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NOT FOR PUBLICATION

UNITED STATES BANKRUPTCY APPELLATE PANEL  
OF THE NINTH CIRCUIT

In re:	)	BAP No. CC-14-1307-PaTaKu
	)	
MARK CHRISTIAN TARCZYNSKI,	)	Bankr. No. 13-38642-BB
	)	
Debtor.	)	Adv. Proc. 14-01149-BB
	)	
1100 WILSHIRE BLVD., LLC,	)	
	)	
Appellant,	)	
	)	
v.	)	<b>MEMORANDUM</b> <sup>1</sup>
	)	
MARK CHRISTIAN TARCZYNSKI;	)	
1100 WILSHIRE PROPERTY OWNERS	)	
ASSOCIATION,	)	
	)	
Appellees.	)	

Argued and Submitted on November 20, 2014  
at Los Angeles, California

Filed - February 19, 2015

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

Honorable Sheri Bluebond, Chief Bankruptcy Judge, Presiding

Appearances: Joshua Ruben Furman argued for appellant 1100  
Wilshire Blvd., LLC; Mark M. Sharf of Merritt,  
Hagen & Sharf LLP argued for appellee Mark  
Christian Tarczynski.

Before: PAPPAS, TAYLOR, and KURTZ, Bankruptcy Judges.

<sup>1</sup> 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.



1 Mackey together own Wilshire Commercial, LLC, a corporation that  
2 owns a commercial condominium unit in the Property, and is a  
3 member of the POA.

4 In June 2013, JP Morgan Chase Bank ("Chase") announced that  
5 it would open a branch office on the first floor of the Property  
6 in space leased from Wilshire Commercial. Shortly thereafter,  
7 the POA Board and Chase announced that Chase would install a  
8 large sign on the exterior of the Property. Among other  
9 features, the sign would spell out "CHASE" in nine-foot  
10 illuminated letters mounted directly outside Appellant's units.  
11 The lease for placement of the sign provided for approximately  
12 \$3.5 million in annual payments from Chase to 1100 Wilshire  
13 Boulevard.

14 Concerned with these developments, on June 18, 2013, counsel  
15 for Appellant sent to the POA Board president a "Pre-litigation  
16 Demand for Action by the Board" (the "Demand Letter"). Among  
17 other things, the Demand Letter requested that the POA Board not  
18 grant any signage rights on the Property without an authorizing  
19 vote of the POA membership and that the POA Board investigate  
20 certain allegedly improper self-dealings by some POA Board  
21 members regarding the Property.

22 Counsel for the POA Board provided a lengthy response to the  
23 Demand Letter on July 5, 2013. In it, he defended the POA  
24 Board's authority to enter into, and their strategy in  
25 negotiating, the Chase sign lease. He pointed out that without  
26 the lease income, the POA members' "assessments would need to  
27 increase substantially in order to pay for necessary repairs and  
28 improvements to the building." As to Appellant's allegations

1 about improper activities by POA Board members, POA counsel  
2 demanded proof of Appellant's claims and cautioned Appellant's  
3 counsel that these allegations could be considered "defamatory  
4 and subject both you and your clients to damages for such  
5 defamation."

6       Apparently dissatisfied with this response, Appellant filed  
7 a lawsuit against the POA, Tischer, Tarczynski, and Chase in Los  
8 Angeles Superior Court on August 20, 2013 (the "State Court  
9 Action"). In its original complaint, Appellant sought a  
10 declaratory judgment that, because of the conflicting interests  
11 of POA Board members, the lease for the sign between the POA and  
12 Chase was void. Appellant also requested that a restraining  
13 order and an injunction be entered preventing construction of the  
14 sign.<sup>3</sup> It also sought an order directing the election of a new  
15 POA Board.

16       Appellant's application for a temporary restraining order  
17 and preliminary injunction to stop construction of the sign was  
18 denied by the state court on September 4, 2013. Thereafter,  
19 Appellant filed a First Amended Complaint deleting the request  
20 for injunctive relief, but now asserting, as a representative of  
21 the POA, several derivative causes of action against Debtor and  
22 Tischer as POA Board members for their alleged breach of  
23 fiduciary duty, conspiracy to breach fiduciary duty, intentional  
24

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25  
26       <sup>3</sup> Three successive versions of the complaint were filed in  
27 state court, in each of which Appellant argues that the POA Board  
28 and Debtor were not properly elected, and alleging other  
violations of the Davis-Sterling Common Interest Development Act,  
Cal. Civ. Code §§ 4000-4070 (2013).

1 interference with prospective economic advantage, and  
2 constructive fraud.

3 On December 2, 2013, Debtor filed a petition for relief  
4 under chapter 7 of the Bankruptcy Code. As a result, the State  
5 Court Action was stayed as to Debtor. Appellant, ostensibly  
6 acting as a representative on behalf of the POA under  
7 Rule 7023.1/Civil Rule 23.1, filed an adversary complaint against  
8 Debtor seeking an exception to discharge under § 523(a)(2)(A),  
9 (a)(4), and (a)(6) for the debts arising from the claims asserted  
10 in the State Court Action (the "First Adversary Complaint").

11 On April 10, 2014, Debtor filed a motion to dismiss the  
12 First Adversary Complaint under Rule 7012/Civil Rule 12(b)(6).  
13 In the motion, Debtor argued that Appellant was not an adequate  
14 representative of the POA for purposes of pursuing the discharge  
15 exception action because Appellant had sued the POA in the State  
16 Court Action. Debtor also alleged that the First Adversary  
17 Complaint failed to allege fraud with specificity as required by  
18 Rule 7009/Civil Rule 9. Appellant responded to the motion, and  
19 on April 9, 2014, filed an amended adversary complaint (the  
20 "Amended Adversary Complaint") pleading more facts regarding  
21 Debtor's alleged improper conduct.<sup>4</sup>

22 \_\_\_\_\_  
23 <sup>4</sup> On April 16, 2014, Appellant also filed a Second Amended  
24 Complaint in the State Court Action, adding Mackey and Wilshire  
25 Commercial as defendants, adding new causes of action against the  
26 POA and Chase for public nuisance (i.e., diminishing the value of  
27 the individual owner's interests in the Property) and private  
28 nuisance (i.e., for light pollution and excessive electromagnetic  
radiation) (the "Second Amended State Complaint" or "SASC"). The  
Amended Adversary Complaint indicates that a copy of the SASC was  
(continued...)

1 The bankruptcy court heard Debtor's motion to dismiss on  
2 May 13, 2014. Before the hearing, the court had issued a  
3 tentative ruling indicating that it was inclined to:

4 [g]rant [the] motion without leave to amend.  
5 [Appellant] lacks standing to prosecute this action and  
6 cannot do so in a derivative capacity. [Appellant] is  
7 not an appropriate representative in light of  
8 antagonism between the interests of the plaintiff and  
9 the homeowners association. Further, directors are  
10 entitled to exercise their business judgment as to  
11 whether or not to sue on behalf of the corporation and  
12 it appears that they have done so and have concluded  
13 that no action against the debtor is appropriate or  
14 warranted. Further, [the Amended Adversary Complaint]  
15 fails to state a claim under sections 523(a)(2)(A), (4)  
16 or (6). What representations did the debtor make to  
17 the plaintiff on which the plaintiff relied? Amended  
18 complaint pleads that debtor was not a member of the  
19 board of directors at the time the signage lease was  
20 signed. How did the debtor owe the plaintiff a  
21 fiduciary duty? What did he do that breached it? If  
22 debtor was not on the board when the lease was signed,  
23 what did he do that was a wrongful, intentional and  
24 malicious act?

15 After hearing arguments from counsel for Appellant and  
16 Debtor, the bankruptcy court granted the motion to dismiss,  
17 explaining:

18 Well, I'm going to grant the motion to dismiss because  
19 I don't think it works for you to assert these claims  
20 derivatively, particularly not when you're also  
21 alleging that the corporation was controlled by parties  
22 who were in conspiracy with this. . . . You've got to  
23 have misrepresentation that was relied on to the  
24 detriment [of the POA] - and if you're making these  
25 . . . misrepresentations [to] parties he's conspir[ing]  
26 with, then he didn't defraud Mackey and the gang. . . .  
27 I don't think this works to have you step into those  
28 shoes derivatively on these facts. And, as I say, I  
29 don't think the corporation has got a claim in light of  
30 the way you've framed the nature of the misconduct  
31 here. So I'm going to grant the motion without leave

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26 <sup>4</sup>(...continued)  
27 attached as an exhibit. It was not. However, a copy of the SASC  
28 was attached to the Debtor's reply brief in support of the motion  
to dismiss.

1 to amend[.]

2 Hr'g Tr. 23:19-24:11, May 13, 2014.

3 The bankruptcy court entered an order dismissing Appellant's  
4 Amended Adversary Complaint without leave to amend on May 30,  
5 2014 "for the reasons set forth on the record at the time of the  
6 hearing on the motion and other good cause appearing therefor."

7 Appellant filed a timely appeal on June 12, 2014.

### 8 JURISDICTION

9 The bankruptcy court had jurisdiction under 28 U.S.C.  
10 §§ 1334 and 157(b) (2) (I). We have jurisdiction under 28 U.S.C.  
11 § 158.

### 12 ISSUES

13 Whether the bankruptcy court erred in dismissing the  
14 Appellant's Amended Adversary Complaint under Rule 7012/Civil  
15 Rule 12(b) (6).

16 Whether the bankruptcy court abused its discretion in  
17 deciding that Appellant was not an adequate representative of the  
18 POA for the purposes of Rule 7023.1/Civil Rule 23.1.

### 19 STANDARDS OF REVIEW

20 A trial court's dismissal of an action under Civil  
21 Rule 12(b) (6) for failure to state a claim is reviewed de novo.  
22 N.M. State Inv. Council v. Ernst & Young, LLP, 641 F.3d 1089,  
23 1094 (9th Cir. 2011); Barnes v. Belice (In re Belice), 461 B.R.  
24 564, 572 (9th Cir. BAP 2011). A trial court's determination as  
25 to the adequacy of representation under Civil Rule 23.1 is  
26 reviewed for abuse of discretion. Kayes v. Pac. Lumber Co.,  
27 51 F.3d 1449, 1464 (9th Cir. 1995). A bankruptcy court abuses  
28 its discretion if it applies an incorrect legal standard, or

1 misapplies the correct legal standard, or if its factual findings  
2 are illogical, implausible, or without support from evidence in  
3 the record. United States v. Hinkson, 585 F.3d 1247, 1262 (9th  
4 Cir. 2009) (en banc)).

#### 5 **DISCUSSION**

6 Under Civil Rule 12(b)(6), made applicable in adversary  
7 proceedings by Rule 7012, a bankruptcy court may dismiss an  
8 adversary complaint if it fails to "state a claim upon which  
9 relief can be granted." In reviewing Debtor's Civil  
10 Rule 12(b)(6) motion, the bankruptcy court was required to accept  
11 as true all facts alleged in Appellant's Amended Adversary  
12 Complaint and to draw all reasonable inferences in Appellant's  
13 favor. Newcal Indus., Inc. v. Ikon Office Solutions, 513 F.3d  
14 1038, 1043 n.2 (9th Cir. 2008). An inference is reasonable "in  
15 light of the competing inferences" that might show contrary  
16 results. Matsushita Elec. Indus. Co. v. Zenith Radio Corp.,  
17 475 U.S. 574, 588 (1986). However, the bankruptcy court was not  
18 required to accept as true conclusory allegations in Appellant's  
19 complaint, nor to accept any legal characterizations cast in the  
20 form of factual allegations. Bell Atl. Corp. v. Twombly,  
21 550 U.S. 544, 555-56 (2007); Warren v. Fox Family Worldwide,  
22 Inc., 328 F.3d 1136, 1139 (9th Cir. 2003).

23 To survive a Civil Rule 12(b)(6) dismissal motion, a  
24 complaint must present cognizable legal theories and sufficient  
25 factual allegations to support those theories. See Johnson v.  
26 Riverside Healthcare Sys., LP, 534 F.3d 1116, 1121-22 (9th Cir.  
27 2008). As the Supreme Court has explained:

28 a complaint must contain sufficient factual matter,

1 accepted as true, to state a claim to relief that is  
2 plausible on its face. . . . A claim has facial  
3 plausibility when the plaintiff pleads factual content  
4 that allows the court to draw the reasonable inference  
5 that the defendant is liable for the misconduct  
6 alleged. . . . Threadbare recitals of the elements of  
7 a cause of action, supported by mere conclusory  
8 statements, do not suffice.

9 Ashcroft v. Iqbal, 556 U.S. 662, 678 (2009). By definition, a  
10 claim cannot be plausible when it lacks any legal basis. Cedano  
11 v. Aurora Loan Servs. (In re Cedano), 470 B.R. 522, 528 (9th Cir.  
12 BAP 2012). A dismissal under Civil Rule 12(b)(6) may be based on  
13 either the lack of a cognizable legal theory, or on the absence  
14 of sufficient facts alleged under a cognizable legal theory.  
15 Johnson v. Riverside Healthcare Sys., 534 F.3d at 1121.

16 In deciding a Civil Rule 12(b)(6) motion to dismiss, the  
17 trial court may consider the existence and content of documents  
18 attached to and referenced in the complaint. Lee v. City of  
19 L.A., 250 F.3d 668, 688 (9th Cir. 2001). Even when a document is  
20 not physically attached to the complaint, the court may consider  
21 its existence and contents when its authenticity is not contested  
22 and when it necessarily is relied upon by the plaintiff in its  
23 complaint. See United States v. Ritchie, 342 F.3d 903, 907-08  
24 (9th Cir. 2003).

25 Here, the bankruptcy court dismissed Appellant's Amended  
26 Adversary Complaint because it concluded that the claims it  
27 asserted had no legal basis. The bankruptcy court determined  
28 that the legal theory espoused in that complaint – that Appellant  
could prosecute a § 523(a) exception to discharge action against  
Debtor as a representative under Rule 7023.1/Civil Rule 23.1 on  
behalf of an alleged creditor, the POA – lacked merit because

1 Appellant was antagonistic to the interests of the other members  
2 of the POA. Hr'g Tr. 3:22-4:2.<sup>5</sup> In the alternative, the  
3 bankruptcy court concluded that dismissal was justified because:  
4 (1) The "Business Judgment Rule" supported the apparent decision  
5 by the POA Board not to prosecute a § 523(a) claim in its own  
6 right, Hr'g Tr. 4:2-7; and (2) assuming that Appellant's claim  
7 that the POA Board members conspired with Debtor were true, then  
8 Appellant's derivative claims against Debtor were barred by the  
9 equitable doctrine of in pari delicto, Hr'g Tr. 23:1-5.

10 After a de novo review of the record, we disagree with the  
11 bankruptcy court's determination that dismissal of Debtor's  
12 complaint was appropriate.

13 I.

14 **The bankruptcy court erred in granting the motion to**  
15 **dismiss by drawing inferences in favor of Debtor to conclude**  
16 **that Appellant was not an adequate representative of the POA.**

17 It is not disputed in this appeal that, because Appellant is  
18 not a creditor of Debtor, it lacks standing to prosecute an  
19 exception to discharge action against him in its own right. See  
20 § 523(c)(1) (providing that a debt excepted from discharge under  
21 subsections (2), (4) or (6) shall be discharged "unless, on  
22 request of the creditor to whom such debt is owed" the bankruptcy  
23 court determines such debt to be excepted from discharge);  
24 Rule 4007(a) (providing that "[a] debtor or any creditor may file

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25 <sup>5</sup> The bankruptcy judge recited the full text of the  
26 tentative decision on the record at the hearing. Although the  
27 bankruptcy judge did not expressly indicate that she intended to  
28 adopt the tentative, we assume, as have the parties in their  
briefs in this appeal, that the tentative ruling explains the  
reasons for its ruling.

1 a complaint to obtain a determination of the dischargeability of  
2 any debt). Rather, Appellant's action is based on its alleged  
3 capacity to sue Debtor as a representative of the POA under  
4 Rule 7023.1. Rule 7023.1 makes Civil Rule 23.1 applicable in  
5 adversary proceedings. Civil Rule 23.1 provides in relevant  
6 part:

7 Derivative Actions

8 (a) Prerequisites. This rule applies when one or more  
9 shareholders or members of a corporation or an  
10 unincorporated association bring a derivative action to  
11 enforce a right that the corporation or association may  
12 properly assert but has failed to enforce. The  
13 derivative action may not be maintained if it appears  
14 that the plaintiff does not fairly and adequately  
15 represent the interests of shareholders or members who  
16 are similarly situated in enforcing the right of the  
17 corporation or association.

18 (b) Pleading Requirements. The complaint must be  
19 verified and must: (1) allege that the plaintiff was a  
20 shareholder or member at the time of the transaction  
21 complained of, or that the plaintiff's share or  
22 membership later devolved on it by operation of law;  
23 (2) allege that the action is not a collusive one to  
24 confer jurisdiction that the court would otherwise  
25 lack; and (3) state with particularity: (A) any effort  
26 by the plaintiff to obtain the desired action from the  
27 directors or comparable authority and, if necessary,  
28 from the shareholders or members; and (B) the reasons  
for not obtaining the action or not making the effort.

The Ninth Circuit recently discussed the history and purpose  
of derivative suits under Civil Rule 23.1:

The derivative form of action permits an individual  
shareholder to bring "suit to enforce a corporate cause  
of action against officers, directors, and third  
parties." Kamen v. Kemper Fin. Servs., Inc., 500 U.S.  
90, 95, 111 S. Ct. 1711, 114 L. Ed. 2d 152 (1991)  
(quoting Ross v. Bernhard, 396 U.S. 531, 534, 90 S. Ct.  
733, 24 L. Ed. 2d 729 (1970)) (emphasis omitted).  
"Devised as a suit in equity, the purpose of the  
derivative action [is] to place in the hands of the  
individual shareholder a means to protect the interests  
of the corporation from the misfeasance and malfeasance  
of 'faithless directors and managers.'" Id. (quoting  
Cohen v. Beneficial Loan Corp., 337 U.S. 541, 548,

1           69 S. Ct. 1221, 93 L. Ed. 1528 (1949)).

2           Rosenbloom v. Pyott, 765 F.3d 1137, 1147-48 (9th Cir. 2014).

3           In its Amended Adversary Complaint, Appellant alleges that  
4 it is and was at all relevant times a member of the POA, and that  
5 it "will adequately and fairly represent the interests of the POA  
6 and members in enforcing and prosecuting its rights." The  
7 complaint asserts that Appellant made a demand on the POA Board  
8 to take action against Debtor and other parties, and the POA  
9 Board "has taken no steps to enforce its rights against these  
10 Board members and former Board members." Appellant then alleges  
11 in the complaint, with particularity, the reasons why the POA  
12 Board was so dominated by Debtor that any further demand on the  
13 POA Board to take action against Debtor would be futile. Based  
14 upon these allegations, Appellant asserts that it should be  
15 allowed to pursue an exception to discharge of the POA's claims  
16 against Debtor under § 523(a)(2)(A), (a)(4), and (a)(6).

17           Neither the bankruptcy court nor Debtor disputes Appellant's  
18 status as a member of the POA, nor that the POA has not pursued  
19 an exception to discharge action in Debtor's bankruptcy case.  
20 However, Debtor hotly disputes the factual assertions in the  
21 complaint. To support its dismissal motion, Debtor focuses on  
22 its procedural objections under Civil Rule 23.1: that, based  
23 upon this record, Appellant cannot appropriately act as a  
24 representative of the interests of the POA in the adversary  
25 proceeding; that Appellant did not make an adequate demand on the  
26 POA Board to act in advance of commencing this action; and that  
27 the business judgment rule applies to foreclose Appellant's  
28 action. Appellant disagrees with these contentions.

1 In our view, the issues raised by Debtor in its motion to  
2 dismiss all present fundamentally factual disputes. In general,  
3 a trial court may not rule on disputed factual matters in  
4 resolving a Civil Rule 12(b)(6) dismissal motion. Penilla v.  
5 City of Huntington Park, 115 F.3d 707, 710 (9th Cir. 1997). As  
6 discussed below, in resolving the motion to dismiss, the  
7 bankruptcy court appears to have drawn several critical  
8 inferences in favor of Debtor, the moving party, something which  
9 is not appropriate in this context. Ikon Office Solutions,  
10 513 F.3d at 1043 n.2. We must therefore reverse the bankruptcy  
11 court's order.

12 **A. Adequate Representation.**

13 For purposes of Civil Rule 23.1, "[a]n adequate  
14 representative must have the capacity to vigorously and  
15 conscientiously prosecute a derivative suit and be free from  
16 economic interests that are antagonistic to the interests of the  
17 class." Larson v. Dumke, 900 F.2d 1363, 1367 (9th Cir. 1989)  
18 (citing Lewis v. Curtis, 671 F.2d 779, 788-89 (3rd Cir. 1982)).  
19 The Ninth Circuit has held that a disqualifying conflict does not  
20 necessarily exist when a party asserts both a derivative claim on  
21 behalf of a corporation, and a personal claim against the  
22 corporation. Pareto v. FDIC, 139 F.3d 696, 699 (9th Cir. 1988)  
23 ("The mere presence of an injury to the corporation does not  
24 negate the simultaneous presence of an individual injury . . .  
25 [because] an action may lie both derivatively and individually  
26 based on the same conduct"). While a trial court must consider  
27 any conflicts of interest in determining the adequacy of  
28 representation, "[t]he prevailing view appears to be that there

1 is no per se rule prohibiting shareholders from simultaneously  
2 bringing both direct and derivative actions," and that the  
3 better-reasoned and predominant rule is to look behind the  
4 surface duality of the two types of actions, and to allow them to  
5 proceed unless an actual conflict emerges. Natomas Gardens Inv.  
6 Group, LLC v. Sinadinos, 2009 WL 1363382, \*15 (E.D. Cal. 2009)  
7 (applying both California and federal derivative law); see also  
8 Field Turf Builders, LLC v. Fieldturf USA, Inc., 2010 WL 817628,  
9 at \*12 (D. Ore. 2010) (no per se rule); In re Rasterops Corp.  
10 Sec. Litig., 1993 WL 476651, at \*13 (N.D. Cal Sept. 10,  
11 2010) (same); First Am. Bank and Trust by Levitt v. Frogel, 726 F.  
12 Supp. 1292, 1298 (S.D. Fla. 1989) (simultaneous direct and  
13 derivative claims could proceed); Keyser v. Commonwealth Nat.  
14 Fin. Corp., 120 F.R.D. 489, 492 n.8 (M.D. Pa. 1988) (in holding  
15 that the plaintiff's simultaneous direct and derivative claims  
16 could proceed, the court stated, "[i]f and when plaintiffs prove  
17 their allegations and the remedy stage is reached, the court may  
18 take corrective measures to resolve any actual conflicts which  
19 arise at that time"). In short, the case law instructs that a  
20 derivative claim should not be dismissed solely because the  
21 plaintiff is also asserting direct claims against the  
22 corporation.

23 In granting Debtor's motion to dismiss, the bankruptcy court  
24 noted in its tentative ruling that Appellant could not adequately  
25 and fairly represent the POA "in light of [the] antagonism  
26 between the interests of the plaintiff and the homeowners  
27 association." However, the bankruptcy court did not explain in  
28 its tentative ruling or final order the conflict or antagonism to

1 which it was referring. The relief sought in the Amended  
2 Adversary Complaint is an exception to Debtor's ability to  
3 discharge what Appellant alleges are \$3,471,814 in cumulative  
4 damages owed to the POA. Plaintiff seeks no relief in the  
5 Amended Adversary Complaint against the POA or the POA Board.

6 Apparently, the bankruptcy court was concerned that, given  
7 the claims being asserted by Appellant in the State Court Action,  
8 its interests were antagonistic to the POA. In particular,  
9 Appellant's SASC asserts three non-derivative claims: one to void  
10 the sign lease between the POA and Chase; another in favor of  
11 both Appellant and the POA to recover \$5 million in public  
12 nuisance damages from Debtor; and another to recover \$200,000 in  
13 damages from the POA and Debtor for private nuisance.<sup>6</sup> Of these,  
14 it is a matter of disputed fact whether voiding the sign lease  
15 would prejudice the interests of the POA and its members. And  
16 the claim for \$5 million for public nuisance also arguably favors  
17 all POA members, not just Appellant.

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18  
19 <sup>6</sup> Cal. Civ. Code § 3479 defines a nuisance as "anything  
20 which is injurious to health, or is indecent or offensive to the  
21 senses, or an obstruction to the free use of property, so as to  
22 interfere with the comfortable enjoyment of life or property  
23 . . . ." Newhall Land & Farming Co. v. Super. Ct., 19 Cal. App.  
24 4th 334, 341 (1993). A nuisance may be a public nuisance, a  
25 private nuisance, or both. Venuto v. Owens-Corning Fiberglas  
26 Corp., 22 Cal.App.3d 116, 124 (1971). "A public nuisance is one  
27 which affects at the same time an entire community or  
28 neighborhood, or any considerable number of persons, although the  
extent of the annoyance or damage inflicted upon individuals may  
be unequal." Cal. Civ. Code § 3480. Every other nuisance is  
private. Cal. Civ. Code, § 3481. However, "[a] private person  
may maintain an action for a public nuisance, if it is specially  
injurious to himself, but not otherwise." Cal. Civ. Code § 3493.

1 Of the causes of action asserted in the SASC, only  
2 Appellant's private nuisance claim against the POA and Debtor, on  
3 its face, potentially favors Appellant to the detriment of the  
4 POA. But even this is disputed. At oral argument, counsel for  
5 Appellant explained that the POA was named as a defendant as to  
6 the nuisance claims in state court only because it was the owner  
7 of the Property. Hr'g Tr. 17:2-5.<sup>7</sup> If that is correct, whether  
8 the private nuisance claim gives rise to a disqualifying conflict  
9 of interest between Appellant and the POA is matter for debate  
10 and proof. Instead, the bankruptcy court concluded that  
11 Appellant's assertion of the nuisance claim against the POA  
12 prevented Appellant from fairly and adequately representing the  
13 POA in the adversary proceeding. While such a conclusion may  
14 ultimately prove correct after a fuller development of the  
15 relevant facts, it was premature for the bankruptcy court to  
16 adopt that conclusion based solely on inferences drawn from the  
17 allegations of the Amended Adversary Complaint and the SASC.

18 In sum, here, the bankruptcy court appeared to determine  
19 that Appellant was not an adequate representative of the POA  
20 under Civil Rule 23.1 to prosecute the § 523(a) exception to  
21 discharge claims against Debtor by relying upon disputed facts,  
22 and by drawing inferences from the alleged facts against  
23

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24 <sup>7</sup> The owner of real property is ordinarily a necessary  
25 party to be joined in any litigation affecting that property.  
26 However, this is a discretionary rule of fairness under  
27 California law and may not be applicable where the owner's  
28 interest is adequately represented by another party. People ex  
rel. Lungren v. Cmty. Redevelopment Agency, 56 Cal.App.4th 868,  
876 (1997).

1 Appellant. This was impermissible in resolving a motion to  
2 dismiss and, as a result, an abuse of discretion.

3 **B. The Business Judgment Rule and Demand Futility**

4 The United States Supreme Court has described the Business  
5 Judgment Rule as a "deferential" common law principle applicable  
6 in most states that implements "the basic principle of corporate  
7 governance that the decisions of a corporation – including the  
8 decision to initiate litigation – should be made by the board of  
9 directors or the majority of shareholders." Kamen, 500 U.S. at  
10 101. The California Supreme Court has explained that "[t]he  
11 common law business judgment rule has two components – one which  
12 immunizes [corporate] directors from personal liability if they  
13 act in accordance with its requirements, and another which  
14 insulates from court intervention those management decisions  
15 which are made by directors in good faith in what the directors  
16 believe is the organization's best interest." Lamden v. LaJolla  
17 Clubdominium Homeowners Ass'n, 980 P.2d 940, 948 (Cal. 1999).

18 The Business Judgment Rule is implemented in this context by  
19 the "demand requirement" set forth in Civil Rule 23.1(b)(3).  
20 Kamen, 500 U.S. at 101. That Rule requires that a  
21 representative's complaint "state with particularity: (A) any  
22 effort by the plaintiff to obtain the desired action from the  
23 directors or comparable authority and, if necessary, from the  
24 shareholders or members; and (B) the reasons for not obtaining  
25 the action or not making the effort." The Supreme Court has  
26 instructed that the demand requirements for a derivative suit are  
27 determined by the law of the state of incorporation. Kamen,  
28 500 U.S. at 96-97. In this case, California's law nearly

1 duplicates Civil Rule 23.1(b) (3), providing in relevant part  
2 that:

3 No action may be instituted or maintained in right of  
4 any domestic or foreign corporation by any holder of  
5 shares . . . of the corporation unless both of the  
6 following conditions exist: . . . (2) The plaintiff  
7 alleges in the complaint with particularity plaintiff's  
8 efforts to secure from the board such action as  
9 plaintiff desires, or the reasons for not making such  
10 effort[.]

11 Cal. Corp. Code § 800 (b). California case law links the  
12 reasoning for this requirement to the Business Judgment Rule.

13 Where a board of directors, in refusing to commence an  
14 action to redress an alleged wrong against a  
15 corporation, acts in good faith within the scope of its  
16 discretionary power and reasonably believes its refusal  
17 to commence the action is good business judgment in the  
18 best interest of the corporation, a stockholder is not  
19 authorized to interfere with such discretion by  
20 commencing the action.

21 Findley v. Garrett, 109 Cal.App.2d 166, 174 (1952).

22 Appellant, in the Amended Adversary Complaint, asserted that  
23 it made a demand on the POA Board to pursue actions against  
24 Debtor and his alleged accomplices, and that the POA Board had  
25 taken no action. Appellant then alleged with particularity  
26 several reasons that it would be a futile gesture for it to  
27 request any further action from the POA Board. In our view,  
28 assuming the facts asserted by Appellant were proven to be true,  
the Amended Adversary Complaint satisfied the pleading  
requirements of Civil Rule 23.1(b) and Cal. Corp. § 800 (b).

The bankruptcy court, as an alternative grounds for  
dismissal, explained its view that the POA Board was entitled to  
exercise its business judgment to conclude that no action against  
Debtor was "appropriate or warranted." Hr'g Tr. 4:2-7. Based on

1 this record, however, it is difficult to understand whether the  
2 POA Board actually took any action on the Demand Letter. Indeed,  
3 since there is no evidence in the record regarding any board  
4 action, it was error for the bankruptcy court to infer that the  
5 POA Board "concluded that no action against the debtor is  
6 appropriate or warranted."

7 More specifically, the Demand Letter was sent by Appellant's  
8 lawyer to counsel for the POA Board on June 18, 2013, and  
9 provided a four-page litany of grievances by Appellant against  
10 the POA Board. The specific allegations of conflicts of interest  
11 among the POA Board members is contained in Paragraph 8.

12 **8. Conflict of interest among the board members who**  
13 **retain significant personal interest in the commercial**  
14 **property and/or the profitability of the commercial**  
15 **property.** The Board has been dominated by persons  
16 whose interests are intertwined with the commercial  
17 lots. Not surprisingly, the Board has made innumerable  
18 decisions that favor the commercial owners over the  
19 interests of the residential owners – and i[n] many  
20 cases to the detriment of the residential owners. The  
21 Board has continued to perpetuate the unconscionable  
22 cost-splitting agreement in the CC&Rs between  
23 commercial and residential owners, and the  
24 unconscionable nature of the commercial owners'  
25 guaranteed board positions and voting powers.

26 These concerns are serious. The conduct by the  
27 Board described herein demonstrates repeated, reckless  
28 breaches of the Board's fiduciary duties to the  
residential owners. While all parties recognize that  
the building includes commercial use, and that  
commercial uses may sometimes be less convenient for  
residents, that does not permit the property rights and  
safety of the residential owners to be compromised in  
the name of total commercial exploitation. . . . We  
further demand that the Board immediately . . .  
investigate those Board members involved in the  
aforementioned commercial dealings, and take such legal  
action against those persons as is necessary to  
preserve the rights of the Association.

Although the Demand Letter was sent to counsel for the POA  
Board, neither the Demand Letter nor other excerpts of the record

1 indicate that the POA Board members were provided with copies of  
2 the Demand Letter. Counsel for the POA responded to the Demand  
3 Letter twice. The first response was on June 21, 2013 (the  
4 "First Response Letter"). In the Demand Letter, counsel for  
5 Appellant had indicated that he and his client would attend an  
6 "open board meeting" on June 24, 2013. In the First Response  
7 Letter, counsel for the POA Board forbade Appellant's counsel to  
8 attend the meeting because the POA Board's counsel could not  
9 attend. There is no indication in the record that Appellant  
10 attended the open meeting without counsel. Further, the First  
11 Response Letter does not indicate if the members of the POA Board  
12 were copied.

13 Counsel for the POA provided a more detailed response on  
14 July 5, 2013 (the "Second Response Letter"). Counsel's specific  
15 response concerning Appellant's allegations about the alleged  
16 conflict of interest by members of the POA Board was:

17 You state that the board is "dominated by persons whose  
18 interests are intertwined with the commercial lots." I  
19 have no idea where you are taking this information  
20 from. It is true that the commercial owner, who is  
21 guaranteed representation and a single space on the  
22 board, has elected a representative to the board.  
23 However, to my knowledge, no other member of the board  
24 has any financial interest in the commercial owner.  
25 Since the board is composed of five individuals,  
26 elected by the entire Association, exactly how is it  
27 that the commercial owner is dominating the decisions  
28 of the board of directors? The CC&Rs pre-date each and  
every owner's interest in the building and bind each  
and every owner. The CC&Rs are clear that the board of  
directors has no right to interfere with the commercial  
owners' lawful use of the commercial spaces in the  
building. Moreover, the CC&Rs state that they may not  
be amended to change the commercial owners' interest in  
the building without the commercial owners' approval.  
This is simply a fact; this does not show any sort of  
conflict of interest. . . .

28 You state that the Association should recover any

1 funds "misappropriated or improperly disposed of by the  
2 relevant board members." However, you have never  
3 stated once in your letter that any funds were  
4 misappropriated or "improperly disposed of." The board  
5 knows of no such instance, and I know of no such  
6 instances. If you have evidence of misappropriation,  
7 then I hereby demand that you provide them to me, in  
8 writing, immediately. If you do not, then I strongly  
9 suggest that you cease this spurious claim since it is  
10 defamatory and subjects both you and your clients to  
11 damages for such defamation.

12 Fairly interpreted, the letters show that Debtor made demand  
13 on the POA Board as required by Civil Rule 23.1 ("The complaint  
14 must be verified and must . . . (3) state with particularity:  
15 (A) any effort by the plaintiff to obtain the desired action from  
16 the directors or comparable authority and, if necessary, from the  
17 shareholders or members)[.]"); and Cal. Civ. Code 800(b)(2) ("The  
18 plaintiff alleges in the complaint with particularity plaintiff's  
19 efforts to secure from the board such action as plaintiff  
20 desires[.]").

21 After further proceedings, Debtor may be able to demonstrate  
22 sufficient facts to show that the POA's actions justify the  
23 protections of the Business Judgment Rule. However, here the  
24 bankruptcy court inferred that the POA made a business decision  
25 not to pursue a § 523(a) action against Debtor based solely on  
26 the POA Board's failure to join in Debtor's action or to file its  
27 own action. In resolving the motion to dismiss, on this record,  
28 such an inference was improper under Civil Rule 12(b)(6).

Debtor thus satisfies the first part of the federal and  
California procedural rules for derivative actions. However, as  
noted, the POA Board does not appear to have taken any action in  
state court against Debtor, nor has it sought a claim against  
Debtor in this appeal. Appellant has not sought any further

1 action from the POA Board because, as argued in the First Amended  
2 Complaint, such requests would be "futile." Thus, the second  
3 part of the federal and California derivative rules attach: Civil  
4 Rule 23.1(b)(2)(B) ("The complaint must . . . state with  
5 particularity: . . . (B) the reasons for not obtaining the action  
6 or not making the effort."); Cal. Corp. Code § 800(b)(2) ("The  
7 plaintiff alleges in the complaint with particularity plaintiff's  
8 efforts to secure from the board such action as plaintiff  
9 desires, or the reasons for not making such effort[.]").

10 The "reasons for not making such effort" is known as the  
11 demand futility rule. "Although jurisdictions differ widely in  
12 defining the circumstances under which demand on directors will  
13 be excused, demand typically is deemed futile when a majority of  
14 the directors have participated in or approved the alleged  
15 wrongdoing, or are otherwise financially interested in the  
16 challenged transactions." Kamen, 500 U.S. at 101-102 (citations  
17 and quotation marks omitted). In California, courts look to the  
18 derivative law of Delaware for instruction. Bader v. Anderson,  
19 179 Cal.App.4th 775 (2009).

20 The test commonly employed in determining the adequacy of  
21 the pleading of demand futility was articulated in Aronson v.  
22 Lewis, 473 A.2d 805 (Del. 1984); see Bader, 179 Cal.App.4th at  
23 482 (citing Aronson). The Aronson court observed that "the  
24 entire question of demand futility is inextricably bound to  
25 issues of business judgment and the standards of that doctrine's  
26 applicability." Id. at 812. Aronson held that a court, in  
27 deciding whether a plaintiff will be excused from making a demand  
28 on the board, must evaluate "whether, under the particularized

1 facts alleged, a reasonable doubt is created that: (1) the  
2 directors are disinterested and independent and (2) the  
3 challenged transaction was otherwise the product of a valid  
4 exercise of business judgment." Id. at 814; Oakland Raiders v.  
5 NFL, 93 Cal.App.4th 572, 587 (2001) (applying the Aronson test].)  
6 "[F]utility is gauged by the circumstances existing at the  
7 commencement of a derivative suit." Aronson, 473 A.2d at 810.  
8 And the two-prong test under Aronson is disjunctive; thus, demand  
9 is excused if either prong is satisfied. Brehm v. Eisner,  
10 746 A.2d 244, 256 (Del. 2000).

11 Appellant pleaded sufficient facts in the Amended Adversary  
12 Complaint, which we must accept as true under Civil  
13 Rule 12(b)(6), to establish that Debtor and his alleged co-  
14 conspirators controlled a majority of the POA Board at the time  
15 of the lease signing and at the time Appellant asserted the  
16 derivative claims in the bankruptcy court. From the allegations  
17 of the Amended Adversary Complaint, the bankruptcy court could  
18 infer that a majority of the POA Board members would favor the  
19 commercial interests represented by Debtor and would be adverse  
20 to the requests for the POA Board to prosecute an action against  
21 Debtor in either the state or bankruptcy courts. Because the  
22 Business Judgment Rule is unavailable to the POA Board when a  
23 demand is made on the board and the futility of a further demand  
24 is shown, the bankruptcy court erred in dismissing the Amended  
25 Adversary Complaint on the basis of the Business Judgment Rule.

26 **C. In Pari Delicto.**

27 Based upon the Amended Adversary Complaint, the bankruptcy  
28 court concluded, as a matter of law,, that application of the

1 doctrine of in pari delicto barred Appellant's claims against  
2 Debtor. We disagree.

3 The Supreme Court discussed the doctrine's application:

4 The common-law defense at issue in this case derives  
5 from the Latin, in pari delicto potior est conditio  
6 defendentis: "In a case of equal or mutual fault . . .  
7 the position of the [defending] party . . . is the  
8 better one." The defense is grounded on two premises:  
9 first, that courts should not lend their good offices  
10 to mediating disputes among wrongdoers; and second,  
11 that denying judicial relief to an admitted wrongdoer  
12 is an effective means of deterring illegality of  
13 wrongdoing as defendants.

14 Bateman Eichler, Hill Richards, Inc. v. Berner, 472 U.S. 299, 303  
15 (1985). The Ninth Circuit has endorsed the application of the  
16 in pari delicto doctrine in civil litigation. See Kardoh v.  
17 United States, 572 F.3d 697, 700 (9th Cir. 2009) (although a  
18 criminal case, the doctrine was applied to resolve a civil issue,  
19 that a party could not seek approval from the district court to  
20 recover fees voluntarily paid in furtherance of an illegal  
21 agreement). Application of in pari delicto is governed by state  
22 law. Hagan v. Baird (In re B&P Baird Holdings, Inc.), 2015 U.S.  
23 App. LEXIS 30, at \*15 (6th Cir. Jan. 2, 2015). California  
24 recognizes in pari delicto as an equitable defense in civil  
25 litigation. Mailand v. Burckle, 572 P.2d 1142, 1147 (Cal. 1978).

26 Traditionally, the defense was limited to situations where  
27 both parties bore "at least substantially equal responsibility"  
28 for their acts." Berner, 472 U.S. at 307; 1 J. Story, Equity  
Jurisprudence 399-400 (14th ed. 1918). This requirement of equal  
responsibility for the wrong continues in current California case  
law. Mountain Air Enterprises, LLC v. Sundowner Towers, LLC,  
231 Cal.App.4th 805, 847 (2014) (explaining that in pari delicto

1 applies when parties are in "equal wrong").

2 Here, the bankruptcy court reasoned that, accepting the  
3 allegations of Appellant's Amended Adversary Complaint as true,  
4 the POA and the POA Board were in pari delicto with Debtor in  
5 entering into the lease, and Appellant, as the representative of  
6 the POA, could not seek relief for what amounted to the  
7 collective misconduct of Debtor and the POA Board. Again,  
8 however, this conclusion is founded upon inferences.

9 In dismissing it, the bankruptcy court relied upon the  
10 allegations in the Amended Adversary Complaint, which included  
11 that: (1) Debtor and his "co-conspirators" on the POA Board set  
12 up the governing documents of the POA so as to allow them to  
13 leach from the residential owners; (2) Debtor and these members  
14 of the Board acted with the express intention to damage the POA  
15 and to enrich themselves; (3) "The [POA Board] that made the  
16 decision to enter into the sign lease was elected through a  
17 flawed election that did not conform with the constitutional  
18 documents of the POA, because, in part, Debtor and his  
19 coconspirators orchestrated undisclosed changes in the voting  
20 rules . . . in order to stack the board with directors whom he  
21 and his coconspirators could control"; and (4) "The board is  
22 dominated by Debtor and his co-conspirators."

23 Standing alone, these allegations do not support application  
24 of the equitable doctrine. At worst, the allegations suggest  
25 that Debtor and the POA Board were possibly in pari delicto.  
26 There are no facts alleged in the Amended Adversary Complaint or  
27 otherwise appearing in the record to support the bankruptcy  
28 court's inference that the POA, as opposed to the POA Board,

1 participated in the alleged wrongdoing. We have located no case  
2 law that would allow the bankruptcy court to attribute the  
3 wrongdoing of a board to the corporation for purposes of a  
4 derivative action.<sup>8</sup> On the other hand, the well-pled facts of  
5 the Amended Adversary Complaint support an inference that the POA  
6 was a victim of the fraud and fiduciary breaches of Debtor and  
7 members of the POA Board. It was therefore error for the  
8 bankruptcy court to infer that the claims alleged in the Amended  
9 Adversary Complaint were barred by in pari delicto.

#### 10 **CONCLUSION**

11 The bankruptcy court erred in dismissing Debtor's Amended  
12 Adversary Complaint under Civil Rules 12(b)(6) and 23.1. We  
13 therefore REVERSE the bankruptcy court's order and REMAND this  
14 matter to the bankruptcy court for further proceedings.<sup>9</sup>

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15  
16  
17  
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19  
20 <sup>8</sup> Indeed, we have found no published cases where a  
21 bankruptcy court has considered the in pari delicto defense in  
22 the context of a Civil Rule 23.1 or Rule 7023.1 action. However,  
23 district courts considering shareholder derivative actions under  
24 Civil Rule 23.1 have allowed the in pari delicto defense when the  
25 corporation is in equal fault with its board. Miller v.  
26 Interfirst Bank Dallas, N.A., 608 F. Supp.169, 171-72 N.D. Tex  
27 1985) ("fault of the parties must be clearly mutual,  
28 simultaneous, and relatively equal"). Here, as discussed above,  
there is nothing in the record to show that the POA participated  
in the alleged wrongdoing by the Debtor and the POA Board.

<sup>9</sup> Because we reverse the dismissal order, we need not  
address whether the bankruptcy court erred in dismissing  
Appellant's Amended Adversary Complaint without leave to amend.