NOT FOR PUBLICATION

UNITED STATES BANKRUPTCY APPELLATE PANEL

OF THE NINTH CIRCUIT

In re:	)	BAP No. CC-10-1445—PaMkB
	)	BAP No. CC-10-1446-PaMkB
PETER THOMAS MCCARTHY,	)	(Consolidated)
	)	
Debtor.	)	Bk. No. SV 05-18622-GM
_____	)	
	)	Adv. No. SV 06-01104-GM
PETER THOMAS MCCARTHY,	)	
	)	
Appellant,	)	
	)	
v.	)	**M E M O R A N D U M**[1]
	)	
NATURE'S WING FIN DESIGN, LLC,	)	
	)	
Appellee.	)	
_____	)	

Argued and Submitted on July 21, 2011
at Pasadena, California

Filed - August 10, 2011

Appeal from the United States Bankruptcy Court
for the Central District of California

Honorable Geraldine Mund, Bankruptcy Judge, Presiding

Appearances: Peter T. McCarthy, appellant, argued pro se. Rebecca Yuan Lawlor argued for appellee Nature's Wing Fin Design, LLC.

Before: PAPPAS, MARKELL and BRANDT,[2] Bankruptcy Judges.

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[1] This disposition is not appropriate for publication. Although it may be cited for whatever persuasive value it may have (see Fed. R. App. P. 32.1), it has no precedential value. See 9th Cir. BAP Rule 8013-1.

[2] The Honorable Philip H. Brandt, U.S. Bankruptcy Judge for the Western District of Washington, sitting by designation.

Chapter 7[3] debtor Peter Thomas McCarthy ("McCarthy") appeals the bankruptcy court's order granting summary adjudication and a final judgment determining that his debt to Nature's Wing Fin Design, LLC ("NWFD") was excepted from discharge under § 523(a)(4). We AFFIRM.

FACTS

NWFD is a small limited liability intellectual property company formed in 1997 under California law. From its founding to August 2005, McCarthy was the sole manager and chairman of the board of NWFD, and at all relevant times he (and his spouse) have owned the majority of the shares/interests in NWFD. As its manager, McCarthy received an annual salary of $98,000, and exercised sole control over NWFD's operations.

McCarthy is the inventor of a "split fin" technology. He patented it and then licensed it back to NWFD. NWFD, in turn, licenses the split fin technology to manufacturers of swim and scuba fins.

NWFD obtained its start up capital from approximately thirty individual cash investors (the "Minority Shareholders") who collectively contributed about $758,000 in exchange for their membership interests in NWFD. McCarthy contributed no cash, but obtained his controlling interest in exchange for the licensing rights to the split fin patent.

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[3] Unless otherwise indicated, all chapter, section and rule references are to the Bankruptcy Code, 11 U.S.C. §§ 101-1330, and to the Federal Rules of Bankruptcy Procedure, Rules 1001-9036, as enacted and promulgated prior to the effective date (October 17, 2005) of The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. 109-8, 119 Stat. 23. The Federal Rules of Civil Procedure are referred to as "Civil Rules."

After years of contention between McCarthy and the Minority Shareholders, a majority of those Minority Shareholders commenced a shareholder derivative action against him in California state court, Jenkins, et al. v. McCarthy, et al., Case no. BC309875 (Los Angeles Superior Court, January 30, 2004), alleging claims for breach of fiduciary duties, conversion, and for an accounting, among others. After a three-and-a-half-week bench trial, the state court entered judgment on August 19, 2005, in favor of NWFD (through the Minority Shareholders) against McCarthy for $849,754 (later reduced to $778,000) for breach of fiduciary duty.

Along with the judgment, the state court entered a Statement of Decision ("SOD"). Among the state court's findings and conclusions were the following excerpts:

> LLC managers owe the same fiduciary duties of care and loyalty as are owed by a partner to a partnership and its partners. [Citing Cal. Corp. Code § 17153]. . . . A partner's duty of loyalty to the partnership and other partners includes [] the following: (i) to account to the partnership and hold as a trustee for it any property, profit or benefit derived by the partner in the conduct and winding up of the partnership business [citing Cal. Corp. Code § 16404][.]

SOD at 19.

> The Court finds that McCarthy is in violation of Corporations Code 17253 and 17255 and has breached his fiduciary duties of loyalty and care to the Company and its members by doing, among other things, the following:
>
> (a) Taking $95,000 from Nature's Wing in 2001 in a manner which left the Company liable for an accelerated return to the Sommers [an investor, not a party to the state court litigation] as a capital investment without a corresponding use

of the money by Nature's Wing;[4]

(b) Making improper "mandatory" distributions which benefitted him to the detriment of the cash contributors who were promised that they would receive back their investment before McCarthy took any money other than his salary;[5]

(c) Taking approximately $650,000 (to date) as an "advance" to fund McCarthy's personal defense in this action over the express objections of the Board and the Board's determination that McCarthy was not acting in good faith;

(d) Taking improper expense reimbursements;[6]

(e) Manipulating board elections by failing to comply with part 4.2, 6.2, and 7.13 of the Operating Agreement in order to eliminate members of the Board who were opposing the improper mandatory distributions which benefitted McCarthy to the detriment of the cash investors and other improper distributions to McCarthy, including improper expense reimbursements;[7] and

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[4] A 2004 audit showed that the Sommers' payment of $94,500 was entered as a capital investment on the books of the company, but that McCarthy had written checks to himself on NWFD's account for $94,500 as a "personal share sale." SOD at 11.

[5] McCarthy made four "mandatory" distributions between November 2002 and September 2003 totaling $182,648, of which he paid himself $128,170. The state court determined that none of the distributions were mandatory, but discretionary under the operating agreement, and required authorization by the board, which was not granted. The distributions were not consistent with various provisions of the Internal Revenue Code. SOD at 26. McCarthy was required under the operating agreement to obtain board approval for the distributions, which he did not obtain and, in fact, two distributions paid wholly to McCarthy were made over the board's express objections. SOD at 19, 22.

[6] The state court found that McCarthy admitted to the board that he took $44,000 in improper expenses, but only after the discovery of the expenses was unearthed by the board. SOD at 38.

[7] In February 2004, the board scheduled a meeting at which (continued...)

> (f) Interfering with and manipulating the intended forensic audit commissioned by the board in early 2004 to determine the extent of McCarthy's financial wrongdoings, actively causing the removal of the original conclusion that mandatory distributions should not have been made, never disclosing to the board that he did so, and then presenting to the Board and Members an audit report with such [falsified] conclusion.

SOD at 20-21.

After making these findings, the state court concluded that, "in breaching his fiduciary duties, McCarthy was not acting in good faith and is not entitled to be indemnified by Nature's Wing." SOD at 21.

McCarthy appealed the state court judgment. In an unpublished, but detailed, eighteen-page decision, the California Court of Appeals affirmed the state court judgment in all respects. Jenkins v. McCarthy, case no. BC309875 (Cal. Ct. App., October 29, 2008), rev. denied, case no. S168937 (Cal., January 21, 2009), cert. denied, 130 S.Ct. 824 (2009), and reh'g denied, 130 S.Ct. 231 (2009).

On October 12, 2005, McCarthy filed a petition under chapter 11 of the Bankruptcy Code. McCarthy then filed a motion for

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[7](...continued)
it planned to consider McCarthy's alleged thefts, its disagreements with McCarthy's "mandatory" distributions, and to vote against advancing NWFD funds for McCarthy's defense in the state court action. McCarthy "unilaterally and at the last minute voted [two directors who opposed him] off the Board and then refused to attend the board meeting despite previously agreeing to the date and time." SOD at 49. The state court later determined that McCarthy could not remove directors without notice and waiver of consent, per the LLC's operating agreement. There was no notice and waiver of consent. SOD at 55.

relief from the automatic stay so that he could prosecute an appeal of the state court judgment. The Minority Shareholders, on behalf of NWFD, opposed the motion and moved to dismiss the bankruptcy case, or to convert it to a chapter 7 case.

At the hearing on the motion to dismiss or convert, the bankruptcy court expressed doubts about McCarthy's fitness and willingness to perform his fiduciary duties as a chapter 11 debtor in possession. According to the bankruptcy court, McCarthy "has proven himself unreliable in his business dealings, that he also is not trustworthy. He failed to declare $94,000 on his tax returns. He issued a false financial statement when he got a house loan. I don't think he should be a debtor in possession." Tr. Hr'g 21: 16-21 (November 22, 2005).

The bankruptcy court entered its order dismissing McCarthy's chapter 11 case on December 13, 2005. On December 22, 2005, McCarthy moved ex parte to reconsider the dismissal and consented to the appointment of a chapter 11 trustee. After a hearing at which McCarthy and NWFD were represented by attorneys, the bankruptcy court, in an order entered December 22, 2005, granted the reconsideration motion, vacated the dismissal, and ordered the appointment of a chapter 11 trustee.

The trustee determined that there was no reasonable likelihood of rehabilitation of the debtor, and moved to convert the bankruptcy case to chapter 7. McCarthy responded by moving to dismiss the case. After a hearing at which McCarthy, the trustee and NWFD were again represented, the bankruptcy court entered an order granting the motion to convert the case to chapter 7 and denying the motion to dismiss.

While the parties were sparring over dismissal or conversion, NWFD commenced this adversary proceeding on February 6, 2006, challenging the dischargeability of the state court judgment under § 523(a)(2) and (4). McCarthy filed an answer on April 5, 2006, generally denying the allegations of NWFD's complaint.

On December 12, 2006, NWFD moved for summary judgment of its claim under § 523(a)(4). NWFD argued that the judgment debt to NWFD was nondischargeable because it was based upon McCarthy's defalcation as a fiduciary to NWFD. In lieu of a response, McCarthy requested a continuance to allow him to obtain the state court transcripts and prepare his arguments. The bankruptcy court granted the continuance, and then eighteen additional hearing continuances over the next three years, while McCarthy appealed the state court judgment through the state courts, and then sought certiorari twice in the U.S. Supreme Court. McCarthy was unsuccessful in all appeals.

After all of McCarthy's appeals had run their course, in December 2009, he filed his opposition to the summary judgment motion, arguing, inter alia, that there was no express trust under California law, and consequently, he could not have committed any defalcation.

The bankruptcy court held the hearing on NWFD's summary judgment motion on March 17, 2010. Before the hearing, the court provided the parties with a detailed tentative ruling ("Tentative Ruling"), which was docketed the next day. In tentatively deciding to grant NWFD's summary judgment motion, the court noted that the state court's SOD provided detailed fact findings about

how McCarthy had made improper distributions to himself before paying back investor funds, allowed an improper investment in NWFD, commingled funds, interfered with a forensic audit, and improperly removed directors. The bankruptcy court examined the requirements for giving preclusive effect to NWFD's state court judgment under California and federal law, and concluded that they were present and that preclusion should be applied.

After hearing from the parties at the hearing, the bankruptcy court adopted its Tentative Ruling. On April 21, 2010, the court entered its Order granting summary judgment to NWFD that its judgment against McCarthy was excepted from discharge pursuant to § 523(a)(4). The Order incorporated the Tentative Ruling.

On April 1, 2010, McCarthy appealed the order granting summary judgment. However, the Panel dismissed the appeal as interlocutory because NWFD's complaint had also asserted that its debt was excepted from discharge under § 523(a)(2), a claim that had not been decided by the bankruptcy court.

At a status conference in the adversary proceeding on September 15, 2010, the bankruptcy court dismissed NWFD's § 523(a)(2) claim to allow entry of final judgment without prejudice to the right of NWFD to reopen the § 523(a)(2) claim if the § 523(a)(4) claim was altered on appeal. The bankruptcy court entered its order of dismissal on October 12, 2010. McCarthy filed an opposition to that dismissal, arguing prejudice. By order on October 22, the bankruptcy court overruled McCarthy's objection to the order of dismissal, observing that, "The Court has read the opposition and finds that

the order as entered does not prejudice the defendant. To force the parties and the court to litigate the first claim for relief would merely cause undue delay, excessive work for the parties and the court, and be extremely inefficient."

The bankruptcy court entered a final judgment, determining NWFD's claim nondischargeable under § 523(a)(4), and dismissing the § 523(a)(2) claim without prejudice. On October 29, 2010, McCarthy filed timely, separate appeals of (1) the final judgment and (2) the summary judgment order and order dismissing the § 523(a)(2) claim.

Since the second appeal was composed of interlocutory orders that were reviewable with the final judgment, the Panel ordered that the appeals be consolidated under BAP No. 10-1446.

JURISDICTION

The bankruptcy court had jurisdiction under 28 U.S.C. §§ 1334 and 157(b)(2)(J). We have jurisdiction under 28 U.S.C. § 158.

On March 17, 2011, McCarthy filed a motion to dismiss this appeal, in which he argued that the bankruptcy court's dismissal of NWFD's claim under § 523(a)(2) "without prejudice" to allow entry of final judgment under § 523(a)(4) was an attempt to manipulate the appellate jurisdiction of this Panel. McCarthy sought dismissal of this appeal with instructions from the Panel to the bankruptcy court to permanently dispose of all of NWFD's claims. A few days later, McCarthy submitted his opening brief in this appeal, and incorporated the dismissal arguments as his first issue on appeal. NWFD opposed McCarthy's motion, and our motions panel denied the motion and all relief requested in the

motion in an order entered on April 8, 2011.

A merits panel is not bound by the decisions of a motions panel. Stagecoach Utilities, Inc. v. County of Lyon (In re Stagecoach Utilities, Inc.), 86 B.R. 229, 230 (9th Cir. BAP 1988). However, we also decline to dismiss this appeal, and instead conclude the bankruptcy court's judgment is sufficiently final to allow us to reach the merits on appeal. Simply put, there is no evidence in the record that the bankruptcy court or NWFD attempted to manipulate the jurisdiction of this Panel.

In James v. Price Stern Sloan, 283 F.3d 1064 (9th Cir. 2002), the Ninth Circuit examined the case law on manufactured or manipulated jurisdiction, including two cases cited by McCarthy to support his argument to this Panel, Cheng v. Comm'r, 878 F.2d 306 (9th Cir. 1994) and Dannenberg v. Software Toolworks, 16 F.3d 1073 (9th Cir. 1994). As the James court observed, Cheng and Dannenberg involved stipulations by the parties to manufacture a final judgment, without the review or other significant involvement of the trial judge, by dismissing claims, but providing that if a judgment on one claim was reversed on appeal, the appellant would be permitted to reinstate and pursue the dismissed claims. The James court observed that such practices are manipulative, and that the parties should not be allowed to create appellate jurisdiction in such fashion. James, 283 F.3d at 1066. However, the James court observed that, if the trial court had been involved, that "is usually sufficient to ensure that everything is kosher." Id. In other words, the fair view of James and the case law is that manipulation may be present when appellate jurisdiction is manufactured by the parties either

without the knowledge of, or by deceiving, the trial court.

In both the James case and this appeal, the trial courts were actively involved in the decision to dismiss the other pending claims, and approved the order leading to the appeal. Indeed, from our review of the record, it was the bankruptcy court that "recommended" that NWFD's § 523(a)(2) claim be dismissed without prejudice to allow entry of a final judgment on the § 523(a)(4) claim. See Order Overruling Defendant's Opposition to Plaintiff's Proposed Order Dismissing Nature's Wing Fin Design, LLC's First Cause of Action for False Pretenses, False Representation, or Actual Fraud Pursuant to 11 U.S.C. § 523(a)(2), at 2 ("Overruling Order"). The bankruptcy court explained the reasons for its recommendation and concluded that such actions "do not prejudice the defendant. To force the parties and the court to litigate the first claim for relief would merely cause undue delay, excessive work for the parties and the court, and be extremely inefficient." Overruling Order at 2.

Under these facts, we conclude that there was good cause for the bankruptcy court's decision to dismiss NWFD's § 523(a)(2) claim, that there is no evidence of manipulation of appellate jurisdiction in this case, and that the bankruptcy court's judgment on appeal is final for jurisdictional purposes. McCarthy's appeal from the bankruptcy court's order dismissing NWFD's § 523(a)(2) claim lacks merit.[8]

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[8] For much the same reason that the bankruptcy court gave in support of its Overruling Order, the bankruptcy court could (continued...)

ISSUES

1. Whether the bankruptcy court erred in determining that issue preclusion was available, or abused its discretion in applying issue preclusion, to the state court judgment.
2. Whether the bankruptcy court erred in granting summary judgment to NWFD on its § 523(a)(4) claim.

STANDARDS OF REVIEW

The availability of issue preclusion is reviewed de novo. Af-Cap Inc. v. Chevron Overseas (Congo) Ltd., 475 F.3d 1080, 1086 (9th Cir. 2007). If issue preclusion is available, the trial court's decision to apply it is reviewed for abuse of discretion. Parklane Hosiery Co., Inc. v. Shore, 439 U.S. 322, 331 (1979).

In applying the abuse of discretion standard, we first "determine de novo whether the [bankruptcy] court identified the correct legal rule to apply to the relief requested." United States v. Hinkson, 585 F.3d 1247, 1262 (9th Cir. 2009) (en banc). If the correct legal rule was applied, we then consider whether its "application of the correct legal standard was (1) illogical, (2) implausible, or (3) without support in inferences that may be drawn from the facts in the record." Id. Only in the event that one or more of these three apply are we then able to find that the bankruptcy court abused its discretion. Id.

We review summary judgments de novo. FTC v. Stefanchik,

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[8](...continued)
have exercised its authority under Civil Rule 54(b) to direct the entry of final judgment on the § 523(a)(4) claim for relief, without having to dismiss the § 523(a)(2) claim for relief. Rule 7054 makes Civil Rule 54(b) applicable in adversary proceedings.

559 F.3d 924, 927 (9th Cir. 2009); Expeditors Int'l v. Official Creditors Comm. of CFLC, Inc. (In re CFLC, Inc.), 209 B.R. 508, 512 (9th Cir. BAP 1997). If the pleadings, depositions, answers to interrogatories, and admissions on file, together with any affidavits, show that there is no genuine issue of material fact and that the moving party is entitled to judgment as a matter of law, summary judgment will be upheld. Civil Rule 56(c), incorporated by Rule 7056. Gertsch v. Johnson & Johnson, Fin. Corp. (In re Gertsch), 237 B.R. 160, 165 (9th Cir. BAP 1999).

DISCUSSION

I.

The bankruptcy court did not err in determining that issue preclusion was available, and in applying issue preclusion to the state court judgment.

The primary issue on this appeal is whether the bankruptcy court appropriately applied preclusive effect to the state court judgment.

Issue preclusion applies in proceedings to determine the dischargeability of debts. Grogan v. Garner, 498 U.S. 279, 284-85 (1991). "Issue preclusion . . . bars successive litigation of an issue of fact or law actually litigated and resolved in a valid court determination essential to the prior judgment." New Hampshire v. Maine, 532 U.S. 742, 748 (2001). The policy underlying issue preclusion is:

> To preclude parties from contesting matters that they have had a full and fair opportunity to litigate protects their adversaries from the expense and vexation attending multiple lawsuits, conserves judicial resources, and fosters reliance on judicial action by minimizing the possibility of inconsistent decisions.

Montana v. United States, 440 U.S. 147, 153 (1979).

Under the federal Full Faith and Credit Act, the judicial proceedings of a state court "shall have the same full faith and credit in every court within the United States and its Territories and Possessions as they have by law or usage in the courts of such State, Territory or Possession from which they are taken." 28 U.S.C. § 1738. Thus, in determining the preclusive effect of a state court judgment, a federal court must apply that state's law of issue preclusion. Harmon v. Kobrin (In re Harmon), 250 F.3d 1240, 1245 (9th Cir. 2001).

The state court judgment, and orders affirming the judgment entered in the subsequent appeals, were entered in courts in the state of California. California courts will apply issue preclusion to prevent "relitigation of issues argued and decided in prior proceedings." Lucido v. Super. Ct., 795 P.2d 1223, 1225 (Cal. 1990) (en banc). However, California courts will apply issue preclusion only if certain threshold requirements are met, and then only if application of preclusion furthers the public policies underlying the doctrine. Id. at 1226. There are five threshold requirements:

> First, the issue sought to be precluded from relitigation must be identical to that decided in a former proceeding. Second, this issue must have been actually litigated in the former proceeding. Third, it must have been necessarily decided in the former proceeding. Fourth, the decision in the former proceeding must be final and on the merits. Finally, the party against whom preclusion is sought must be the same as, or in privity with, the party to the former proceeding.

Id. In its Tentative Ruling, incorporated in the summary judgment order, which then merged in the final judgment, the

bankruptcy court properly addressed these criteria.

A. The issue litigated in the state court proceedings, and in the adversary proceeding, was the same: Whether McCarthy breached a fiduciary duty.

In the SOD, the state court made the explicit finding that McCarthy "breached his fiduciary duty of loyalty and care to the Company and its members" by doing the following: (a) taking $95,000 from Nature's Wing in 2001 in a manner which left the Company liable for an accelerated return to an investor without a corresponding use of the money by NWFD; (b) making improper "mandatory" distributions which benefitted him to the detriment of the cash contributors who were promised that they would receive back their investment before McCarthy took any money other than his salary; (c) taking approximately $650,000 as an "advance" to fund his litigation expenses over the express objections of the Board and the Board's determination that McCarthy was not acting in good faith; (d) taking improper expense reimbursements; (e) manipulating board elections in order to eliminate members of the Board who were opposing the improper mandatory distributions; and (f) interfering with and manipulating the forensic audit commissioned by the board in early 2004 to determine the extent of McCarthy's financial wrongdoings. SOD at 20-21. The state court also found that McCarthy's conduct was "grossly self-interested," and that his only goal was to protect himself against having to return the distributions and continue making and enjoying the large payouts from his improper distributions. SOD at 47. The state court concluded that McCarthy was not credible, and that he had "lied to his home lender under penalty of perjury and lied to the IRS."

SOD at 27, 68, 69. Based on these findings, the bankruptcy court determined that "the state court judgment is based on debtor's breaches of fiduciary duty, as is the complaint for nondischargeability; thus the issues are identical." Tentative Ruling at 4.

In determining whether the issues in a prior proceeding are identical to those in the subsequent proceeding, the Ninth Circuit has developed a list of four factors to be considered:

> (1) is there a substantial overlap between the evidence or argument to be advanced in the second proceeding and that advanced in the first?
>
> (2) does the new evidence or argument involve the application of the same rule of law as that involved in the prior proceeding?
>
> (3) could pretrial preparation and discovery related to the matter presented in the first action reasonably be expected to have embraced the matter sought to be presented in the second?
>
> (4) how closely related are the claims involved in the two proceedings?

Resolution Trust Corp. v. Keating, 186 F.3d 1110, 1116 (9th Cir. 1999). All four conditions are present in this appeal. Since federal law is guided by state law in gauging whether an entity is a fiduciary for bankruptcy discharge purposes, and whether there has been a breach of fiduciary duty, the evidence, argument, legal applications and discovery considerably overlap between the earlier and later proceedings. In addition, in this case, the claim involved in the earlier state court proceeding – to recover damages for breach of fiduciary duty – is closely related to the claim in the adversary proceeding dealing with the dischargeabilty of that damage claim.

As did the bankruptcy court, we conclude that the issues in

the state court action, and those in the adversary proceeding, are fundamentally the same: Was McCarthy a fiduciary and, if so, did he breach his duty to NWFD? The first criterion for application of issue preclusion is therefore satisfied.

B. The issue was actually litigated.

The state court conducted a three-and-a-half-week bench trial, reviewed thousands of pages of documentary exhibits, and entered a twenty-three page Statement of Decision, finding in favor of NWFD, and against McCarthy "on all causes of action" including those for breach of fiduciary duty. SOD at 1. Throughout the year and a half of state court pretrial proceedings, McCarthy was represented by attorneys. On this record, the bankruptcy court found that "it is clear that the issues have been actually litigated since the state court conducted a three-week bench trial which resulted in extensive findings of fact and conclusions of law." Tentative Ruling at 4.

To determine if an issue has been actually litigated, we are required to examine the records of the prior court. United States v. Hernandez, 572 F.2d 218, 222 (9th Cir. 1978). Although we do not have transcripts of the state court hearings, we do have the detailed SOD. And McCarthy has never argued that he was not adequately represented at the trial.

We agree with the bankruptcy court that the issues have been actually litigated. The second criterion for application of issue preclusion has been satisfied.

C. The state court judgment was a final order, and the parties to the state court proceedings and the adversary proceeding are the same.

The bankruptcy court confidently concluded that the fourth

and fifth elements for preclusive effect of the state court judgment were also satisfied. Tentative Ruling at 4. This conclusion is not disputed. The parties are unquestionably the same, and the state trial court's judgment was affirmed by the California Court of Appeals, and review denied by both the California and United States Supreme Courts.

D. The necessary elements to determine an exception to discharge under § 523(a)(4) were necessarily determined by the state court.

Having decided that the other criteria for issue preclusion were satisfied, the bankruptcy court turned its attention to whether the elements required under § 523(a)(4) had been necessarily decided in the state court proceedings. It concluded that the facts required to determine that McCarthy had engaged in defalcation by a fiduciary had indeed been determined.

Section 523(a)(4) excepts from discharge debts "for fraud or defalcation while acting in a fiduciary capacity, embezzlement or larceny." In an action under § 523(a)(4), a creditor must establish: (1) that an express trust existed between the debtor and creditor; (2) that the debt was caused by the debtor's fraud or defalcation; and (3) that the debtor was a fiduciary to the creditor at the time the debt was created. Otto v. Niles (In re Niles), 106 F.3d 1456, 1459 (9th Cir. 1997); Nahman v. Jacks (In re Jacks), 266 B.R. 728, 735 (9th Cir. BAP 2001).

As noted by the state and bankruptcy courts, an express trust[9] under California law existed between McCarthy and NWFD at

[9] Technically, the trust relationship in this case is statutory rather than express, because it is imposed on partners/LLC managers by operation of law. However, statutory (continued...)

the time he engaged in the offensive conduct. According to Cal. Corp. Code § 17001(w), "'Manager' means a person elected by the members of a limited liability company to manage the limited liability company[.]" McCarthy was identified in the Operating Agreement as the sole "Manager" of NWFD with complete authority to manage the LLC. SOD at 2.

California limited liability company law provides that "the fiduciary duties a manager owes to a limited liability company are those of a partner to a partnership and to the partners of the partner." Cal. Corp. Code § 17153. One of the fiduciary duties imposed on partners (and, by operation of Cal. Corp. Code § 17153, an LLC manager) is "to account to the partnership and hold as trustee for it any property, profit, or benefit derived by the partner in the conduct and winding up of the partnership business or derived from a use by the partner of partnership property or information." Cal. Corp. Code § 16404 (emphasis added). Interpreting Cal. Corp. Code § 16404, the Ninth Circuit has ruled that partners are fiduciaries for the purposes of § 523(a)(4). Ragsdale v. Haller, 780 F.2d 794, 796-97 (9th Cir. 1986).

Based on its review of the statutes and case law, and its reading of the SOD, the bankruptcy court found that "the required

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[9](...continued)
trusts are to be treated as the equivalent of express trusts in California for purposes of the application of § 523(a)(4). Runnion v. Pedrazzini (In re Pedrazzini), 644 F.2d 756, 758 (9th Cir. 1981) ("The precise manner in which a trust is created, by consent or by statute, is of little importance. Rather, the focus should be on whether true fiduciary responsibilities have been imposed.").

express trust relationship existed in this case and that debtor was a fiduciary for purposes of section 523(a)(4) at the time the improper acts were done." Tentative Ruling at 5. After our independent review of the record, we agree. This determination is dispositive of the first and third requirements under § 523(a)(4), that an express trust and a fiduciary relationship existed between McCarthy and NWFD. The only remaining question is whether the state court found that McCarthy committed defalcations sufficient to satisfy § 523(a)(4).

A defalcation occurs for purposes of this statute through the "misappropriation of trust funds or money held in a fiduciary capacity; failure to properly account for such funds." Lewis v. Scott (In re Lewis), 97 F.3d 1182, 1186 (9th Cir. 1996). A defalcation also exists when a fiduciary cannot account for the trust res, commingles funds with trust funds, and uses the company's money for his personal benefit. Id. at 1186-87. As the bankruptcy court observed, the detailed findings of the state court show that McCarthy made improper distributions in violation of the Operating Agreement (SOD at 20), improperly obligated the company (SOD at 35), lied to the board about the cause for overpayments (SOD at 37), used and lied about using company funds for personal expenses (SOD at 37-38), commingled funds (SOD at 39), interfered with an audit (SOD at 41), and acted fraudulently and in bad faith in removing board members (SOD at 58). Tentative Ruling at 5. We agree with the bankruptcy court that these findings are more than sufficient to satisfy the element of defalcation under § 523(a)(4). In sum, the bankruptcy court correctly decided that the third criterion for application of

issue preclusion had been met: The issue of breach of fiduciary duty was necessarily decided in the state court, and the state court's findings on that issue met the requirements for breach of fiduciary duty under § 523(a)(4).

We conclude that the bankruptcy court correctly decided that "all elements of [issue preclusion] have been met" and were available in this litigation. Tentative Ruling at 7. Having determined that issue preclusion was available, the bankruptcy court was required by Parklane Hosiery Co. to make an explicit, discretionary decision whether to apply it. 439 U.S. at 331. The bankruptcy court stated that it applied issue preclusion on the grounds of fairness and judicial economy: "It is fair to apply the doctrine in this case to prevent further unnecessary litigation that would not produce a different result in light of the fact that the state court's findings are sufficient to satisfy § 523(a)(4)." Tentative Ruling at 7. The bankruptcy court did not abuse its discretion in applying issue preclusion in this case.

II.

The bankruptcy court did not err in granting summary judgment to NWFD on its claim pursuant to § 523(a)(4).

Summary judgment may be granted "if the pleadings, the discovery and disclosure materials on file, and any affidavits show that there is no genuine issue as to any material fact and that the movant is entitled to judgment as a matter of law." Civil Rule 56(c)(2), as incorporated by Rule 7056. Barboza v. New Form, Inc. (In re Barboza), 545 F.3d 702, 707 (9th Cir. 2008). The trial court may not weigh evidence in resolving such

motions, but rather determines only whether a material factual dispute remains for trial. Covey v. Hollydale Mobilehome Estates, 116 F.3d 830, 834 (9th Cir. 1997). A dispute is genuine if there is sufficient evidence for a reasonable fact finder to hold in favor of the non-moving party, and a fact is "material" if it might affect the outcome of the case. Far Out Prods., Inc. v. Oskar, 247 F.3d 986, 992 (9th Cir. 2001). The initial burden of showing there are no genuine issues of material fact rests on the moving party. Margolis v. Ryan, 140 F.3d 850, 852 (9th Cir. 1998). Where issue preclusion bars the parties from relitigating the essential issues, summary judgment may be granted. Ross v. Alaska, 189 F.3d 1107, 1113 (9th Cir. 1999).

In this case, the bankruptcy court determined that, based on the application of issue preclusion, no genuine issues of fact remained for trial because "the state court's findings are sufficient to satisfy section 523(a)(4) [and] summary judgment is proper and should be granted." Tentative Ruling at 7. McCarthy challenges this conclusion, arguing that issues of fact existed for each of the three areas where he was directed to return funds to NWFD.

Regarding the alleged "mandatory distributions" he had made to himself, McCarthy argues that the NWFD board purportedly "ratified" all those distributions. This factual issue was litigated exhaustively at both the state trial and appellate levels. Indeed, according to the state trial court, McCarthy breached his fiduciary duty by making "improper 'mandatory' distributions which benefitted him to the detriment of cash contributors who were promised they would receive back their

investment before McCarthy took any money other than salary." McCarthy apparently made his argument about this point again before the Court of Appeals of California. The California appellate court affirmed the trial court, adding that in making the distributions to himself, McCarthy's "interpretations of the operating agreement . . . were unreasonable and unsupported by any expert testimony." McCarthy v. NWFD at 16.

McCarthy also argues that his action in taking $580,000 to fund his litigation defense expenses over the board's express objections was really a loan approved by the board. But this is flatly inconsistent with the record. The state court found that the board not only never ratified McCarthy's takings, but instead, "at the February 10, 2004 meeting, the Board met and unanimously voted against advancing Nature's Wing's funds to McCarthy for his legal defense in this matter. . . . The Court further found that in an effort to derail the Board's vote . . . McCarthy fraudulently and in bad faith held an 'election' in which he fraudulently voted off Board members in an attempt to prevent the vote against him from going forward." SOD at 16.

In this appeal, McCarthy has attempted to buttress his argument that the board approved funds for his legal defense by asking the Panel to take judicial notice of a recent state court action, Nature's Wing Fin Design, LLC v. Edward Treska et al., case no. BC-373239 (Los Angeles Superior Court, April 22, 2010). According to McCarthy, in this action the state court determined that his advance of attorney fees in the earlier state court action was not an act of wrongdoing, but was fully authorized by all members of the LLC "by contract."

We decline McCarthy's invitation to take judicial notice of this decision because, in order to do so, the proposed noticed facts must be "not subject to reasonable dispute." Fed. R. Evid. 201(b). Obviously, because a different state court earlier made a finding directly contradictory to McCarthy's assertion about what is found in the record in the later state action, McCarthy is asking us to take notice of conflicting, not undisputed, facts. Moreover, even if McCarthy's contention about what is found in the later action is correct, the bankruptcy court's decision to apply issue preclusion to the original state court judgment is not impaired so long as the loser in the prior litigation (i.e., McCarthy) had the opportunity to test the final judgment on appeal. Fed. Dep't Stores v. Moitie, 452 U.S. 394, 398 (1981). Of course, McCarthy availed himself of such opportunity, in that he tried and failed repeatedly to have the judgment overturned on appeal.[10]

Finally, regarding the $94,500 taken from NWFD by McCarthy as payment for a purported sale of his shares, McCarthy continues to argue that the board ratified this action despite the findings of the state court that it was yet another breach of his

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[10] Further, McCarthy is effectively asking us to review and reject a final state court judgment. Neither we nor the bankruptcy court have jurisdiction to entertain such an invitation. See Rooker v. Fid. Trust Co., 263 U.S. 413 (1923); D.C. Court of Appeals v. Feldman, 460 U.S. 462 (1983). The Rooker-Feldman doctrine bars legal proceedings "brought by state-court losers complaining of injuries caused by state-court judgments rendered before the [bankruptcy] court proceedings commenced and inviting [bankruptcy] court review and rejection of those judgments." Exxon Mobil Corp. v. Saudi Basic Indust. Corp., 544 U.S. 280, 284 (2005), quoted in Carmona v. Carmona, 603 F.3d 1041, 1050 (9th Cir. 2010).

fiduciary duties. SOD at 20. The state court finding detailed multiple breaches of his duties. The state court found that this taking of corporate funds was done "in a manner which left the Company liable for an accelerated return to the investor without a corresponding use of the money by Nature's Wing," and that McCarthy took the money in defiance of the board's wishes that he "obtain professional advice or advise the board in advance." Id.

Having considered all of McCarthy's arguments anew, like the bankruptcy court, we conclude that there were no genuine issues of material fact preventing the bankruptcy court from entering summary judgment on NWFD's claim for an exception to discharge under § 523(a)(4).

CONCLUSION

We AFFIRM the judgment and order of the bankruptcy court.