What is the response to that? The judge will likely look for any arguments left unanswered in the briefing as the starting point for his or her questions.

Reread your own briefs and ask colleagues to do the same. Play devil's advocate. Find any potential places where a hole could be poked in your arguments—an area where case law is lacking in your jurisdiction, or an argument with only weak facts to support it. Then, before the

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judge asks you, determine the best way to respond to questions about those issues. This exercise will prove particularly valuable if your judge is known for reading briefs in advance.

There is a second reason why new litigators struggle with questions from the bench: they can throw you off your carefully prepared outline. While drafting a written argument gives you control over what information is presented (and how and when it is presented), that control is ceded to the judge at oral argument. Because young litigators have a strong desire to map out their entire arguments—just as they did in their briefs—they often will find themselves lost when the judge proffers a question or comment, or asks for discussion on a particular argument.

Some of the best advice I ever received about oral argument was to remember that I know the information in my briefing, and the facts of the case, better than anyone else in the room. So while notes are certainly helpful, there is no need to be bound to an outline. Have the main points prepared, pertinent citations listed, and materials on the table in case you draw a blank. But the less you feel committed to the argument's proceeding in a particular way, the better your delivery will be.

At the end of the day, litigation merges two art forms—the written word and the spoken word. Although they work together to deliver the same message, you must pay attention to both. Using the strengths of both mediums together, you can deliver a very persuasive argument to the judge.

**Keywords:** litigation, woman advocate, oral argument, motions, litigation skills, young lawyers, persuasion, advocacy

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# Oral Argument: Facing the Challenge and Embracing the Opportunity

By Margaret Grignon

For many years, I sat as an appellate judge in state court, listening to oral arguments, questioning counsel about the record and case authorities, and testing my conclusions about the appeal. For the last eight years, I have stood on the other side of the bench, attempting to answer the judges' questions, trying to decipher the purpose of the questions and, perhaps, persuading the judges to change their minds.

Both of these perspectives have made it clear to me that while oral argument is stressful and time consuming, it is a chance to have a conversation with the judges deciding your case, to present your arguments in a new way that the judges may find persuasive when previous iterations may have been unsuccessful, to answer any questions the judges may have, to clear up any misperceptions of the record or the law, to persuade one or more judges in a split panel to move in your direction, and to convince judges who appear to be against your position to change their minds.

The challenge, of course, is to be prepared to take advantage of the opportunity. And the key to a successful oral argument is preparation. Did I catch the judges' interest by shining a different light on my arguments, did I rebut my opponent's arguments, did I anticipate the questions the judges would ask, did I have answers for all the questions, and was I able to bring the argument back on track when it was momentarily thrown off course by my opponent's argument or the court's questions?

Frequently, I am asked how I prepare for oral argument. To some extent, the answer to this question is individual and case and client dependent. But there are some universal tenets that I believe hold true for most arguments.

To begin, I start my preparation early—usually as soon as possible after I receive the oral argument notice—by reviewing the briefs. Typically, it has been some time between the preparation of the briefs and the setting of argument, and I need to get my head back into the appeal and reconnect with the essence of the case. Then, I let it percolate.

Next, I review the case authorities—all the case authorities—cited in the briefs. For me, the most useful practice is to prepare a notebook (or notebooks) of all the cases cited in the briefs in alphabetical order. I associate each case with the briefs and the issues raised. For example, I note that the appellant cited the case in its reply brief on the parole evidence rule issue. As I read through the cases, I note the pertinent facts and procedure on the caption page and I tag the cases that are particularly significant.

Do I read every word of every case? Of course not. If a familiar case is cited for the standard of review, for example, and the standard of review is not an issue in the case, there is no need to

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read the case. Likewise, if a case is significant in your appeal only for its attorney fee holding, there may be no reason to review the entire case.

While the appeal has been pending, I have been on the alert for any new, relevant authority. But at this time, I conduct a more formal search to update the case authority and confirm that the cited cases remain good law. I then consider whether any new authority should or must be brought to the attention of the court and opposing counsel. This needs to be done in writing before argument. You cannot spring new authority on the court and opposing counsel at the time of argument, unless the new authority actually came out the night before the argument.

After I have finished with the case authorities, I turn to the record. Depending on the size of the record, I either review the record in its entirety or I review the summary of the record prepared at the time the briefs were written. I take notes. I make timelines. I write down important names and places. This pre-argument record review is always an eye opener for me. It makes me remember things I have forgotten. It corrects any misunderstandings or misremembrances of the facts and procedure. And occasionally I discover a new way to look at the theories, facts, and procedural events of the case.

Why do I review the record? It would be a mistake to believe that judges and their law clerks simply rely on the briefs and the record references cited in the briefs. Judges want to make sure they get their decisions right. They want to be fair. They want to understand the flow of the case in the trial court. In a recent oral argument, one of the judges confronted my opposing counsel with a statement he had made in a brief in a prior appeal in the case that contradicted the argument he was currently making. In another, a judge confronted my opposing counsel with a fact from the record, disposing of one of counsel's arguments—a fact neither side had noted in the briefing. Both of these judges had gone well beyond the briefs in their record reviews and brought fresh new considerations to light.

Having reviewed the cases and the record, I turn to my oral argument notes. If I am the appellant, I frequently prepare a detailed outline or write out my argument. I practice. This serves two purposes. If I am asked no questions, I am prepared to highlight the points I think are most important. If I do get asked questions, and I have correctly anticipated the questions, the answers may be found in my prepared remarks.

Then I anticipate questions and prepare answers to those questions. The goal is not to have a script you can read verbatim to the judges—that usually is not effective advocacy. But if you have written a proposed answer, your delivery of that answer will be fluent, complete, and comprehensible.

If feasible, you should participate in a moot court a few days before the scheduled oral argument. This is invaluable both as practice and, more importantly, to let fresh eyes ferret out the weaknesses in the case.

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Now you are prepared. On the day of oral argument, review your notes and your prepared remarks. Get to court early so you are calm and collected. If you are the appellant, approach the lectern with a paragraph introduction ready to go. If you are the respondent, respond to the appellant's oral argument—and where necessary the appellant's reply brief arguments—within the context of your "story" or theme. Maintain eye contact with all the judges as much as possible. Be respectful. Don't ever interrupt a judge. Don't fail to answer a question directly and immediately. Welcome questions as the beginning of a conversation with the judges that is the best and most meaningful part of oral argument.

Focus on the judges, their body language and their questions. Your preparation will mean that you will not need to search frantically through your brain to figure out the answer to the question. Instead, you will know the answer and can devote your thoughts to the purpose of the question, the best way to frame the answer, and the means to segue from the answer to another point that needs to be made. If the panel has indicated explicitly or implicitly that they are with you, truncate your argument, highlight any additional grounds for ruling in your favor on which the court may not have focused—such as procedural bars or defaults and standards of review—sum up, and remind the court of the relief or remedy that you have requested.

Oral argument can be an exhilarating experience. Confronted with three to nine prepared and engaged appellate judges—sometimes with different perspectives or views of your case—a good oral argument inspires a good appellate advocate to be the best that she can be or, as I like to say, "turn her brain on full blast." Life presents few opportunities for such high-level interactions. They should be cherished and sought out.

You cannot prevail in every case in which you participate, whether you are the appellant or the respondent. You cannot win every oral argument. But every oral argument can be successful because you were prepared, faced the challenge of pointed and occasionally even hostile questions, and embraced the opportunity for one last chance to persuade the appellate judges.

**Keywords:** woman advocate, litigation, appeals, appellate argument, oral argument, judges, persuasion, preparation, moot court, appellate record

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