Docket #0019 Date Filed: 2/26/2019

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UNITED STATES BANKRUPTCY COURT

CENTRAL DISTRICT OF CALIFORNIA, LOS ANGELES DIVISION

In re

VERITY HEALTH SYSTEM OF CALIFORNIA, INC., et al.,

Debtors and Debtors in Possession.

☐ Affects All Debtors
☐ Affects Verity Health System of California, Inc.
☐ Affects O'Connor Hospital
☐ Affects Saint Louise Regional Hospital
☒ Affects St. Francis Medical Center
☒ Affects St. Vincent Medical Center
☐ Affects Seton Medical Center
☐ Affects O'Connor Hospital Foundation
☐ Affects Saint Louise Regional Hospital Foundation
☐ Affects St. Francis Medical Center of Lynwood Foundation
☐ Affects St. Vincent Foundation
☐ Affects St. Vincent Dialysis Center, Inc.
☐ Affects Seton Medical Center Foundation
☐ Affects Verity Business Services
☐ Affects Verity Medical Foundation
☐ Affects Verity Holdings, LLC
☐ Affects De Paul Ventures, LLC
☐ Affects De Paul Ventures - San Jose Dialysis, LLC

Debtors and Debtors In Possession.

Lead Case No. 2:18-bk-20151-ER

Jointly administered with:
Case No. 2:18-bk-20162-ER;
Case No. 2:18-bk-20163-ER;
Case No. 2:18-bk-20164-ER;
Case No. 2:18-bk-20165-ER;
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Case No. 2:18-bk-20180-ER;
Case No. 2:18-bk-20181-ER

Chapter 11 Cases

Adv. Proc. No. 2:19-ap-01002-ER

MEMORANDUM OF POINTS AND AUTHORITIES REGARDING NON-CORE DESIGNATION

Date: April 2, 2019
Time: 10:00 A.M.
Judge: Hon. Ernest M. Robles
Courtroom: 1568

ST. VINCENT MEDICAL CENTER, a California nonprofit public benefit corporation and ST. FRANCIS MEDICAL CENTER, a California nonprofit public benefit corporation,

Plaintiffs,

v.

LOCAL INITIATIVE HEALTH AUTHORITY FOR LOS ANGELES COUNTY DBA L.A. CARE HEALTH PLAN, an independent local public agency,

Defendant.

MEMORANDUM OF POINTS AND AUTHORITIES

I. INTRODUCTION

This adversary proceeding is a garden-variety state-law breach of contract dispute, a "non-core" proceeding. Plaintiffs St. Vincent Medical Center ("SVMC") and St. Francis Medical Center ("SFMC," and together with SVMC, the "Plaintiffs") assert nine purported Claims for Relief in their complaint in this adversary proceeding ("Complaint") against Defendant Local Initiative Health Authority for Los Angeles County, operating as L.A. Care Health Plan ("L.A. Care"). All of Plaintiffs' purported Claims are based upon and grounded in alleged breaches by L.A. Care of a pre-petition contract between L.A. Care and SVMC and a pre-petition contract between L.A. Care and SFMC.

"[T]he restructuring of debtor-creditor relations, which is at the core of the federal bankruptcy power, must be distinguished from the adjudication of state-created private rights, such as the right to recover contract damages that is at issue in this case." *N. Pipeline Constr. Co. v. Marathon Pipe Line Co.*, 458 U.S. 50, 71 (1982). No cause of action in the Complaint is a "core" proceeding; on the contrary, this adversary proceeding is a standard state-law breach of contract dispute "before the Bankruptcy Court only because the [Plaintiffs have] previously filed a petition for reorganization." *Id.* at 91 (Rehnquist, C.J., concurring). Nor for that matter have Plaintiffs even stated a valid cause of action; the Complaint should be dismissed in its entirety with prejudice. (*See* Motion for Entry of Order Dismissing Complaint or, in the Alternative, Motion for Entry of Order Staying Trial of Adversary Proceeding, and Memorandum of Points and Authorities in Support Thereof ("Motion to Dismiss"), ECF No. 17.)

In an attempt to manufacture "core" jurisdiction over this adversary proceeding, however, Plaintiffs have repackaged their state-law-based breach of contract claims as so-called "turnover" proceedings and as purported "damages for violation of the automatic stay." (*See, e.g.,* Complaint, ECF No. 1 at 5:18-6:15, 7:6-8:8.) But cleverly renaming a non-core claim does not convert it into a core claim: when the bankruptcy buzzwords are stripped away, the purported Claims for Relief are clearly non-core

contract claims that arise under state law and not bankruptcy.

II. FACTUAL ALLEGATIONS

A. The Parties and the Contracts.

Plaintiffs are separate, but affiliated, nonprofit corporations providing hospital and ancillary medical services in Los Angeles County. (Complaint ¶¶ 5, 6.) L.A. Care is an independent local public agency that provides a prepaid comprehensive health plan and is licensed to conduct business in Los Angeles County under the Knox-Keene Health Care Services Plan Act of 1975, as amended. (*Id.* ¶ 7.)

L.A. Care entered into separate written contracts with SVMC and SFMC (attached to the Complaint as Exhibits A and C respectively), whereby Plaintiffs agreed to provide medical services to L.A. Care's members, and L.A. Care agreed to reimburse Plaintiffs for "covered medical services [they] rendered to L.A. Care's members at agreed upon rates." (*Id.* ¶¶ 13, 40.)

Under the terms of those agreements, if Plaintiffs obtained prior authorization from L.A. Care to provide an L.A. Care member covered services and then properly submitted a "Clean Claim" for that care, L.A. Care then had thirty business days to reimburse Plaintiffs at the negotiated rates. (*Id.* at Exh. A ¶¶ 1.4, 2.7; *id.* at Exh. C ¶ 3.2.) Nonetheless, L.A. Care was permitted to deny payment for a claim if, for example, Plaintiffs submitted the claim more than six months after the date the medical services were rendered. L.A. Care was also permitted to pay less than the agreed upon reimbursement rate – or even nothing at all – if another party (*e.g.,* Medicare or another insurer) had primary responsibility for paying for the medical services. (*Id.* at Exh. A ¶ 2.9; *id.* at Exh. C ¶ 3.8.) The contracts also give L.A. Care the right to deny payment under certain circumstances (*id.* at Exh. A ¶¶ 2.2, 2.7, 2.9; *id.* at Exh. C ¶¶ 3.2, 3.8), and, importantly, provide L.A. Care with an express right to recoup overpayments from "any future payments" (*id.* at Exh. A ¶ 2.6; *id.* at Exh. C ¶ 3.6.).

B. Plaintiffs Initiate This Contract Dispute in the Bankruptcy Court.

On August 31, 2018, Plaintiffs (together with numerous affiliate entities)

commenced voluntary Chapter 11 cases before this Court. (Complaint ¶ 8.) Believing that L.A. Care failed fully to reimburse Plaintiffs for certain medical services in accordance with the contractually agreed upon terms, Plaintiffs initiated this adversary proceeding on January 3, 2019. (*See, generally id.*) The Complaint alleges the following nine purported Claims for Relief:

(a) The First and Fifth Claims for Relief for L.A. Care's purported breach of its contracts with SVMC and SFMC respectively (*id.* ¶¶ 12-19, 39-46);

(b) The Second and Sixth Claims for Relief for a "turnover" order directing L.A. Care to pay Plaintiffs the damages they claim on their breach of contract claim and any amounts L.A. Care purportedly deducted from post-petition payments to Plaintiffs pursuant to LA. Care's contractual right to recoupment (*id.* ¶¶ 20-26, 47-53);

(c) The Third and Seventh Claims for Relief, which reframe the purported breach of contract claims as quasi-contract "unjust enrichment" claims (*id.* ¶¶ 27-31, 54-58);

(d) The Fourth and Eighth Claims for Relief assert that, by exercising its contractual right to recoupment and deducting prior overpayments to Plaintiffs from post-petition payments to Plaintiffs, L.A. Care violated the automatic stay (*id.* ¶¶ 32-38, 59-65); and

(e) The Ninth Claim for Relief which seeks an order enjoining L.A. Care from exercising its contractual right to recoupment in the future (*id.* ¶¶ 66-68).

On February 15, 2018, L.A. Care moved to dismiss the complaint in its entirety because (1) none of the purported Claims for Relief state a claim upon which relief can be granted; (2) as a prerequisite to bringing the claims, Plaintiffs were required to comply with the claims presentation requirements of the California Government Claims Act, but failed to do so; and (3) even if the first two issues could be overcome, the claims would be subject to the mandatory arbitration clause in Plaintiffs' contracts with L.A. Care, and Plaintiffs must therefore pursue those claims in arbitration and not before this Court.

(*See generally* Motion to Dismiss.)

III. LEGAL ARGUMENT

A. The First and Fifth Claims for Relief Are Non-Core Breach of Contract Claims

Plaintiffs' state law breach of contract claims are prototypical "non-core" proceedings. Core proceedings are ones "arising under title 11, or arising in a case under title 11." 28 U.S.C. § 157(b). Therefore, to be a core claim, a claim for relief must "invoke substantive rights created by federal bankruptcy law." *In re BBeautiful*, No. 2:16-ap-01506-ER, 2017 WL 932945 at * (Bank. C.D. Cal. Mar. 8, 2017) (Report and Recommendation of Hon. Ernest M. Robles, U.S. Bank. Judge, to the U.S. Dist. Ct. for C.D. Cal, Containing Proposed Findings of Fact and Conclusions of Law, and Proposed Final Judgment). On the other hand, "[a]ctions that do not depend on bankruptcy laws for their existence and that could proceed in another court are considered 'non-core.'" *Security Farms v. Int'l Bhd. of Teamsters*, *Chauffers, Warehousemen & Helpers,* 124 F.3d 999, 1008 (9th Cir. 1997).

Congress has specifically enumerated the types of proceedings that are core proceedings. 28 U.S.C. § 157(b)(2). The sixteen categories listed in Section 157(b)(2) include fourteen specific categories of core proceedings, and two "catch-all" provisions, subsection (A) and subsection (O). *In re Castlerock Properties*, 781 F.2d 159, 161 (9th Cir. 1986). Because state law contract claims can also be adjudicated in state courts, contract claims can only be core if they "depend on bankruptcy laws for their existence." *Security Farms*, 124 F.3d at 1008. The fact that a breach of contract cause of action could augment the debtor's estate is irrelevant. *Stern v. Marshall*, 564 U.S. 462, 495 (2011). Consequently, state law contract claims must fall within the fourteen specific categories listed in Section 157(b)(2) to be considered core proceedings. *Castlerock,* 781 F.2d at 162. But if they merely fall within the sweep of the catch-all provisions in subsection (A) or (O), the claims are non-core. *Id.*

Plaintiffs' breach of contract claims are clearly non-core claims. *In re Gurga*, 176

B.R. 196, 199 (B.A.P. 9th Cir. 1994) ("Breach of contract actions are noncore claims."). As in *Gurga*, Plaintiffs' breach of contract claims involve purported breaches of a pre-petition contract governed by state law. *Id.* at 197-99. They are likewise no different than the breach of contract claims the Supreme Court rejected as non-core in *Marathon*. 458 U.S. at 71 ("[T]he restructuring of debtor-creditor relations, which is at the core of the federal bankruptcy power, must be distinguished from the adjudication of state-created private rights, such as the right to recover contract damages that is at issue in this case.").

B. The Second and Sixth Claims for Relief Are Non-Core Breach of Contract Claims

Plaintiffs' breach of contract claims are clearly non-core matters, so Plaintiffs attempted to recast their non-core breach of contract claims as so-called "turnover" claims in the Second and Sixth Claims for Relief. While a true turnover claim would be a core claim, 28 U.S.C. § 157(b)(2)(E), Plaintiffs' Second and Sixth Claims for Relief are not turnover claims. They are merely non-core breach of contract claims.

Plaintiffs' turnover claims seek an order compelling L.A. Care to pay the amounts Plaintiffs claim they are due under their contracts with L.A. Care. (Complaint ¶¶ 26, 53.) L.A. Care disputes that it has breached the contracts and disputes that it owes Plaintiffs the amounts they claim as damages. "It is settled law that the debtor cannot use the turnover provisions to liquidate contract disputes or otherwise demand assets whose title is in dispute." *United States v. Inslaw, Inc.*, 932 F.2d 1467, 1472 (D.C. Cir. 1991). Nor do the turnover provisions apply to disputed amounts under an unjust enrichment theory. *In re Falzerano*, 686 F.3d 885, 887-88 (8th Cir. 2012). Turnover claims can only be core proceedings if their "purpose is the collection rather than the creation, recognition, or liquidation of a matured debt. . . . When a bona fide dispute exists as to liability involving state law, then the proceeding cannot be core under § 157(b)(2)(E)." *Acolyte Elec. Corp. v. City of New York*, 69 B.R. 155, 172 (Bank. E.D.N.Y. 1986).

Plaintiffs cannot refashion their breach of contract claims as a "turnover claim" in

an attempt to manufacture core jurisdiction. *Id.; In re Charter Co*., 913 F.2d 1575, 1579 (11th Cir. 1990). Courts consistently reject such attempts. In *Gurga*, the debtor also tried to reframe its breach of contract claims as so-called turnover claims, just as Plaintiffs have tried to do here. *Gurga*, 176 B.R. at 199. The Ninth Circuit BAP rejected this transparent ruse:

> Despite Source's attempts to frame the issues herein as core, we find that the claims are noncore. It is undisputed that the underlying action is a breach of contract action. The adversary proceeding filed by Source entitled "Complaint for turnover of property, accounting, breach of contract, conversion, and breach of fiduciary duty," includes only one potential core issue – turnover of property pursuant to 11 U.S.C. § 542(b). However, turnover proceedings involve return of *undisputed* funds. … Here, the amounts, if any, owed to Source by MCI are in dispute and this dispute rests on breach of contract issues. … Breach of contract actions are noncore claims. See 28 U.S.C. § 157.

Id.

The same transparent attempt to re-characterize a contract or similar claim as a turnover action has been universally rejected by other Circuit Courts of Appeal (e.g. *Charter* and *Inslaw*) and bankruptcy courts throughout the country (e.g. *Acolyte* and *In re Heller Ehrman LLP*, 461 B.R. 606, 607-08 (Bank. N.D. Cal. 2011)). At bottom, "this adversary proceeding is not a core proceeding, notwithstanding [Plaintiffs'] designation of one claim for relief as a turnover action under 11 U.S.C. § 542. Whatever the label, this is not an action for turnover of estate property; it is essentially an action to recover an account receivable, for breach of contract and quantum meruit." *Heller Ehrman*, 461 B.R. at 607-08.

C. The Third and Seventh Claims for Relief Are Non-Core Quasi-Contract Claims

Under California law, the Third and Seventh Claims for Relief, styled "unjust enrichment," would be interpreted as claims for restitution under a quasi-contract or *quantum meruit* theory. *Durell v. Sharp Healthcare*, 183 Cal. App. 4th 1350, 1370 (2010) ("There is no cause of action in California for unjust enrichment."). As with Plaintiffs' breach of contract claims, these claims are state-law claims "before the Bankruptcy Court

only because the [Plaintiffs have] previously filed a petition for reorganization." *Marathon*, 458 U.S. at 91 (Rehnquist, C.J., concurring).

An unjust enrichment claim is non-core "because it is not a cause of action created by title 11 or one that only arises in title 11 cases . . . [and] could just as easily have been brought in state court, regardless of whether [Plaintiffs were] in bankruptcy." *In re Eastport Associates*, 935 F.2d 1071 (9th Cir. 1991). Accordingly, Plaintiffs' Third and Seventh Claims for Relief are non-core claims. *In re AWTR Liquidation Inc.*, 547 B.R. 831, 835 (Bank. C.D. Cal. 2016) (unjust enrichment claims are non-core); *Heller Ehrman*, 461 B.R. at 607-08 (*quantum meruit* claims are non-core).

D. The Fourth and Eighth Claims for Relief Are Non-Core Breach of Contract Claims

Plaintiffs' Fourth and Eighth Claims for Relief assert that L.A. Care violated the automatic stay by making unauthorized "setoffs" of L.A. Care's pre-petition overpayments to Plaintiffs which reduced L.A. Care's post-petition payments to Plaintiffs. Although claims for violation of the automatic stay would typically be core claims, Plaintiffs have not alleged any violations of the stay. The purported Fourth and Eighth Claims for Relief are therefore non-core matters.

Beyond this basic pleading deficiency, the fundamental problem with Plaintiffs' theory is the Complaint's false conclusory allegations that L.A. Care's purported reductions are "setoffs" that violated the automatic stay. They are not. As the agreements between Plaintiffs and L.A. Care make clear, L.A. Care had the right to reduce future payments to Plaintiffs for any overpayments L.A. Care had previously made to them. (Complaint at Exh. A ¶ 2.6; *id*. at Exh. C ¶ 3.6.) This is a textbook example of recoupment and not a "setoff." *In re TLC Hosps.,* Inc., 224 F.3d 1008, 1011-13 (9th Cir. 2000) (U.S. Department of Health and Human Services' reduction of Medicare reimbursements by previous overpayments was a recoupment and not a setoff).

"It is well settled . . . that a bankruptcy defendant can meet a plaintiff-debtor's claim with a counterclaim arising out of the same transaction, at least to the extent that

the defendant merely seeks recoupment." *Reiter v. Cooper*, 507 U.S. 258, 265 n.2 (1993) (citing *In re B & L Oil Co*., 782 F.2d 155, 157 (10th Cir. 1986) and *Lee v. Schweiker*, 739 F.2d 870, 875 (3rd Cir. 1984)). Claims arise from "the same transaction" for purposes of recoupment in bankruptcy where, as here, "the creditor's claim against the debtor and the debtor's claim against the creditor arise out of the same contract." *Lee*, 739 F.2d at 875; *see also B & L Oil Co*., 782 F.2d at 157 (overpayment on earlier purchases under a contract can be recouped against later purchases under same contract); *In re ETM Entertainment Network, Inc.,* 154 Fed.Appx. 4, 5 (9th Cir. 2005) (recoupment allowed for offsetting claims under the same contract).

Unlike setoff, recoupment is an equitable doctrine that "exempts a debt from the automatic stay when the debt is inextricably tied up in the post-petition claim . . . and thus may be employed to recover across the petition date." *TLC Hosps.,* Inc., 224 F.3d at 1011. Consequently, property of the estate is taken subject to any right to recoupment, and recoupment does not violate the automatic stay even if the party's right to recoupment arose before the bankruptcy filing and is used to reduce the party's post-petition obligations to the debtor. *Id*. (recouping pre-petition overpayments to healthcare provider from payments due for post-petition services rendered does not violate stay); *In re Holford*, 896 F.2d 176, 179 (5th Cir. 1990) (no violation of stay for recouping pre-petition overpayments for rent against post-petition rent payments to debtor); *B & L Oil Co.,* 782 F.2d at 157 (oil company permitted to recoup overpayment on pre-petition oil purchase from payments due for post-petition oil purchases from debtor).

Moreover, L.A. Care's right of recoupment arises directly out of its contracts with Plaintiffs, and the "recoupment does not owe its legitimacy to anything in the Bankruptcy Code." *TLC Hosps.,* Inc., 224 F.3d at 1011. Indeed, where a party has a contractual recoupment right, neither the automatic stay provision nor the turnover provision are implicated, and "the undisputed terms of the contractual arrangement between the parties control." *In re Charter Co*., 913 F.2d at 1578-79.

Recoupment is therefore non-core because it does not "invoke substantive rights

created by federal bankruptcy law." *In re BBeautiful*, 2017 WL 932945 at *14 (Bank. C.D. Cal. Mar. 8, 2017) (Robles, Bank. J.); Because L.A. Care's right to recoupment exists independent of bankruptcy, could be asserted in any other court, and is only before this Court because Plaintiffs have brought their non-core breach of contract claims here, the Fourth and Eighth Claims for Relief which challenge L.A. Care's right to that recoupment are non-core. *In re Adams*, No. 8:09-BK-12450-TA, 2018 WL 3748816, at *9 (B.A.P. 9th Cir. Aug. 7, 2018) (recoupment claims are non-core claims).

As with Plaintiffs' so-called "turnover" claims, courts peer past the clever window dressing and see claims like Plaintiffs' so-called "violation of the automatic stay" claims for what they really are – non-core breach of contract claims. *Inslaw*, 932 F.2d at 1472 (no bankruptcy court jurisdiction over violation of automatic stay claims where title to funds was in dispute); *In re Charter Co*., 913 F.2d at 1578-79 (claim that defendant violated the automatic stay by only paying the net amount it owed under several contracts was "a state law contractual dispute, a non-core proceeding"). Essentially, Plaintiffs want "the bankruptcy court to decide a wide range of 'non-core' disputes under the guise of an automatic stay violation," which is contrary to the constitutional limitations of bankruptcy jurisdiction outlined in *Marathon* and would give a bankruptcy court jurisdiction over every case in which title to funds is in dispute. *Inslaw*, 932 F.2d at 1473. That is not the law. *Id.* Plaintiffs' Fourth and Eighth Claims for Relief are therefore non-core.

E. The Ninth Claim for Relief Is a Non-Core Breach of Contract Claim.

The purported Ninth Claim for Relief seeks an injunction prohibiting L.A. Care from exercising its contractual recoupment rights. (Complaint ¶ 67.) Plaintiffs therefore seek to have the bankruptcy court determine the rights and obligations of the parties under L.A. Care's contracts with Plaintiffs. The Ninth Claim of Relief is non-core for the same reasons that Plaintiffs' purported "turnover" and "violation of automatic stay" claims are non-core: Plaintiffs are merely cloaking a non-core breach of contract action in the shroud of bankruptcy in an attempt to manufacture bankruptcy jurisdiction over Plaintiff's non-core contract claims. *In re Charter Co*., 913 F.2d at 1578-79; *Inslaw*, 932 F.2d at 1472-

73. As with Plaintiffs' other purported Claims for Relief, the purported Ninth Claim for Relief is non-core.

IV. CONCLUSION

Each of Plaintiffs' purported Claims for Relief are non-core breach of contract claims or non-core state common law unjust enrichment claims. Plaintiffs' attempts to tie their non-core contract claims to "turnover" and "automatic stay" provisions does not change the analysis – all of Plaintiffs' purported Claims for Relief are state law claims, none of which "invoke substantive rights created by federal bankruptcy law." *In re BBeautiful*, 2017 WL 932945 at *14 (Bank. C.D. Cal. Mar. 8, 2017) (Robles, Bank. J.). For these reasons, and for all of the above-stated reasons, L.A. Care respectfully requests that this Court find that this adversary proceeding is a non-core proceeding.

DATED: February 26, 2019

HANSON BRIDGETT LLP

By: */s/ Anthony J. Dutra*
NEAL L. WOLF
ANTHONY J. DUTRA
Attorneys for Local Initiative Health Authority for Los Angeles County operating as L.A. Care Health Plan

PROOF OF SERVICE OF DOCUMENT

I am over the age of 18 and not a party to this bankruptcy case or adversary proceeding. My business address is: 425 Market Street, 26th Floor, San Francisco, California, 94105

A true and correct copy of the foregoing document entitled (*specify*):

MEMORANDUM OF POINTS AND AUTHORITIES REGARDING NON-CORE DESIGNATION

will be served or was served **(a)** on the judge in chambers in the form and manner required by LBR 5005-2(d); and **(b)** in the manner stated below:

1. **TO BE SERVED BY THE COURT VIA NOTICE OF ELECTRONIC FILING (NEF)**: Pursuant to controlling General Orders and LBR, the foregoing document will be served by the court via NEF and hyperlink to the document. On February 26, 2019, I checked the CM/ECF docket for this bankruptcy case or adversary proceeding and determined that the following persons are on the Electronic Mail Notice List to receive NEF transmission at the email addresses stated below:

Steven J Kahn skahn@pszyjw.com
United States Trustee (LA) ustpregion16.la.ecf@usdoj.gov

☐ Service information continued on attached page

2. SERVED BY UNITED STATES MAIL:
On February 26, 2019, I served the following persons and/or entities at the last known addresses in this bankruptcy case or adversary proceeding by placing a true and correct copy thereof in a sealed envelope in the United States mail, first class, postage prepaid, and addressed as follows. Listing the judge here constitutes a declaration that mailing to the judge will be completed no later than 24 hours after the document is filed.

Honorable Judge Ernest M. Robles
U.S. Bankruptcy Court
Roybal Federal Building
255 E. Temple Street
Suite 1560
Los Angeles, CA 90012

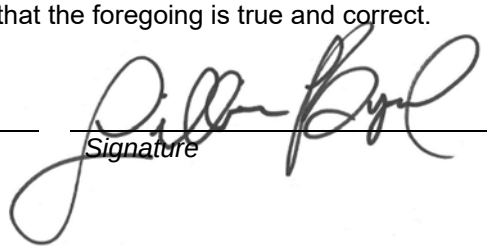
☐ Service information continued on attached page

3. SERVED BY PERSONAL DELIVERY, OVERNIGHT MAIL, FACSIMILE TRANSMISSION OR EMAIL (state method for each person or entity served): Pursuant to F.R.Civ.P. 5 and/or controlling LBR, on (*date*) _____, I served the following persons and/or entities by personal delivery, overnight mail service, or (for those who consented in writing to such service method), by facsimile transmission and/or email as follows. Listing the judge here constitutes a declaration that personal delivery on, or overnight mail to, the judge will be completed no later than 24 hours after the document is filed.

☐ Service information continued on attached page

I declare under penalty of perjury under the laws of the United States that the foregoing is true and correct.

February 26, 2019	LILLIAN A. BYRD	
Date	*Printed Name*	*Signature*



This form is mandatory. It has been approved for use by the United States Bankruptcy Court for the Central District of California.

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Attorneys for Local Initiative Health Authority for Los Angeles County operating as L.A. Care Health Plan

UNITED STATES BANKRUPTCY COURT

CENTRAL DISTRICT OF CALIFORNIA, LOS ANGELES DIVISION

In re

VERITY HEALTH SYSTEM OF CALIFORNIA, INC., et al.,

Debtors and Debtors in Possession.

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☐ Affects Verity Health System of California, Inc.
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☐ Affects Verity Holdings, LLC
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☐ Affects De Paul Ventures - San Jose Dialysis, LLC

Debtors and Debtors In Possession.

Lead Case No. 2:18-bk-20151-ER

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Chapter 11 Cases

Adv. Proc. No. 2:19-ap-01002-ER

LOCAL INITIATIVE HEALTH AUTHORITY FOR LOS ANGELES COUNTY OPERATING AS L.A. CARE HEALTH PLAN'S APPENDIX OF UNPUBLISHED CASES IN SUPPORT OF MEMORANDUM OF POINTS AND AUTHORITIES REGARDING NON-CORE DESIGNATION

Date: April 2, 2019
Time: 10:00 A.M.
Judge: Hon. Ernest M. Robles

ST. VINCENT MEDICAL CENTER, a California nonprofit public benefit corporation and ST. FRANCIS MEDICAL CENTER, a California nonprofit public benefit corporation, Plaintiffs, v. LOCAL INITIATIVE HEALTH AUTHORITY FOR LOS ANGELES COUNTY DBA L.A. CARE HEALTH PLAN, an independent local public agency, Defendant.	Courtroom: 1568

For the Court's convenience, Local Initiative Health Authority for Los Angeles County Operating as L.A. Care Health Plan submits this Appendix of Unpublished Cases in Support of Memorandum of Points and Authorities Regarding Non-Core Designation.

APPENDIX OF AUTHORITIES

Cases

In re BBeautiful, Not Reported in B.R. (2017)……Ex. 1

In re Adams, Slip Copy (2018)……Ex. 2

DATED: February 26, 2019

HANSON BRIDGETT LLP

By: */s/ Anthony J. Dutra*
NEAL L. WOLF
ANTHONY J. DUTRA
Attorneys for Local Initiative Health Authority for Los Angeles County operating as L.A. Care Health Plan

Exhibit 1

KeyCite Yellow Flag - Negative Treatment
Report and Recommendation Adopted as Modified by In re Bbeautiful, a California, LLC, C.D.Cal., April 12, 2017

2017 WL 932945
Only the Westlaw citation is currently available.
United States Bankruptcy Court,
C.D. California,
Los Angeles Division.

IN RE: BBEAUTIFUL, a California LLC, Debtor
BBeautiful, a California LLC, Plaintiff
v.
Rieke–Arminak Corp., a
Delaware Corp., et al., Defendants

Case No.: 2:16–bk–10799–ER
|
Adv. No.: 2:16–ap–01506–ER
|
Signed March 8, 2017

Attorneys and Law Firms

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Does 1 to 25, pro se.

REPORT AND RECOMMENDATION OF THE HONORABLE ERNEST M. ROBLES, UNITED STATES BANKRUPTCY JUDGE, TO THE UNITED STATES DISTRICT COURT FOR THE CENTRAL DISTRICT OF CALIFORNIA, CONTAINING PROPOSED FINDINGS OF FACT AND CONCLUSIONS OF LAW, AND PROPOSED FINAL JUDGMENT

Ernest M. Robles, United States Bankruptcy Judge

***1** This Report and Recommendation is submitted by the undersigned Judge of the United States Bankruptcy Court for the Central District of California (the "Court") to the United States District Court for the Central District of California (the "District Court") pursuant to 28 U.S.C. § 157(c)(1) and Federal Rule of Bankruptcy Procedure ("Bankruptcy Rule") 9033, based upon the Court's determination that the Court lacks constitutional authority to enter a final judgment with respect to the matters addressed herein. [1]

1 In preparing this Report and Recommendation, the Court considered the following pleadings and papers:
1) Plaintiff's Motion for Partial Summary Judgment:
a) Notice of Motion and Plaintiff's Motion for Partial Summary Judgment ("MSJ") [Doc. No. 33]
i) Plaintiff's Statement of Uncontroverted Facts and Conclusions of Law in Support of Motion for Partial Summary Judgment ("SUF") [Doc. No. 34]
ii) Declaration of Helga Arminak in Support of Plaintiff's Motion for Partial Summary Judgment [Doc. No. 35]
iii) Proposed Judgment and Order Granting Plaintiff's Motion for Partial Summary Judgment [Doc. No. 36]
iv) Proof of Service [Doc. No. 37]
v) Notice of Errata Regarding Notice of Motion and Plaintiff's Motion for Partial Summary Judgment [Doc. No. 38]
b) Defendant's Response to BBeautiful's Motion for Partial Summary Judgment [Doc. No. 61]
c) Plaintiff's Reply Memorandum of Points and Authorities in Further Support of its Motion for Partial Summary Judgment [Doc. No. 62]
2) Defendant's Motion to Dismiss:
a) Defendants Rieke–Arminak Corporation, Trimas Corporation, Rieke Corporation, and Arminak & Associates, LLC's Notice of Motion and (1) Motion to Dismiss Debtor BBeautiful's First Amended Complaint for Lack of Subject Matter Jurisdiction (FRCP 12(b)(1)); (2) Motion to Dismiss Debtor's First Amended Complaint for Failure to State a Claim (FRCP 12(b)(6)); or in the Alternative (3) Motion for Abstention (28 USC § 1334(c)(1)) ("MTD") [Doc. No. 53]
i) Request for Judicial Notice in Support of Motion to Dismiss [Doc. Nos. 54–58]
ii) Proof of Service [Doc. No. 59]
b) Plaintiff's Memorandum of Points and Authorities in Opposition to Defendants' (1) Motion to Dismiss Debtor BBeautiful's First Amended Complaint for Lack of Subject Matter Jurisdiction (FRCP 12(b)(1)); (2) Motion to Dismiss Debtor's First Amended

Complaint for Failure to State a Claim (FRCP 12(b)(6)); or in the Alternative (3) Motion for Abstention (28 USC § 1334(c)(1)) (includes Declaration of Helga Arminak, Appendix of Unpublished Authorities, and Request for Judicial Notice) [Doc. No. 63]

i) Proof of Service [Doc. No. 64]

c) Defendants Rieke–Arminak Corporation, Trimas Corporation, Rieke Corporation, and Arminak & Associates, LLC's Memorandum of Points and Authorities in Reply to Plaintiffs' Opposition [Doc. No. 66]

i) Defendants' Appendix of Unpublished Opinions in Support of Their Motion to Dismiss [Doc. No. 67]

ii) Proof of Service [Doc. No. 68]

3) Other relevant papers:

a) Defendants' (I) Notice of Motion and Motion to Stay All Proceedings in Adversary Proceeding No. 2:16–ap–01506–ER Pending the District Court's Ruling on Their Motion to Withdraw the Reference; or, Alternatively (II) Defendants' Motion for an Extension of Time to File an Opposition to Debtor's Motion for Partial Summary Judgment and for a Continuance of the March 8, 2017 Hearing Date [Doc. No. 40]

b) Order Denying Defendants' Motion to Stay All Proceedings [Doc. No. 47]

c) Defendants Rieke–Arminak Corporation, Trimas Corporation, Rieke Corporation, and Arminak & Associates, LLC's Notice of Motion and Motion to Withdraw the Reference of Adversary Case No. 2:16–ap–01506–ER to the Bankruptcy Court Pursuant to 28 U.S.C. § 157(d) [Doc. No. 49]

i) Defendants Rieke–Arminak Corporation, Trimas Corporation, Rieke Corporation, and Arminak & Associates, LLC's Memorandum of Points and Authorities in Support of Their Motion to Withdraw the Reference of Adversary Case No. 2:16–ap–01506–ER to the Bankruptcy Court Pursuant to 28 U.S.C. § 157(d) [Doc. No. 50]

d) Defendants Rieke–Arminak Corporation, Trimas Corporation, Rieke Corporation, and Arminak & Associates, LLC's Statement of Non–Consent to Bankruptcy Court's Authority to Enter a Final Judgment and Memorandum of Points and Authorities in Support of Their Position that this Adversary Proceeding is Non–Core [Doc. No. 52]

***2** For the reasons in the Final Ruling set forth below, the Court recommends that the District Court:

1) Enter judgment that BBeautiful is entitled to a declaration that it may (a) sell the Permitted Beauty Products[2] and may (b) acquire packaging for the purpose of manufacturing the Permitted Beauty Products.

2) Dismiss BBeautiful's claim that it is entitled to a declaration that it may sell stand-alone packaging products, on the ground that the claim is not ripe for adjudication, with such dismissal being without prejudice to BBeautiful's ability to file a new complaint if and when the packaging claims become ripe; but deny BBeautiful leave to amend the existing complaint, based upon the finding that at the present time, BBeautiful can allege no facts showing that its packaging claims are ripe.

3) Dismiss with prejudice BBeautiful's claim for tortious interference with prospective economic advantage.

4) Dismiss with prejudice BBeautiful's claim for violation of the UCL.

2 All terms are defined in the Final Ruling.

Final Ruling

I. Background Facts

Ms. Arminak Founds and Operates BBeautiful and Associates

BBeautiful, LLC ("BBeautiful") commenced a voluntary Chapter 11 petition on January 22, 2016. Helga Arminak ("Ms. Arminak") is the operating manager of BBeautiful. Declaration of Helga Arminak in Support of Plaintiff's Motion for Partial Summary Judgment ("Second Arminak Decl.") [Doc. No. 35] at ¶ 1. Ms. Arminak founded Arminak & Associates, LLC ("Associates") in 1999, and founded BBeautiful in 2006. *Id.* at ¶¶ 2 and 9. For many years, Ms. Arminak jointly operated BBeautiful and Associates. *Id.* at ¶ 11. During that time, the companies shared offices and often used the same employees. *Id.* at ¶ 9.

Associates designs, manufactures, and supplies packaging solutions for the cosmetic, personal care, beauty aid, and household product markets. *Id.* at ¶ 10. Associates'

customers have included corporations that manufacture and sell beauty, cosmetic, and personal care products, such as L'Oreal, Colgate, Bayer, and Johnson and Johnson. Declaration of Helga Arminak in Support of Motion by Debtor to Enforce the Automatic Stay and Assess Sanctions [Doc. No. 154, main bankruptcy case] ("First Arminak Decl.") at ¶ 3. Ms. Arminak's husband, Armin Arminak, and her brother, Roger Abadjian, were shareholders in Associates before it was sold (Ms. Arminak, Armin Arminak, and Roger Abadjian collectively, the "Arminaks"). *Id.* at ¶ 4.

BBeautiful develops personal beauty products, such as eye shadow, lip gloss, nail polish, and makeup powders. Second Arminak Decl. at ¶ 3. BBeautiful develops the formulas for these products and oversees their development, production (including packaging), and distribution to retail stores. *Id.* BBeautiful also sells its products directly to customers through the websites *www.chrislie.com* and *www.lashem.com*. *Id.* BBeautiful does not sell any packaging components to its customers. Plaintiff's Statement of Uncontroverted Facts ("SUF") [Doc. No. 34] at ¶ 7. Specifically, BBeautiful does not sell any dispensing systems, airless dispensing packages, jars, bottles, caps, closures, plastic tubes, or any other related containers as standalone products. *Id.* at ¶ 8.

The Arminaks Sell Associates to Rieke

***3** In 2012 and 2014, the Arminaks sold Associates to Rieke–Arminak Corporation in a two-phase purchase transaction for a purchase price of $110 million (70% of Associates was sold in 2012; the remaining 30% was sold in 2014). *Id.* at ¶ 12. Rieke–Arminak Corporation is a wholly-owned subsidiary of Rieke Corporation. Rieke is an entity within TriMas Corporation's packaging segment (Rieke–Arminak, Rieke Corporation, and Trimas collectively, "Rieke").

The 2012 Purchase Agreement prohibits the Arminaks from engaging in any "competing business," defined as "any business that designs, manufactures and/or sells dispensing systems, airless dispensing packages, jars, bottles, caps, closures, plastic tubes and other related containers for the cosmetic and beauty, personal care and household products industries" (the "Non–Compete Provision"). *See* 2012 Purchase Agreement at §§ 9.2(a) and 1.1 (attached to MSJ as Ex. 1). The Non–Compete Provision contains a carve-out, which provides that "nothing herein shall prohibit ... (ii) the participation in and conduct of the business of BBeautiful (dba Chrislie Foundations) by Helga Arminak, except as it is limited by her Employment Agreement." *Id.* at § 9.2(a). The Employment Agreement designates Ms. Arminak as the chief executive of Associates. It permits Ms. Arminak to devote an average of up to fifty hours per month to the management and operation of BBeautiful, provided that Ms. Arminak devotes an average of at least forty hours per week to the business of Associates. Employment Agreement at § 2(d) (attached to MSJ as Ex. 3). The Non–Compete Provision remains in force until March 31, 2019. *See* 2012 Purchase Agreement § 15; 2014 Purchase Agreement § 4(a) (the 2012 Purchase Agreement, together with the 2014 Purchase Agreement, the "Purchase Agreements"). The 2012 Purchase Agreement also prohibits the Arminaks from soliciting or hiring any of Rieke's employees (the "Non–Solicitation Provision") (the Non–Compete Provision, together with the Non–Solicitation Provision, the "Restrictive Covenants").

Litigation Ensues Between the Arminaks and Rieke

After Associates was acquired by Rieke, the Arminaks —Helga, her husband Armin, and her brother Roger— continued working at Associates/Rieke until February 2016. The parties dispute the circumstances under which the Arminaks ceased working for Associates/Rieke; that dispute is not relevant to the present matter. Since leaving Associates/Rieke, the Arminaks or companies controlled by the Arminaks have initiated four actions against Rieke or Rieke's officers and/or employees. BBeautiful is not a party to any of these actions. On February 16, 2016, the Arminaks filed an action in the Los Angeles Superior Court seeking to invalidate the Restrictive Covenants. On April 19, 2016, the Arminaks filed an action in the Los Angeles Superior Court alleging that Associates and Mark Box, a Rieke employee, had made slanderous statements. Both actions were removed to the U.S. District Court for the Central District of California, and were subsequently consolidated (the "Consolidated Action"). On December 7, 2016, Judge Kronstadt granted Rieke's motion to transfer venue, and ordered that the claims relating to the Restrictive Covenants be severed and transferred to the Southern District of New York, on the grounds that the disputes concerning the Restrictive Covenants "should be adjudicated in New York under New York law." *See* Order Re: Defendants' Motion to Transfer Venue ("Dec. 7 Order") [Defendant's RJN, Ex. 8].

***4** On April 4, 2016, two limited liability companies controlled by the Arminaks filed an action against Associates in the Los Angeles Superior Court. That action alleges that Associates damaged property that it had leased from the Arminaks' companies.

On April 14, 2016, the Arminaks filed an action in the New York Supreme Court [3] **[Note 1]** against Associates and Rieke (the "New York Action"). [4] **[Note 2]** The New York Action seeks, *inter alia*, to invalidate the Non–Compete Provision. Associates and Rieke filed a counterclaim asserting breach of the Non–Compete Provision and seeking a temporary restraining order and preliminary injunction preventing the Arminaks from launching a competing business.

[3] In New York, the trial court is referred to as the Supreme Court.

[4] Helga and Armin Arminak, and corporations owned or controlled by the Arminaks, filed the New York Action. Although Roger Abadjian, Helga's brother, was previously a shareholder of Associates, he is not involved in the New York Action.

Rieke Obtains a TRO in the New York Action

On November 10, 2016, the New York Court granted Associates and Rieke's motion for a temporary restraining order (the "New York TRO"), but modified the proposed TRO that was submitted by Rieke. The New York TRO provides in relevant part (language added by the court is in bold):

> Plaintiffs [the Arminaks], and all those acting in concert or cooperation with them, are hereby enjoined from directly or indirectly:
>
> > **Except as it relates to BBeautiful and its specific carve-out, which she [Helga Arminak], a sophisticated businesswoman advised by counsel, signed**, competing with Rieke, directly or indirectly, from the present date until and including the date of trial in the above-captioned action, by, among other conduct:
> >
> > a. owning, operating, maintaining or engaging in any business, including but not limited to, *Arminak Solutions I, Inc.* and *Arminak Solutions LLC*, that designs, manufactures and/or sells dispensing systems, airless dispensing packages, jars, bottles, caps, closures, plastic tubes and other related containers for the cosmetic and beauty, personal care and/or household products industries; or
> >
> > b. participating in a bid solicitation process **to supply packaging** organized by Henkel Corporation; or
> >
> > c. selling, or offering to sell, any dispensing systems, airless dispensing packages, jars, bottles, caps, closures, plastic tubes and other related containers to any current or former Rieke customers, including but not limited to, Clorox or Colgate; or
> >
> > d. maintaining, operating or causing the web site www.arminaksolutions.com to be maintained or operated.

New York TRO (Defendant's RJN, Ex. 11).

A hearing on whether the New York TRO should be converted to a preliminary injunction is scheduled to take place on March 10, 2017. The Arminaks state that they offered to stipulate that the New York TRO be converted to a preliminary injunction, provided that the injunction retain the exclusion for BBeautiful's activity. According to the Arminaks, Rieke refused to enter into such a stipulation, and seeks to have a preliminary injunction entered omitting the exclusion for BBeautiful.

This Court Denies BBeautiful's Motion to Enforce the Automatic Stay

On January 13, 2017, this Court entered an order denying BBeautiful's motion seeking to enforce the automatic stay against Rieke (the "Enforcement Motion"). *See* Order Denying Motion by Debtor to Enforce the Automatic Stay and to Assess Sanctions [Doc. No. 193, main bankruptcy case] and Final Ruling Denying Enforcement Motion [Doc. No. 184, main bankruptcy case]. In the Enforcement Motion, BBeautiful contended that a letter that Rieke had sent to its customers on November 22, 2016 (the "November 22 Letter") regarding the New York TRO violated the automatic stay. The November 22 Letter provides:

***5** On Friday, November 11, 2016, [5] **[Note 3]** Justice Kornreich of the Supreme Court of the State of New York issued a temporary restraining order prohibiting Helga Arminak, Armin Arminak, and affiliated businesses and individuals, from competing,

directly or indirectly, with Rieke Corporation or Arminak & Associates LLC. These individuals are currently prohibited from, among other things, selling or providing any dispensing systems, airless dispensing packages, jars, bottles, caps, closures, plastic tubes and other related containers for the cosmetic and beauty, personal care and household products industries. They may not advertise such products, solicit such business, and/or participate in any related requests for proposal, or other bidding procedures.

Justice Kornreich's Order is effective immediately, and will remain effective until at least February 2, 2017. On that date, Justice Kornreich will hold a hearing to determine whether to further extend the Order.

If you would like a copy of the Order please contact the General Counsel of TriMas Corporation.

November 22 Letter (Ex. C, Doc. No. 162, main bankruptcy case).

5 The New York TRO was issued on November 10, 2016, not on November 11, 2016.

According to BBeautiful, the November 22 Letter constituted an effort to obtain possession of or exercise control over property of the estate, because it interfered with BBeautiful's potential customer relationships. BBeautiful asserted that by failing to explain that the New York TRO contained an exclusion for BBeautiful's activities, the letter discouraged BBeautiful's potential customers from doing business with it.

The Court found that the November 22 Letter did not violate the automatic stay, reasoning that BBeautiful's potential customer relationships did not constitute property of the estate:

Section 541 defines "property of the estate" as "all legal or equitable interests of the debtor in property *as of the commencement of the case* " (emphasis added). Accordingly, Rieke's alleged interference with these potential relationships did not violate § 362(a)(3)'s stay of "any act to obtain possession of property of the estate or of property from the estate or to exercise control over property of the estate."

BBeautiful commenced this voluntary Chapter 11 petition on January 22, 2016. On behalf of BBeautiful, Helga attempted to establish relationships with new customers and new suppliers in October, November, and December of 2016. These business relationships did not exist "as of the commencement of the case," and therefore cannot constitute property of the estate within the meaning of § 541(a)(1). Section 541(a)(7) provides that "[a]ny interest in property that the estate acquires after the commencement of the case" also constitutes property of the estate. BBeautiful attempted to establish business relationships with potential customers and potential suppliers in late 2016, but was unsuccessful in doing so, in part as a result of Rieke's communications to those potential customers. Since these prospective business relationship were never actually established, they cannot constitute an "interest in property" under § 541(a)(7).

None of the cases cited by BBeautiful are to the contrary. All those cases involved existing, not prospective, business relationships. For example, in *In re Trump Entm't Resorts, Inc.*, 534 B.R. 93, 102–03 (Bankr. D. Del. 2015), the debtor, the Taj Mahal resort, had contracts with organizations under which the debtor agreed to host conventions on behalf of those organizations. The *Trump* court held that the debtor's contracts to host these future conventions constituted property of the estate. Although the *Trump* court described the organizations as "potential" customers, that was only because the conventions had not yet taken place. That is, in contrast to the present case, the debtor in *Trump* had existing business relationships with various organizations. Here, BBeautiful did not have an existing business relationship with any of the potential customers or suppliers; it was seeking to form entirely new business relationships.

***6** Similarly, in *In re Family Health Servs., Inc.*, 105 B.R. 937, 943 (Bankr. C.D. Cal. 1989), the court found that the debtor's existing business relationships with health care subscribers constituted property of the estate; *In re HMH Motor Servs., Inc.*, 259 B.R. 440, 451 (Bankr. S.D. Ga. 2000) likewise pertained to existing, not prospective, business relationships. *In re All Trac Transp., Inc.*, 306 B.R. 859 (Bankr. N.D. Tex. 2004) also involved interference with existing customer relationships. In *In re MCEG Prods., Inc.*, 133 B.R. 232, 234 (Bankr. C.D. Cal. 1991), the court held that a post-petition compromise and sale agreement was property of the estate. *MCEG Products* does not support the contention that a prospective business relationship constitutes estate property.

Final Ruling Denying Enforcement Motion at 9–10.

BBeautiful Commences an Action Against Rieke in the Bankruptcy Case

On November 16, 2016, BBeautiful commenced an action against Rieke in the bankruptcy case. On December 29, 2016, BBeautiful filed a First Amended Complaint, which is the operative complaint ("Complaint"). The Complaint alleges that despite the Non–Compete Provision's specific carve-out for BBeautiful, Rieke and its employees "have falsely stated to BBeautiful's potential customers and suppliers that they may not do business with BBeautiful. Such statements have prevented new customers from transacting with BBeautiful and prevented Helga Arminak from utilizing her long-standing industry contracts to develop and sell existing and new products for Plaintiff [BBeautiful]." Complaint at ¶ 17.

The Complaint asserts claims for declaratory relief, tortious interference with prospective economic advantage, and violation of California Business and Professions Code § 17200. In the first claim, for declaratory relief, BBeautiful seeks a declaration that the Non–Compete Provision (1) does not bar BBeautiful from conducting its historic business of selling finished beauty products and (2) does not bar BBeautiful from conducting a contemplated new business selling packaging products. Complaint at ¶¶ 21–23. In the second claim, for tortious interference with prospective economic advantage, BBeautiful alleges that Rieke and its employees "intentionally contacted BBeautiful's customers and told them not to do business with BBeautiful because they falsely claim BBeautiful is not allowed to compete with Rieke under the terms of the Purchase Agreement." *Id.* at ¶ 26. BBeautiful seeks damages of not less than $40 million on the second claim. In the third claim, for violation of California Business and Professions Code § 17200 (the Unfair Competition Law or "UCL"), BBeautiful alleges that the Non–Compete Provision is void pursuant to California Business and Professions Code § 16600, and that accordingly Rieke's assertion of the Non–Compete Provision is an unlawful business practice barred by the UCL. BBeautiful seeks damages of not less than $40 million on the third claim.

On January 6, 2017, Rieke moved to extend its time to respond to the Complaint from January 18, 2017 to February 17, 2017. Doc. No. 23. On January 10, 2017, the Court granted the motion in part, and extended Rieke's time to file a responsive pleading from January 18, 2017 to February 1, 2017. Doc. No. 24. On February 1, 2017, Rieke filed in the District Court a motion to withdraw the reference with respect to the adversary proceeding. The District Court has scheduled a hearing on Rieke's motion to withdraw the reference for April 17, 2017. On February 1, 2017, Rieke filed in the Bankruptcy Court a motion to stay all proceedings in the action until the District Court decided Rieke's motion to withdraw the reference. In the alternative, Rieke sought an extension of time to oppose BBeautiful's pending motion for partial summary judgment. On February 2, 2017, the Court denied Rieke's motion to stay the adversary proceeding. The Court explained:

> ***7** The standard for issuance of a stay pending the District Court's ruling upon a motion for withdrawal of the reference "is the same as on any motion for stay." *In re Matterhorn Grp., Inc.*, No. 2:10–CV–02849–GEB, 2010 WL 4628119, at *2 (E.D. Cal. Nov. 5, 2010). That standard requires the Court to consider the following four factors:
>
> > (1) whether the stay applicant has made a strong showing that he is likely to succeed on the merits; (2) whether the applicant will be irreparably injured absent a stay; (3) whether issuance of the stay will substantially injure the other parties interested in the proceeding; and (4) where the public interest lies.
>
> *Nken v. Holder*, 556 U.S. 418, 426 (2009).
>
> Defendants have failed to establish that they are entitled to a stay. First, Defendants have not shown that there is a strong likelihood that the District Court will grant their motion to withdraw the reference. Withdrawal of the reference is mandatory if "resolution of the proceeding requires consideration of both title 11 and other laws of the United States regulating organizations or activities affecting interstate commerce." 28 U.S.C. § 157(d). In other cases, withdrawal of the reference is discretionary. Here, Defendants seek discretionary withdrawal. Because the "standard for permissive withdrawal is high and must be satisfied by the party seeking withdrawal," *In re: KSL Media, Inc.*, No. AP 15–01212–GM, 2016 WL 74385, at *2 (C.D. Cal. Jan. 6, 2016), Defendants face a particularly difficult task

in showing a strong likelihood of success on their motion for permissive withdrawal. In considering a motion for permissive withdrawal, the District Court considers factors such as "the efficient use of judicial resources, delay and costs to the parties, uniformity of bankruptcy administration, the prevention of forum shopping, and other related factors." *Sec. Farms v. Int'l Bhd. of Teamsters, Chauffers, Warehousemen & Helpers*, 124 F.3d 999, 1008 (9th Cir. 1997). While Defendants present compelling arguments with respect to many of these factors, given the discretionary nature of permissive withdrawal and Defendants' high burden, the Court cannot find that Defendants have shown a strong likelihood that the District Court will grant their motion to withdraw the reference.

Second, Defendants have failed to show that, absent a stay, they will suffer irreparable injury, or even that the balance of the hardships tips sharply in their favor. Defendants' inability to show hardship is particularly damaging to their motion for a stay. Being required to litigate in the Bankruptcy Court, as opposed to the District Court, does not deprive Defendants of any substantive legal rights. If Defendants prevail upon their motion to withdraw the reference, litigation will continue in the District Court. There is nothing prejudicial about being required to litigate first in the Bankruptcy Court and then in the District Court. In fact, in situations where the right to a jury trial exists, the Ninth Circuit has found that it is entirely appropriate for both the Bankruptcy Court and the District Court to preside over the litigation ....

Third, a stay of the proceedings will harm the Plaintiffs. The declaratory relief sought by the Plaintiffs in connection with their March 8 motion for partial summary adjudication would, if granted, make it easier for Plaintiffs to conduct their business, in turn increasing Plaintiff's likelihood of successfully confirming a plan of reorganization. Further delay in the adjudication of that relief would make confirming a plan more difficult.

***8** Finally, the public interest in the expeditious resolution of bankruptcy cases weighs against staying the proceedings.

Order Denying Defendants' Motion to Stay All Proceedings [Doc. No. 47] at 2–4.

In addition, the Court found that Rieke's motion to stay the adversary proceeding did not constitute a response to the Complaint. The Court ordered Rieke to respond to the Complaint by February 8, 2017. *Id.* at 4. The Court declined to extend Rieke's time to oppose BBeautiful's motion for partial summary judgment, and declined to continue the March 8 hearing on the motion for summary judgment. On February 8, Rieke filed a motion to dismiss the Complaint. A hearing on BBeautiful's motion for partial summary adjudication is scheduled to take place concurrently with the hearing on Rieke's motion to dismiss.

II. Summary of Rieke's Motion to Dismiss and BBeautiful's Motion for Summary Judgment

Summary of Rieke's Motion to Dismiss, BBeautiful's Opposition, and Rieke's Reply

Rieke asserts that the first claim for declaratory relief should be dismissed for the following reasons:

1) BBeautiful lacks standing to seek declaratory relief with respect to the scope of the Restrictive Covenants, because BBeautiful is not a party to the contract containing the Restrictive Covenants. *See McClain v. First Mortg. Corp.*, No. SACV 15–2–JLS (JCGX), 2015 WL 11199074, at *2 (C.D. Cal. Mar. 16, 2015) ("It is well established [ ] that a person who is not a party to a contract does not have standing either to seek its enforcement or to bring tort claims based on the contractual relationship.")

2) The first claim is not ripe for adjudication. Rieke and BBeautiful agree that (1) BBeautiful is not a signatory to the Purchase Agreements; (2) BBeautiful is not bound by the Purchase Agreements or any provisions therein, including the Restrictive Covenants; (3) BBeautiful is not subject to the New York TRO; (4) BBeautiful is allowed to operate its beauty and cosmetic products business; and (5) Ms. Arminak, BBeautiful's principal, is subject to the Restrictive Covenants and the New York TRO and is not permitted to operate any competing business. Therefore, the first claim is not ripe because BBeautiful seeks a judgment that BBeautiful is not subject to the Restrictive Covenants, a fact which the parties do not dispute. Dismissal of a claim for declaratory judgment is appropriate where a court determines that there is no "actual case or

controversy within its jurisdiction." *Principal Life Ins. Co. v. Robinson*, 394 F.3d 665, 669 (9th Cir. 2005).

3) The parties dispute whether BBeautiful is prohibited from selling stand-alone packaging products. However, this dispute is not ripe for adjudication, because BBeautiful concedes that, to date, it has not attempted to sell stand-alone packaging products. Instead, BBeautiful states that it *may seek* to offer stand-alone packaging products as part of its plan of reorganization.

4) Even if the Court determines that BBeautiful has sufficiently pleaded an actual case or controversy, it should dismiss the claim for declaratory relief because it is duplicative of the relief sought in the New York Action. "[A] district court has discretion to dismiss a federal declaratory judgment action when 'the questions in controversy ... can better be settled' in a pending state court proceeding." *R.R. St. & Co. v. Transp. Ins. Co.*, 656 F.3d 966, 975 (9th Cir. 2011). The claim for declaratory relief does not involve federal issues; it concerns the scope and enforceability of the Restrictive Covenants, which are governed by New York law. The scope of the Restrictive Covenants will be determined in the New York Action. "[W]hen a party requests declaratory relief in federal court and a suit is pending in state court presenting the same state law issues, there exists a presumption that the entire suit should be heard in state court." *Chamberlain v. Allstate Ins. Co.*, 931 F.2d 1361, 1366–67 (9th Cir. 1991).

***9** 5) This adversary proceeding is an attempt by Ms. Arminak to avoid adverse rulings in the New York Action and the Consolidated Action. This action was commenced shortly after issuance of the New York TRO. The Complaint was amended to add a cause of action challenging the Restrictive Covenants under a California statute shortly after Judge Kronstadt's December 7 Order, which transferred the claims in the Consolidated Action that related to the Restrictive Covenants to the District Court for the Southern District of New York. Ms. Arminak's forum shopping weighs heavily in favor of dismissal. *See In re GTS 900 F, LLC*, No. 2:09–BK–35127–VZ, 2010 WL 4878839, at *5 (C.D. Cal. Nov. 23, 2010) ("Forum shopping is likely where a party moves ... after adverse findings have been made against it ...."); *In re: KSL Media, Inc.*, No. AP 15–01212–GM, 2016 WL 74385, *9 (C.D. Cal. Jan. 6, 2016) (" 'Forum shopping' occurs when a party attempts to manipulate an action to have it heard before a forum it deems more favorable, charitable, or sympathetic toward its point of view.")

6) If the Court does not dismiss the Complaint, the Court should permissively abstain from hearing the Complaint pursuant to 28 U.S.C. § 1334(c)(1). Permissive abstention is appropriate because:

a) This lawsuit is merely forum shopping by a dissatisfied litigant;

b) The Complaint asserts only non-core, state law claims;

c) Rieke has a right to a jury trial;

d) Rieke does not consent to a jury trial before the Bankruptcy Court and, as a result, the Bankruptcy Court may not preside over a jury trial;

e) The courts in both the New York Action and the Consolidated Action have already interpreted the Restrictive Covenants, and have issued rulings enforcing their terms;

f) Abstention will have little impact on the administration of the estate because the action asserts only non-core claims that the District Court will be required to review *de novo*;

g) The Court has already determined that the conducted alleged in the Complaint does not affect property of the estate;

h) Abstention will promote comity with the Supreme Court of the New York, where the Arminaks have been litigating the same issues since April 4, 2016.

Rieke asserts that the second claim for tortious interference with prospective economic advantage should be dismissed for the following reasons:

1) The elements of a claim for tortious interference with economic advantage are as follows: "(1) an economic relationship between the plaintiff and some third party, with the probability of future economic benefit to the plaintiff; (2) the defendant's knowledge of the relationship; (3) intentional acts on the part of the defendant designed to disrupt the

relationship; (4) actual disruption of the relationship; and (5) economic harm to the plaintiff proximately caused by the acts of the defendant." *Korea Supply Co. v. Lockheed Martin Corp.*, 63 P.3d 937, 950 (2003). BBeautiful has not sufficiently pleaded the existence of any "economic relationship ... with the probability of future economic benefit." Instead, BBeautiful concedes that the alleged interference was with "prospective customers," Complaint at ¶ 27. A claim for tortious interference is insufficient where it alleges only " 'hypothetical relationships' not developed at the time of the allegedly tortious acts." *Silicon Knights, Inc. v. Crystal Dynamics, Inc.*, 983 F.Supp. 1303, 1311 (N.D.Cal. 1997); *Bio–Med. Research Ltd.*, 249 Fed.Appx. at 542 (affirming dismissal where the plaintiff failed to identify "an existing relationship with an identifiable buyer"); *Dooley v. Crab Boat Owners Ass'n*, 271 F.Supp. 2d 1207, 1216–17 (N.D. Cal. 2003) ("The economic relationship must be either in the form of a contract or an existing relationship with an identifiable third party."); *Universal Grading Serv. v. eBay, Inc.*, 2011 WL 846060, at *11 (N.D. Cal. Mar. 8, 2011) ("Without any identifiable prospective buyers, plaintiff's expectation of future business is 'at most a hope for an economic relationship and a desire for future benefit.' "); *Google Inc. v. Am. Blind & Wallpaper Factory, Inc.*, 2005 WL 832398, *9 (N.D. Cal. Mar. 30, 2005) (finding allegations of "future and prospective sales" to "repeat customers ... too speculative to support" a claim for tortious interference).

***10** 2) BBeautiful has not alleged any "actual disruption," instead offering only the conclusory allegation that "customers no longer want to do business" with it. This allegation is insufficient. *See Amaretto Ranch Breedables, LLC v. Ozimals, Inc.*, 790 F. Supp. 2d 1024, 1032 (N.D. Cal. 2011) ("The Ninth Circuit found insufficient the 'conclusory' allegations that the plaintiff 'has been harmed because its ongoing business and economic relationships with Customers have been disrupted. [To sufficiently state a claim for tortious interference] [t]he plaintiff [must] allege, for example, that it lost a contract ... or that a negotiation with a Customer failed.' ").

3) BBeautiful has not sufficiently alleged that Rieke had knowledge of the relationships with which it purportedly interfered. Rieke cannot reasonably be expected to have knowledge of the hypothetical relationships identified in the Complaint.

4) BBeautiful "must plead and prove as part of its case-in-chief that the defendant's conduct was 'wrongful by some legal measure other than the fact of interference itself.' " *Korea Supply*, 63 P.3d at 954. BBeautiful has failed to allege that Rieke's conduct was independently unlawful. In addition, the Court has already determined that communications with prospective customers do not constitute an act to obtain possession of property of the estate.

Rieke asserts that the third claim for violation of the UCL should be dismissed for the following reasons:

1) The UCL prohibits any "unlawful, unfair, or fraudulent business act or practice." California Business and Professions Code § 17200. BBeautiful fails to state a claim under the UCL, because the Restrictive Covenants, which are governed by New York law, are routinely upheld by New York courts.

2) To maintain a claim under the UCL, BBeautiful must show that it has "suffered injury in fact and has lost money or property as a result of unfair competition." California Business and Professions Code § 17204. To make this showing, BBeautiful "must have either prior possession or a vested legal interest in the money or property lost." *Walker v. USAA Cas. Ins. Co.*, 474 F. Supp. 2d 1168, 1172 (E.D. Cal. 2007), *aff'd sub nom. Walker v. Geico Gen. Ins. Co.*, 558 F.3d 1025 (9th Cir. 2009). BBeautiful cannot make this showing, given that it admits that it is not currently selling packaging products and does not have concrete plans to do so in the future.

Rieke argues that the action is not a core proceeding for the following reasons:

1) The Complaint does not invoke any substantive right created by federal bankruptcy law. All three claims for relief have been expressly found to be non-core:

a) The first claim for declaratory relief is non-core per *In re Temecula Valley Bancorp, Inc.*, 523 B.R. 210, 222–3 (C.D. Cal. 2014) (finding that claim for declaratory relief arising out of a pre-petition contract governed by state law is a non-core claim);

b) The second claim for tortious interference with prospective economic advantage is non-core per *Stern v. Marshall*, 564 U.S. 462, 495 (2011) (finding that a "tortious interference [claim is] one at common law that simply attempts to augment the bankruptcy estate—the very type of claim that ... must be decided by an Article III court."); and

c) The third claim for violation of California Business and Professions Code § 17200 is non-core per *N. Pipeline Const. Co. v. Marathon Pipe Line Co.*, 458 U.S. 50, 84 (1982) (finding that a bankruptcy court has no constitutional authority to hear a contract claim arising under state law).

2) The fact that the Complaint seeks to recover funds to augment the estate cannot turn its non-core claims into core-claims. *See In re Cinematronics, Inc.*, 916 F.2d 1444, 1450 (9th Cir. 1990) (finding that "state law claims that relate to a bankruptcy proceeding but that exist against a nondebtor" are non-core); *In re Harris Pine Mills*, 44 F.3d 1431, 1435 (9th Cir. 1995) ("If the proceeding does not invoke a substantive right created by the federal bankruptcy law and is one that could exist outside of bankruptcy it is not a core proceeding; it may be related to the bankruptcy because of its potential effect, but ... it is an 'otherwise related' or non-core proceeding.").

***11** BBeautiful makes the following arguments in opposition to Rieke's motion to dismiss its first claim for declaratory relief:

1) BBeautiful has standing to seek declaratory relief notwithstanding the fact that it is not a party to the Purchase Agreements. Rieke cites cases providing that a non-party lacks standing to enforce a contract. Those cases are inapposite, because BBeautiful is not seeking to enforce the Purchase Agreements; it is seeking a declaration that the Non–Compete Provision of the Purchase Agreements does not bar it from selling (1) beauty products and (2) stand-alone packaging components for beauty products.

2) In its motion to dismiss, Rieke states that BBeautiful "cannot sell stand-alone packaging products" as long as it is operated, managed, or controlled by Ms. Arminak or her family members. MTD at 19. [6] **[Note 4]** Rieke's statement amounts to a threat to sue BBeautiful. "[T]he threat of suit is enough to create standing, such that the threatened party may seek a declaration that the threatening party's putative rights are invalid." *Newcal Indus., Inc. v. Ikon Office Sol.*, 513 F.3d 1038, 1056 (9th Cir. 2008).

3) The action is ripe for adjudication. Although Rieke states to this Court that it does not dispute that BBeautiful is permitted to operate its beauty and cosmetic products business, Rieke's public conduct belies this assertion. As alleged in the Complaint, Rieke has prevented BBeautiful from selling existing and new products by relying upon an unreasonably broad interpretation of the Restrictive Covenants. Complaint at ¶ 19. In addition, Rieke sought a TRO in the New York Action that failed to include any exclusion for BBeautiful.

BBeautiful makes the following arguments in opposition to Rieke's motion to dismiss its second claim for tortious interference with prospective economic advantage:

1) BBeautiful has sufficiently alleged that Rieke has disrupted specific economic relationships—namely relationships with Henkel, Colgate–Palmolive, Avon, Coty, and L Brands. Complaint at ¶ 27. *See Westside Ctr. Assocs. v. Safeway Stores 23, Inc.*, 42 Cal. App. 4th 507, 522, 49 Cal. Rptr. 2d 793, 803 (1996) (holding that "a purely hypothetical relationship" does not provide sufficient probability of future economic benefit to the plaintiff to state a claim for tortious interference with prospective economic advantage).

2) BBeautiful has alleged a violation of California Business and Professions Code § 17200, which satisfies the requirement that BBeautiful allege an independently wrongful act. *See Hilderman v. Enea TekSci, Inc.*, 551 F. Supp. 2d 1183, 1197 (S.D. Cal. 2008) ("A violation of section 17200 can satisfy the requirement of an independently wrongful act.").

BBeautiful makes the following arguments in opposition to Rieke's motion to dismiss its third claim for violation of the UCL:

1) Under California law, a covenant not to compete is void and unenforceable. Thus, the Restrictive Covenants are non-existent in California. By asserting the non-existence Restrictive Covenants against BBeautiful, Rieke is engaging in an unlawful business practice. *See Hauk v. JP Morgan Chase Bank USA*, 552 F.3d 1114, 1124 (9th Cir. 2009)

(holding that "asserting a contractual right one does not have may constitute an unfair business practice").

***12** BBeautiful submits a declaration from Ms. Arminak in support of its opposition (the "Arminak Decl."). In the declaration, Ms. Arminak states that Rieke has discouraged customers from doing business with BBeautiful:

1) "I entered into discussions with Henkel about what products they may be able to purchase from my business. Henkel has an extensive beauty care line and was a potential BBeautiful customer. In connection with these discussions, I signed a non-disclosure agreement with Henkel, and discussions were successfully progressing in the fall of 2016. However, I learned from a Henkel employee that on or about November 2, 2016, TriMas' General Counsel [Rieke's parent], Joshua Sherbin, made a call and sent a letter to the corporate offices of Henkel and instructed them not to do business with BBeautiful or have any dealings with me. Since these communications, Henkel has refused to have any further dealings with BBeautiful." Arminak Decl. [Doc. No. 63–1] at ¶ 5.

2) "I also reached out to my contact [at] Avon to gauge his interest in, among other things, developing a face mask. [Associates] did not sell face masks, and did not sell any packaging to Avon while I worked there. I sent my contact at Avon a copy of the signed TRO so that he could see for himself that BBeautiful was not covered by the injunction, but he expressed confusion about who had added the handwritten note. Avon has since stated it will not continue discussions with me or BBeautiful." *Id.* at ¶ 6.

3) "I had the same experience at Coty, another major cosmetic company and potential customer for BBeautiful, which was also not a customer of [Associates] when I worked there. A representative from Coty has also told me that Coty will not have any further dealings with BBeautiful or me." *Id.* at ¶ 7.

4) "In ... discussions regarding the [New York TRO], Defendants' [Rieke's] highest executives discussed telling 'all main customers' about the TRO in order to 'stop [her] in her tracks' " and to " 'stop the customers investing time in specifying her products.' " *Id.* at ¶ 14.

Rieke makes the following arguments in reply to BBeautiful's opposition to dismissal of its first claim for declaratory relief:

1) Rieke has threatened suit against Ms. Arminak but has not threatened suit against BBeautiful. Because there is no threat of litigation against BBeautiful and BBeautiful is not a party to the Purchase Agreements, it lacks standing to challenge the Restrictive Covenants.

2) BBeautiful "argues that the first claim for declaratory relief is ripe for adjudication because it seeks a declaration of [BBeautiful's] 'distinct' rights under the Restrictive Covenants. This argument is directly at odds with [BBeautiful's] standing argument that it does not seek an adjudication of the force and effect of the Restrictive Covenants. (Opp., 9:7) These positions are mutually exclusive: [BBeautiful] either concedes that it wants this Court to interpret and enforce the Restrictive Covenants to its benefit, in which case the [BBeautiful] lacks standing, or [BBeautiful] concedes that it does not want such an adjudication, in which case, the [BBeautiful] has not alleged a case or case or controversy." Reply to MTD at 10.

Rieke objects to the consideration of the Arminak Declaration in the context of a motion to dismiss and moves to strike the Arminak Declaration in its entirety. In the event the Court does consider the Arminak Declaration, Rieke asserts that the statements therein are inadmissible as irrelevant, misleading, and hearsay.

6 All citations refer to the page numbers that are automatically affixed to the top of each page by the Electronic Case Filing (ECF) system upon filing, rather than to the pagination used by the document's preparer.

***13** Rieke does not raise any new arguments in its reply to BBeautiful's opposition to dismissal of the second and third claims for relief.

Summary of BBeautiful's Motion for Summary Judgment, Rieke's Opposition, and BBeautiful's Reply

BBeautiful seeks partial summary judgment on its claim for a declaration that it is entitled to sell finished beauty products. BBeautiful does not seek summary judgment on

its claim for a declaration that it is entitled to sell stand-alone packaging products. BBeautiful seeks a declaration that it is entitled to sell all the beauty products reflected on a list attached to Ms. Arminak's declaration (the "Permitted Beauty Products"). The 418 Permitted Beauty Products include without limitation eyeshadows, blushes, contours, lip balms, lip glosses, makeup tools, skin cleansers, lotions, fragrances, bath and body products, manicure and pedicure products, essential oils, and nail polishes. BBeautiful also seeks a declaration that it is entitled to purchase packaging components to use in the production of the Permitted Beauty Products. BBeautiful asserts that the plain language of the Non–Compete Provision entitles it to sell the Permitted Beauty Products.

In opposition, Rieke states that it has never taken the position that BBeautiful is not permitted to sell finished beauty products. Rieke argues that there is no actual case or controversy for the Court to resolve, and that BBeautiful accordingly lacks standing to seek declaratory relief. Rieke submits the declaration of Mark Box, the vice president and manager of Associates. The Box declaration provides in relevant part: "Defendants have not sued and have no plans to sue BBeautiful based on conduct consisting of selling the finished beauty products listed in the Appendix to the Arminak Declaration, purchasing packaging components for use in the finished products listed in the Appendix, or applying to become a qualified vendor of the finished beauty products listed in the Appendix." Box Decl. at ¶ 4.

In reply, BBeautiful argues that it has standing to seek declaratory relief. BBeautiful argues that the threat of suit is sufficient to create standing, and maintains that the Box Declaration has not eliminated that threat, since the Box Declaration states only that "Defendants ... have no plans to sue BBeautiful." BBeautiful further argues that Rieke's public behavior is inconsistent with its claim that it does not dispute BBeautiful's right to sell finished beauty products, for the following reasons:

1) Rieke sought a TRO in the New York Action which did not contain a carve-out for BBeautiful's business. The New York Court inserted a handwritten exclusion, clarifying that the injunction would not apply to BBeautiful, at the urging of Ms. Arminak's counsel.

2) Since the motion for summary judgment was filed, Rieke has taken a position in the New York Action that contradicts Rieke's position presented to the Bankruptcy Court. In the New York Action, the Arminaks proposed stipulating to converting the New York TRO to a preliminary injunction, provided that the injunction retain the exclusion for BBeautiful. Rieke refused to enter into the stipulation, and seeks to have a preliminary injunction entered omitting the exclusion for BBeautiful. Rieke's position in the New York Action creates an actual controversy sufficient to confer standing upon BBeautiful to pursue its claims.

III. Findings and Conclusions

This Action is Non–Core

***14** This action is not a core proceeding. None of the claims for relief invoke substantive rights created by federal bankruptcy law. "Actions that do not depend on bankruptcy laws for their existence and that could proceed in another court are considered 'non-core.' " *Sec. Farms v. Int'l Bhd. of Teamsters, Chauffers, Warehousemen & Helpers*, 124 F.3d 999, 1008 (9th Cir. 1997). The claims for declaratory relief, tortious interference with prospective economic advantage, and violation of California Business and Professions Code § 17200 could all be brought in state court. The fact that the Complaint seeks to augment the estate cannot transform it into a core proceeding. *See Stern v. Marshall*, 564 U.S. 462, 495 (2011) (finding that a tortious interference claim "that simply attempts to augment the bankruptcy estate" was non-core). Pursuant to 28 U.S.C. § 157(c)(1) and Bankruptcy Rule 9033, the Court's findings and conclusions will be transmitted to the District Court as a Report and Recommendation.

Rieke's Motion to Dismiss BBeautiful's First Claim for Relief is Granted in Part and Denied in Part

At the outset, the Court declines to consider the Arminak Declaration in determining Rieke's motion to dismiss. Consideration of extrinsic evidence is not appropriate in the adjudication of a motion to dismiss. *See Lee v. Los Angeles*, 250 F.3d 688, 690 (9th Cir. 2001).

The Court Declines to Abstain from Hearing this Action

Title 28 U.S.C. § 1334(c)(1) provides in relevant part: "[N]othing in this section prevents a district court in the interest of justice, or in the interest of comity with State courts or respect for State law, from abstaining from

hearing a particular proceeding arising under title 11 or arising in or related to a case under title 11." In *Christensen v. Tucscon Estates, Inc. (In re Tucscon Estates)*, the Ninth Circuit set forth the factors the Court should consider in determining whether to permissively abstain:

> (1) the effect or lack thereof on the efficient administration of the estate if a Court recommends abstention,
>
> (2) the extent to which state law issues predominate over bankruptcy issues,
>
> (3) the difficulty or unsettled nature of the applicable law,
>
> (4) the presence of a related proceeding commenced in state court or other nonbankruptcy court,
>
> (5) the jurisdictional basis, if any, other than 28 U.S.C. § 1334,
>
> (6) the degree of relatedness or remoteness of the proceeding to the main bankruptcy case,
>
> (7) the substance rather than form of an asserted "core" proceeding,
>
> (8) the feasibility of severing state law claims from core bankruptcy matters to allow judgments to be entered in state court with enforcement left to the bankruptcy court,
>
> (9) the burden of [the bankruptcy court's] docket,
>
> (10) the likelihood that the commencement of the proceeding in bankruptcy court involves forum shopping by one of the parties,
>
> (11) the existence of a right to a jury trial, and
>
> (12) the presence in the proceeding of nondebtor parties.

912 F.2d 1162, 1167 (9th Cir. 1990).

Not all the factors are relevant in every case, and the Court is not required to give equal weight to each factor. *Truebro, Inc. v. Plumberex Specialty Products, Inc. (In re Plumberex Specialty Products, Inc.)*, 311 B.R. 551, 560 (Bankr. C.D. Cal. 2004).

Abstention is not appropriate here. Although the Complaint primarily involves state law issues, the declaratory relief that BBeautiful seeks will assist BBeautiful in consummating a plan of reorganization. Therefore, the efficient administration of the estate weighs against abstention. The New York Action is related to this action in the sense that it involves the same contracts, but differs in a key respect since BBeautiful is not a party. The fact that BBeautiful can obtain a declaration as to its rights only in this Court counsels against abstention (factor four). Contrary to Rieke's contentions, the Court does not view this action as forum-shopping by BBeautiful. As noted, the action differs in a fundamental respect from the New York Action (and from the other proceedings the Arminaks have commenced in the District Court) in that BBeautiful is a party.

BBeautiful Has Standing to Seek A Declaration that it is Entitled to Sell Finished Beauty Products

***15** Title 28 U.S.C. § 2201(a) provides in relevant part: "In a case of actual controversy within its jurisdiction ... any court of the United States, upon the filing of an appropriate pleading, may declare the rights and other legal relations of any interested party seeking such declaration, whether or not further relief is or could be sought. Any such declaration shall have the force and effect of a final judgment or decree and shall be reviewable as such."

Here, BBeautiful has standing to seek declaratory relief because an actual controversy exists between BBeautiful and Rieke with respect to BBeautiful's rights to sell finished beauty products. "To establish Article III standing, an injury must be 'concrete, particularized, and actual or imminent; fairly traceable to the challenged action; and redressable by a favorable ruling.' " *Clapper v. Amnesty Int'l USA*, 133 S. Ct. 1138, 1147.

The Complaint sufficiently alleges a "concrete [and] particularized" injury: that Rieke and its employees have "falsely stated to BBeautiful's potential customers and suppliers that they may not do business with BBeautiful," and that these statements "have prevented new customers from transacting with BBeautiful and prevented Helga Arminak from utilizing her long-standing industry contracts to develop and sell existing and new products" on BBeautiful's behalf. Complaint at ¶ 19. The alleged injury is actual—new customers are refusing to buy BBeautiful's existing products. The alleged injury is traceable to Rieke's alleged conduct, and can be

redressed by a ruling declaring the scope of the Non–Compete Provision and the other Restrictive Covenants.

The fact that BBeautiful is not a party to the Purchase Agreements, which contain the Restrictive Covenants, does not defeat BBeautiful's standing. Ms. Arminak is BBeautiful's principal and managing member, Complaint at ¶ 3, and plays a key role in its operations, being responsible for (1) overseeing the design and manufacture of BBeautiful's products, (2) selling BBeautiful's products using her industry contacts, and (3) developing new products, Complaint at ¶¶ 16, 19. Ms. Arminak is a party to the Purchase Agreements. Rieke takes the position that so long as Ms. Arminak is involved in BBeautiful's operations, BBeautiful is constrained by the Restrictive Covenants. *See* MTD at 19 ("[S]o long as Ms. Arminak ... operates, controls or manages [BBeautiful], it cannot sell stand-alone packaging products."). As a result of Ms. Arminak's involvement, BBeautiful is affected by the Restrictive Covenants, and therefore has standing to seek declaratory relief as to their scope.

The cases cited by Rieke, holding that a non-party to a contract lacks standing to enforce a contract, are inapposite. BBeautiful is not seeking to enforce the Purchase Agreements; it is seeking a declaration that the Restrictive Covenants do not restrict it from conducting certain types of business.

Rieke asserts that BBeautiful lacks standing because Rieke has threatened suit against Ms. Arminak but has not threatened suit against BBeautiful. The Court disagrees with Rieke's position. There is extensive litigation between Rieke and Ms. Arminak. As described above, Ms. Arminak is essential to BBeautiful's operations; without Ms. Arminak, it would be much more difficult for BBeautiful to design, manufacture, and sell its products. Therefore, if BBeautiful were to obtain a judgment prohibiting Ms. Arminak from selling or developing certain products, such a judgment would effectively prevent BBeautiful from selling or developing those products. Consequently, BBeautiful is faced with a reasonable apprehension that its ability to develop and sell products (with the assistance of its founder, principal, and manager member Ms. Arminak) could be jeopardized as a result of litigation against Ms. Arminak. Since litigation against Ms. Arminak is, in terms of its practical effects, tantamount to litigation against BBeautiful, BBeautiful has standing to seek declaratory relief. *See Newcal Indus., Inc. v. Ikon Office Sol.*, 513 F.3d 1038, 1056 (9th Cir. 2008) ("[T]he threat of suit is enough to create standing, such that the threatened party may seek a declaration that the threatening party's putative rights are invalid."); *Societe de Conditionnement en Aluminium v. Hunter Eng'g Co., Inc.*, 655 F.2d 938, 944 (9th Cir. 1981) (holding that an "actual threat of litigation" is not required to establish standing; instead, a plaintiff must only meet the "much lower threshhold" of having "a real and reasonable apprehension" of litigation).

BBeautiful's Claim for a Declaration that it is Entitled to Sell Stand–Alone Packaging is Not Ripe for Adjudication

***16** Rieke argues that the action is not ripe for adjudication, based on the fact that BBeautiful alleges only that it may seek to sell stand-alone packaging products in the future. According to Rieke, these plans are too hypothetical and conjectural to create an actual case or controversy that is ripe for adjudication.

As the Ninth Circuit has explained, the concepts of standing and ripeness are closely related:

> To have standing, a plaintiff must have suffered an injury in fact that is "concrete and particularized"; that can be fairly traced to the defendant's action; and that can be redressed by a favorable decision of the court. "While standing is primarily concerned with *who* is a proper party to litigate a particular matter, ripeness addresses *when* litigation may occur." "[I]n many cases, ripeness coincides squarely with standing's injury in fact prong." The ripeness inquiry in some cases may therefore "be characterized as standing on a timeline."
>
> For example, "[a] claim is not ripe for adjudication if it rests upon contingent future events that may not occur as anticipated, or indeed may not occur at all." That is so because, if the contingent events do not occur, the plaintiff likely will not have suffered an injury that is concrete and particularized enough to establish the first element of standing. In this way, ripeness and standing are intertwined.

Bova v. City of Medford, 564 F.3d 1093, 1096 (9th Cir. 2009) (internal citations omitted).

In *Bova*, employees sued the City of Medford, alleging that they were injured by Medford's policy of discontinuing health insurance coverage to city employees after they

retired. *Id.* at 1094. The plaintiffs were current employees of Medford who had not yet retired and thus had not been denied any benefits. *Id.* The Ninth Circuit dismissed the action as unripe, reasoning that the injury was contingent and had not yet occurred:

> [Plaintiff's injury] is contingent upon two events: (1) each Plaintiff's retirement from City service; and (2) the City's official denial of benefits to him or her. It is possible that neither of the two events will occur. Plaintiffs could change jobs, be terminated, or die (though we hope not) before retiring....
>
> Plaintiffs argue that, because the City's current policy would deny them health insurance coverage after they retire, they *may* delay their retirement, *may* leave the City of Medford to join another public employer that provides post-retirement insurance, or *may* make medical decisions differently than they would if they were guaranteed coverage after retiring. The contingencies that they describe are not sufficiently tangible or definite to meet the "concrete and particularized" injury requirement of *Lujan.*

Id. at 1097.

Here, BBeautiful alleges that it "*may* be approached by customers seeking to purchase the packaging designed by BBeautiful for its products," that it "*may* seek to develop and offer for sale packaging that is not of the type and qualify offered" by Rieke, and that it "*may* also seek to offer such packaging, or other packaging, to persons who are not, and have not been, customers" of Rieke. Complaint at ¶ 17 (emphasis added). Like the contingent future events in *Bova*, these contingencies "are not sufficiently tangible or definite to meet the 'concrete and particularized' injury requirement" of *Lujan v. Defenders of Wildlife*, 504 U.S. 555 (1992). *Bova*, 564 F.3d at 1097. Customers might not approach BBeautiful seeking to purchase the packaging that BBeautiful uses for its own products. And BBeautiful's future plans to offer packaging assume that BBeautiful will be sufficiently successful with its existing business to enable it to expand into new product lines. Given that BBeautiful is presently in bankruptcy and is engaged in expensive litigation with Rieke, its future business prospects are uncertain. The Court finds that BBeautiful's claim for a declaration that it is entitled to sell stand-alone packaging is not ripe for adjudication.

***17** Rieke's motion to dismiss BBeautiful's claim for a declaration that it is entitled to sell packaging products is granted. If BBeautiful could have alleged any facts demonstrating that its packaging claims were ripe, it would have already done so. BBeautiful has already amended its Complaint once. In addition, the papers BBeautiful has filed in connection with its plan of reorganization also state only that BBeautiful *may* seek to sell packaging components in the future, without any indication that BBeautiful is selling packaging components at the present time. Therefore, it is clear that at the present time, BBeautiful can allege no facts showing that its packaging claims are ripe. Accordingly, dismissal of the Complaint without leave to amend is appropriate. However, this does not mean that BBeautiful's packaging claims may not become ripe at some point in the future. Therefore, the dismissal is without prejudice to BBeautiful's ability to file a new complaint if and when its packaging claims become ripe. *See Thomas v. Anchorage Equal Rights Comm'n*, 220 F.3d 1134, 1142 (9th Cir. 2000) (dismissing an action without prejudice where the claims were not ripe).

BBeautiful's Second Claim for Tortious Interference with Prospective Economic Advantage is Dismissed Without Leave to Amend

The elements of a claim for tortious interference with prospective economic advantage are as follows: "(1) an economic relationship between the plaintiff and some third party, with the probability of future economic benefit to the plaintiff; (2) the defendant's knowledge of the relationship; (3) intentional acts on the part of the defendant designed to disrupt the relationship; (4) actual disruption of the relationship; and (5) economic harm to the plaintiff proximately caused by the acts of the defendant." *Korea Supply Co. v. Lockheed Martin Corp.*, 63 P.3d 937, 950 (2003). In addition, to

> establish a claim for interference with prospective economic advantage, therefore, a plaintiff must plead that the defendant engaged in an independently wrongful act. An act is not independently wrongful merely because defendant acted with an improper motive. As we said in *Della Penna,* "the law usually takes care to draw lines of legal liability in a way that maximizes areas of competition free of legal penalties." The tort of intentional interference with prospective economic advantage is not intended to punish individuals or commercial entities for their

> choice of commercial relationships or their pursuit of commercial objectives, unless their interference amounts to independently actionable conduct. We conclude, therefore, that an act is independently wrongful if it is unlawful, that is, if it is proscribed by some constitutional, statutory, regulatory, common law, or other determinable legal standard.

Id. at 953–54.

The Complaint does not sufficiently allege the existence of an economic relationship with which Rieke interfered. The Complaint alleges that Rieke disrupted BBeautiful's relationship with Henkel, "a prospective business partner," and that Rieke disrupted BBeautiful's relationship with "other prospective customers ... including Avon, Coty and L Brands." Complaint at ¶ 27. These *prospective* relationships are insufficient to state a claim. "The economic relationship must be either in the form of a contract or an *existing* relationship with an identifiable third party." *Dooley v. Crab Boat Owners Ass'n*, 271 F. Supp. 2d 1207, 1216–17 (N.D. Cal. 2003) (emphasis added). The fact that these entities are alleged to be long-standing industry contacts of Ms. Arminak is insufficient; there is no allegation that there was a previous relationship between the entities and BBeautiful.

In addition, the Complaint fails to allege that Rieke engaged in an independently wrongful act. BBeautiful argues that the allegation that Rieke violated the UCL furnishes the requisite independently wrongful act. However, as discussed below, the Court finds that the Complaint does not state a claim for violation of the UCL. Therefore, the alleged UCL violation cannot furnish the necessary independently wrongful act. *See CRST Van Expedited, Inc. v. Werner Enterprises, Inc.*, 479 F.3d 1099, 1110 (9th Cir. 2007) (holding that an inadequately alleged UCL violation could not supply the requisite independently wrongful act).

***18** The second claim is dismissed without leave to amend. Even if BBeautiful could file an amended complaint alleging facts showing that existing, rather than prospective, economic relationships were disrupted, BBeautiful could not overcome the hurdle of alleging that Rieke engaged in a wrongful act independent of the alleged interference. Accordingly, leave to amend would be futile.

BBeautiful's Third Claim for Violation of the UCL is Dismissed Without Leave to Amend

The UCL prohibits "any unlawful, unfair or fraudulent business act or practice." California Business and Professions Code § 17200. BBeautiful maintains that the Non–Compete Provision is void pursuant to California Business and Professions Code § 16600, which provides that "every contract by which anyone is restrained from engaging in a lawful profession, trade, or business of any kind is to that extent void." BBeautiful argues that Rieke has violated the UCL by asserting the existence of the Restrictive Covenants, when the Restrictive Covenants are void and unenforceable and therefore do not exist under California law.

The Complaint does not state a claim for relief for violation of the UCL. First, the Non–Compete Provision is governed by New York law, and therefore cannot be invalidated by way of California law. However, even if the Non–Compete Provision somehow were subject to California law, it would not be void. California Business and Professions Code § 16601 provides:

> Any person who sells the goodwill of a business, or any owner of a business entity selling or otherwise disposing of all of his or her ownership interest in the business entity, or any owner of a business entity that sells (a) all or substantially all of its operating assets together with the goodwill of the business entity, (b) all or substantially all of the operating assets of a division or a subsidiary of the business entity together with the goodwill of that division or subsidiary, or (c) all of the ownership interest of any subsidiary, may agree with the buyer to refrain from carrying on a similar business within a specified geographic area in which the business so sold, or that of the business entity, division, or subsidiary has been carried on, so long as the buyer, or any person deriving title to the goodwill or

> ownership interest from the buyer, carries on a like business therein.

Here, the Non–Compete Provision was entered into in connection with the sale of Associates to Rieke. *See* 2012 Purchase Agreement at §§ 9.2(a) (attached to Complaint as Ex. A). The 2012 Purchase Agreement provides: "Each Seller Group Member [i.e., the Arminaks] further acknowledges and agrees that the Restrictive Covenants are being entered into by it in connection with the sale by Seller of the Transferred Membership Interests and the goodwill of the Transferred Companies' business [ ] and not directly or indirectly in connection with such Seller Group Members' employment." Because the Non–Compete Provision was entered into in connection with the transfer of Associates' goodwill, the provision is enforceable pursuant to California Business and Professions Code § 16601. Accordingly, the Non–Compete Provision does not violate the UCL.

In addition, BBeautiful's UCL claim fails because BBeautiful cannot show that it has "suffered injury in fact and has lost money or property as a result of unfair competition." California Business and Professions Code § 17204. To make this showing, BBeautiful "must have either prior possession or a vested legal interest in the money or property lost." *Walker v. USAA Cas. Ins. Co.*, 474 F. Supp. 2d 1168, 1172 (E.D. Cal. 2007), *aff'd sub nom. Walker v. Geico Gen. Ins. Co.*, 558 F.3d 1025 (9th Cir. 2009). Because BBeautiful admits that it is currently not selling packaging products, it has no vested legal interest in the money lost as a result of Rieke's alleged interference with BBeautiful's business relationships.

***19** None of the facts alleged in the Complaint, which has already been amended once, give rise to a claim for violation of the UCL. Accordingly, the Court finds that leave to amend would be futile and dismisses the claim for violation of the UCL with prejudice.

BBeautiful's Motion for Partial Summary Judgment is Granted

Summary judgment is appropriate "if the movant shows that there is no genuine dispute as to any material facts and the movant is entitled to judgment as a matter of law." Civil Rule 56 (made applicable to these proceedings by Bankruptcy Rule 7056). The moving party has the burden of establishing the absence of a genuine issue of material fact and that it is entitled to judgment as a matter of law. *Celotex Corp. v. Catrett*, 477 U.S. 317, 323 (1986). "[S]ummary judgment will not lie if the dispute about a material fact is "genuine," that is, if the evidence is such that a reasonable jury could return a verdict for the nonmoving party." *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 248 (1986). "A fact is 'material' only if it might affect the outcome of the case[.]" *Fresno Motors, LLC v. Mercedes Benz USA, LLC*, 771 F.3d 1119, 1125 (9th Cir. 2014). If the moving party shows the absence of a genuine issue of material fact, the nonmoving party must "go beyond the pleadings and by her own affidavits, or by the 'depositions, answers to interrogatories, and admissions on file,' designate 'specific facts showing that there is a genuine issue for trial.' " *Celotex*, 477 U.S. at 324 (quoting Fed. R. Civ. P. 56(e)). The court is "required to view all facts and draw all reasonable inferences in favor of the nonmoving party" when reviewing the Motion. *Brosseau v. Haugen*, 543 U.S. 194, 195 n.2 (2004).

Rieke does not dispute that BBeautiful is entitled to sell the Permitted Beauty Products, and is entitled to purchase packaging to use in manufacturing the Permitted Beauty Products. Rieke argues that BBeautiful lacks standing to seek a declaration that it is entitled to sell the Permitted Beauty Products, because there is no actual case or controversy for the Court to decide. [7] **[Note 5]**

7 Although the Court has analyzed BBeautiful's standing in the context of Rieke's motion to dismiss, that analysis required the Court to assume that all the well-pleaded allegations in the Complaint were true. A separate standing analysis is necessary in the context of BBeautiful's motion for summary judgment.

The Court finds that there is an actual controversy between BBeautiful and Rieke, and that BBeautiful has standing to seek declaratory relief. The November 22 Letter that Rieke issued to its customers stated that any business affiliated with Ms. Arminak was prohibited from competing with Rieke in the packaging business. Although the November 22 Letter did not state that BBeautiful was prohibiting from competing with Rieke in the finished beauty products business, the testimony of Ms. Arminak states that subsequent to issuance of the letter, BBeautiful has had difficulty selling its beauty products. *See* Arminak Decl. [Doc. No. 35] at ¶ 9 ("BBeautiful has recently faced difficulty in selling its

products because of statements made by [Rieke]"). Based upon Ms. Arminak's testimony and upon the November 22 Letter, the Court finds that at least some of the entities who received the November 22 Letter were confused and incorrectly concluded that BBeautiful was not authorized to sell them finished beauty products. The Court finds that BBeautiful is entitled to declaratory relief to remediate this confusion.

***20** In making the finding that customers were confused by the November 22 Letter, the Court does not find that the November 22 Letter was misleading or failed to accurately describe the terms of the New York TRO. Rather, this confusion was likely the result of customers receiving the letter, not spending the time to discern the precise terms of the injunction, and deciding in an abundance of caution to avoid conducting any business with BBeautiful.

In addition, in the New York Action, Rieke has taken the position that the New York TRO should be converted into a preliminary injunction that does not contain an exclusion for BBeautiful. *See* Reply Memorandum of Law in Support of Rieke–Arminak Corp. and Arminak & Associates, LLC's Motion for a Preliminary Injunction [Doc. No. 107, New York Action] ("Plaintiffs argue that any injunction must expressly exclude BBeautiful. Given that BBeautiful is not a party to the Agreements or to this litigation, there is no need to 'exclude' BBeautiful from any order entered by this Court."). [8] **[Note 6]** Although any preliminary injunction entered by the New York Court would, consistent with the New York TRO, presumably enjoin only the sale of packaging components, BBeautiful's customers could still be confused as to the scope of the injunction absent an express carve-out for BBeautiful. The posture of the dispute in the New York Action provides BBeautiful standing to seek declaratory relief before this Court.

8 The Court may take judicial notice of the Reply Memorandum, even though it has not been filed in this Court (probably because the Reply Memorandum was submitted to the New York Court after the briefing deadlines before this Court had expired).

Having found that BBeautiful has standing to seek declaratory relief, and noting that Rieke does not dispute that the Non–Compete Provision does not bar BBeautiful from selling the Permitted Products, the Court finds that BBeautiful is entitled to a declaration that it may sell the Permitted Beauty Products. The plain language of the Non–Compete Provision clearly permits BBeautiful to sell the Permitted Beauty Products.

IV. Conclusion

The Court recommends that the District Court adopt all the findings of fact and conclusions of law set forth herein, and enter judgment as follows:

1) Enter judgment that BBeautiful is entitled to a declaration that it may (a) sell the Permitted Beauty Products and may (b) acquire packaging for the purpose of manufacturing the Permitted Beauty Products.

2) Dismiss BBeautiful's claim that it is entitled to a declaration that it may sell stand-alone packaging products, on the ground that the claim is not ripe for adjudication, with such dismissal being without prejudice to BBeautiful's ability to file a new complaint if and when the packaging claims become ripe; but deny BBeautiful leave to amend the existing complaint, based upon the finding that at the present time, BBeautiful can allege no facts showing that its packaging claims are ripe.

3) Dismiss with prejudice BBeautiful's claim for tortious interference with prospective economic advantage.

4) Dismiss with prejudice BBeautiful's claim for violation of the UCL.

All Citations

Not Reported in B.R., 2017 WL 932945

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Exhibit 2

2018 WL 3748816
Only the Westlaw citation is currently available.
NOT FOR PUBLICATION
United States Bankruptcy Appellate
Panel of the Ninth Circuit.

IN RE: Kristine L. ADAMS, Debtor.
Kristine L. Adams, Appellant,
v.
Newport Crest Homeowners Association, Inc., Appellee.

BAP No. CC-17-1224-KuFS
|
Bk. No. 8:09-bk-12450-TA
|
Adv. No. 8:16-ap-01238-TA
|
Submitted Without Argument on July 27, 2018
|
Filed – August 7, 2018

Appeal from the United States Bankruptcy Court for the Central District of California, Honorable Theodor C. Albert, Bankruptcy Judge, Presiding

Attorneys and Law Firms

Appellant Kristine L. Adams pro se on brief;

Brian R. Nelson of Ringstad & Sanders, LLP on brief for Appellee Newport Crest Homeowners Association, Inc.

Before: KURTZ, FARIS, and SPRAKER, Bankruptcy Judges.

MEMORANDUM [*]

[*] 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 8024-1.

INTRODUCTION

***1** Kristine Lynne Adams sued Newport Crest Homeowners Association, Inc. (NCHOA) and others in the California state court seeking damages and remediation of her condominium due to water intrusion, mold, and other issues. The parties mediated their dispute and reached a settlement. Due to NCHOA's failure to repair and remediate her property, Ms. Adams moved to enforce the settlement agreement. The state court denied her request and dismissed the lawsuit because it had settled. Ms. Adams appealed the dismissal and at the same time filed a second lawsuit to enforce the settlement agreement. Both matters were pending when she filed a chapter 7 [1] bankruptcy petition.

[1] 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, and all "Civil Rule" references are to the Federal Rules of Civil Procedure.

Postpetition, Ms. Adams filed a reply in the dismissal appeal. The California Court of Appeal later affirmed the trial court's decision. Ms. Adams received her § 727 discharge and her case was closed. NCHOA then successfully moved for its fees and costs in the state court on the basis that it was the prevailing party in Ms. Adams' litigation to enforce the settlement agreement and her appeal of the dismissal of the first lawsuit. Ms. Adams appealed that ruling which was affirmed. NCHOA moved again for its attorney's fees and costs on appeal which were again granted. Meanwhile, in the second lawsuit after a trial, the jury found that NCHOA breached the settlement agreement and awarded Ms. Adams damages.

NCHOA then reopened Ms. Adams bankruptcy case and filed an adversary complaint. NCHOA alleged that its fee awards were excepted from Ms. Adams' discharge under the return to the fray doctrine. Therefore, it sought to setoff or recoup its fee awards against Ms. Adams' judgment in the second lawsuit. In granting NCHOA's motion for summary judgment, the bankruptcy court found that its fee awards were excepted from discharge under the return to the fray doctrine and that NCHOA was entitled to offset and recoup its fee awards against Ms. Adams' judgment claim. This appeal followed.

For the reasons explained below, we AFFIRM the bankruptcy court's grant of summary judgment on NCHOA's first claim for relief finding that the fee awards were excepted from discharge under the return to the fray doctrine. We VACATE the bankruptcy court's grant of summary judgment on NCHOA's claims for setoff and

recoupment and remand with instructions to dismiss these claims without prejudice for lack of jurisdiction.

FACTUAL BACKGROUND

A. The First Lawsuit And Ms. Adams' Bankruptcy

In 2005, Ms. Adams filed a lawsuit against NCHOA and others in the California Superior Court titled *Adams v. Newport Crest Homeowners Association, et al.*, O.C.S.C. Case No. 05CC05516 (First Lawsuit). Ms. Adams alleged bodily injury and property damages arising out of water intrusion and mold in her condominium unit.

***2** In November 2006, before trial, Ms. Adams, NCHOA, and other defendants went to mediation which resulted in a signed settlement agreement and release between the parties. The settlement had a monetary component in the amount of $500,000.00, and a performance component that required NCHOA to remediate and repair Ms. Adams' condominium. The agreement also contained an attorney's fee provision that authorized an award of reasonable attorney's fees and costs to the prevailing party in a dispute to enforce the agreement. Finally, if a dispute arose pertaining to the agreement, the parties agreed to submit the dispute first to a mediator and if issues remained unresolved, the state court would retain jurisdiction to enforce the terms of the settlement.

In June 2007, Ms. Adams filed a motion to enforce the settlement agreement in the state court, asserting that NCHOA had breached the agreement by failing to repair and remediate her property. NCHOA opposed the motion and filed an ex parte application demanding that the state court order the parties to mediation which was required under the terms of the settlement agreement. The state court granted NCHOA's ex parte application, and ordered the parties to mediate their dispute before additional litigation took place.

For reasons that are not completely clear from the record, no mediation took place. The state court sua sponte issued an order to show cause why the First Lawsuit should not be dismissed. After a hearing, the state court ordered the First Lawsuit dismissed on the basis that the matter had been settled. The state court later denied Ms. Adams' motion for reconsideration of the dismissal. Ms. Adams appealed the state court's dismissal and filed her opening brief in late 2008 (First Appeal). NCHOA filed its brief in January 2009.

On March 23, 2009, Ms. Adams filed her chapter 7 bankruptcy case. After her bankruptcy filing, Ms. Adams filed a reply brief in the First Appeal, seeking a reversal of the order dismissing the First Lawsuit, a determination of the validity and enforceability of the settlement agreement, and an award of attorney's fees on appeal against NCHOA.

In September 2009, the California Court of Appeal affirmed the state court's dismissal order. The Court of Appeal found that the court had correctly interpreted the settlement agreement to mean that there would be no court litigation over whether NCHOA had breached its obligations under the settlement agreement without first giving a mediator an opportunity to resolve the dispute.

On November 24, 2009, Ms. Adams filed an amended Schedule F which listed NCHOA as a creditor which was owed attorney's fees and costs on appeal in an unknown amount.

On December 2, 2009, Ms. Adams received her § 727 discharge and her no asset case closed shortly thereafter.

A few weeks after the bankruptcy case was closed, NCHOA filed a motion in the state court seeking attorney's fees and costs incurred in connection with opposing Ms. Adams' motion to enforce the settlement agreement and her First Appeal. NCHOA asserted that it was the prevailing party and entitled to its fees and costs under the terms of the settlement agreement. In August 2010, the state court granted NCHOA's motion, awarding $59,746.26 in attorney's fees and costs, plus interest (First Fee Award).

Ms. Adams appealed from this decision (Second Appeal). In March 2012, the court of appeal affirmed the fee award. In June 2012, NCHOA again filed a motion for attorney's fees and costs incurred in opposing Ms. Adams' Second Appeal (Second Fee Award). On September 6, 2012, the state court granted NCHOA's motion, awarding it $17,296.00 in attorney's fees and costs plus interest against Ms. Adams. On October 26, 2012, the state court entered a final fee award which included the First and Second Fee Awards and accrued interest for a total of $89,705.15 (collectively, the Fee Award).

B. Second Lawsuit

***3** In October 2007, prior to the petition date and dismissal of the First Lawsuit, Ms. Adams filed a second action against NCHOA and other defendants in the California Superior Court titled *Adams v. Newport Crest Homeowners Association, et al.*, O.C.S.C. Case No. 07CC01390 (Second Lawsuit). The complaint alleged fifteen causes arising under the agreement.

In January 2008, NCHOA filed a demurrer, arguing that Ms. Adams' fifteen causes of action boiled down to two legal claims: fraudulent inducement to enter into the settlement agreement and breach of the settlement agreement. NCHOA further argued that the first set of claims was barred by the litigation privilege and that the second set of claims had already been fully adjudicated in the First Lawsuit. Although the state court held a hearing on the demurrer in May 2008, it declined to rule on it due to Ms. Adams' pending appeal of the trial court's dismissal of the First Lawsuit.

The Second Lawsuit was reinstated in February 2011, long after the closing of Ms. Adams' bankruptcy case. On May 2, 2011, the state court sustained NCHOA's demurrer to Ms. Adams' complaint without leave to amend. However, on the following day, the state court, sua sponte, vacated its order and took the matter under submission to further consider the parties' written and oral arguments.

Ms. Adams filed a request for further briefing. She represented to the court that subsequent to the decision in the First Appeal, she attended mediation in January 2010. Because the dispute was not settled, Ms. Adams argued that she was entitled to seek a judicial resolution of NCHOA's alleged breach of the settlement agreement. The trial court declined her request for additional briefing.

Thereafter, the court sustained the demurrer without leave to amend, finding that Ms. Adams' causes of action were either barred by the litigation privilege (for pre-settlement conduct) or res judicata in the First Lawsuit. The Second Lawsuit was dismissed. NCHOA moved for an award of attorney's fees and costs. On August 15, 2011, the state court awarded it $37,336.00 in fees and costs, plus interest against Ms. Adams.

Ms. Adams appealed, seeking to overturn the judgment of dismissal. On August 16, 2012, the court of appeal issued an opinion reversing the judgment of dismissal and award of attorney's fees and remanded the matter for further proceedings. The court of appeal explained that the trial court had misinterpreted its ruling affirming the dismissal of the First Lawsuit. The court of appeal stated that if the mediator did not resolve the matter, the trial court had jurisdiction to do so. Since Ms. Adams contended that she had submitted the matter to mediation — although it did not settle — the court of appeal found that she could now seek a judicial remedy. Due to the reversal of the dismissal, the court of appeal found that the trial court's award of attorney's fees and costs to NCHOA must also fail.

Ms. Adams' fifth amended complaint became the operative complaint in the Second Lawsuit. It alleged two causes of action: breach of contract against the signatories to the settlement agreement in the First Lawsuit and intentional infliction of emotional distress.

On May 29, 2015, NCHOA served on Ms. Adams a settlement offer under Cal. Code of Civ. Proc. § 998 for $110,000 plus a waiver of the Fee Award in the amount of $89,705.15 (998 Offer). Ms. Adams did not accept the 998 Offer and the matter went to trial on May 16, 2016. The jury rendered a verdict on June 2, 2016, finding in favor of Ms. Adams and awarding her damages in the amount of $142,599.00. On August 5, 2016, the state court entered judgment on the jury's verdict.

***4** Thereafter, the state court held a hearing on Ms. Adams' motion for a new trial. The court denied the motion in its entirety. About two weeks later, the state court held a hearing on Ms. Adams' motion for prejudgment interest. The court granted the motion in part, and denied it in part, awarding Ms. Adams $80,679.71 in prejudgment interest.

On September 2, 2016, Ms. Adams filed a notice of appeal from the final judgment and other orders from 2015 and 2016. She also served a motion for an award of attorney's fees in the amount of $283,626.15 and costs in the amount of $55,915.15.

C. The 998 Issue and Reopening of the Bankruptcy Case

A dispute arose between NCHOA and Ms. Adams over whether she was a prevailing party in the Second Lawsuit entitled to attorney's fees and costs. In opposition to Ms. Adams' motion for attorney's fees and costs, NCHOA argued that she was not entitled to fees and costs under the

plain terms of the settlement agreement and also because she did not obtain a more favorable judgment than the 998 Offer. According to NCHOA, its 998 Offer consisted of $110,347.52 in cash and also its waiver of the Fee Award which made the 998 Offer worth $220,347.52. NCHOA contended that Ms. Adams' judgment plus interest and costs was less.

NCHOA also disputed Ms. Adams' contention that the Fee Award was discharged during her bankruptcy in 2009. NCHOA pointed out that Ms. Adams never argued in her appeal of the First Fee Award that it had been discharged thereby waiving her right to raise this argument. NCHOA also contended the Fee Award was not discharged under the return to the fray doctrine. Finally, NCHOA contended that it was entitled to an offset for the judgment it obtained against Ms. Adams and that the doctrine of recoupment applied.

On September 28, 2016, NCHOA filed a motion to reopen Ms. Adams' bankruptcy case seeking to have the bankruptcy court decide these issues and to ensure that NCHOA did not inadvertently violate the discharge injunction.

D. The Bankruptcy Court's Rulings

The bankruptcy court granted NCHOA's motion to reopen Ms. Adams' bankruptcy case. NCHOA filed an adversary complaint alleging five claims for relief: (1) declaratory relief determining that the Fee Award was not discharged based on the return to the fray doctrine; (2) declaratory relief determining that Ms. Adams was equitably estopped from arguing that the Fee Award was discharged because she never raised the discharge in opposing the fees; (3) declaratory relief determining that Ms. Adams waived her right to assert that the Fee Award was discharged because she failed to assert that NCHOA's claims for attorney's fees and costs were discharged in the bankruptcy case prior to entry of the judgment in the Second Lawsuit; (4) to allow NCHOA to set off the Fee Award against Ms. Adams' judgment; and (5) to allow NCHOA to recoup the Fee Award against Ms. Adams' judgment.

Ms. Adams filed an answer and asserted various counterclaims, including (1) damages and sanctions against NCHOA for violating the discharge injunction; (2) declaratory relief determining that NCHOA's 998 Offer was not valid; and (3) setoff in relation to amounts incurred by Ms. Adams in litigating her Second Lawsuit and amounts allegedly seized from Ms. Adams' bank account under a default judgment in a collection action.

NCHOA filed a motion for summary judgment on its complaint. The bankruptcy court granted in part and denied in part the motion for summary judgment. On the first claim for relief, the bankruptcy court decided as a matter of law that the Fee Award was not discharged under the return to the fray doctrine. On the fourth claim for relief, the court found as a matter of law that NCHOA's setoff rights survived the bankruptcy discharge and that all elements for setoff under § 553 were met. Finally, on the fifth claim for relief, the bankruptcy court found as a matter of law that NCHOA could recoup the Fee Award against Ms. Adams' claim as the claims arose out of the same transaction. The court reasoned that the First Lawsuit directly led to both the Fee Award and Ms. Adams' judgment against NCHOA and thus were logically related to each other. The court denied the motion as to the second and third claims for relief.

***5** At the same time, NCHOA filed a motion to dismiss Ms. Adams counter-claims under Civil Rule 12(b)(6). NCHOA argued that her claim for damages for the alleged violation of the discharge injunction and her request for setoff should be dismissed with prejudice on the grounds that res judicata (claim preclusion) applied because both claims were litigated or could have been litigated in prior proceedings that resulted in final adjudications on the merits that involved the same parties. NCHOA further argued that the Fee Award was not discharged because (1) Ms. Adams returned to the fray; (2) Ms. Adams' should be equitably estopped from asserting that the Fee Award was discharged; and (3) Ms. Adams waived her right to assert the Fee Award was discharged. Finally, NCHOA argued that Ms. Adams' claim for setoff failed to state a claim for relief because none of the claims she sought to use for setoff were actual obligations for which NCHOA was responsible.

The bankruptcy court granted the motion to dismiss on Ms. Adams' first claim for relief for NCHOA's alleged violation of the discharge injunction without prejudice. The court found that the claim was barred by the doctrine of claim preclusion. The court abstained from deciding the second claim regarding the validity of the 998 Offer. Finally, the court granted the motion to dismiss the third claim for relief for setoff without prejudice on the

grounds that Ms. Adams had failed to allege that she had a judgment against NCHOA for the amounts allegedly seized or that NCHOA had any obligation to pay those funds to her. The court further stated that the counter-complaint did not mention § 553 and that Ms. Adams should seek setoff in the state court. Accordingly, Ms. Adams' first and third counter claims survived the motion to dismiss with leave to amend.

The bankruptcy court entered orders on its rulings in connection with NCHOA's motion to dismiss and summary judgment. Ms. Adams filed a premature notice of appeal from these orders.

Ms. Adams filed an amended counter-complaint, adding a sole cause of action for "false claim/fraud," alleging that NCHOA's filing of its proof of claim was false and fraudulent. She did not amend her first and third counter claims.

About the same time, NCHOA moved for leave to amend its complaint to withdraw two claims for relief that it did not intend to pursue and for judgment on the amended complaint. NCHOA also moved to dismiss all claims in Ms. Adams' amended counter complaint with prejudice.

Before these motions were heard in the bankruptcy court, NCHOA moved to dismiss Ms. Adams' appeal to this Panel as interlocutory. The parties entered into a stipulation asking the Panel to suspend its adjudication of NCHOA's motion to dismiss until the final motions were heard in the bankruptcy court. The Panel subsequently entered an order approving the suspension.

Meanwhile, the bankruptcy court heard NCHOA's motions on November 30, 2017. The bankruptcy court granted NCHOA's motion to dismiss Ms. Adams' amended counter-complaint. The court found there was no need to "re-dismiss" Ms. Adams' first and third counterclaims as those had already been dismissed and "technically" she was barred from reasserting those claims because of her failure to timely amend. The court dismissed her amended claim for relief with prejudice.

The court also granted NCHOA leave to amend the complaint and then later entered judgment on NCHOA's amended complaint. The court entered judgment on the first claim for relief, finding that the Fee Award was not discharged under the return to the fray doctrine. The second and third claims for relief were withdrawn in the amended complaint. The bankruptcy court entered judgment on the fourth claim for relief, finding that NCHOA was entitled to use the Fee Award to set off against Ms. Adams' judgment under § 553(a). The bankruptcy court also found in favor of NCHOA on the fifth claim for relief, finding that it was entitled to use the Fee Awards to recoup against Ms. Adams' judgment. After entry of the bankruptcy court's judgment, this appeal proceeded.

JURISDICTION

***6** The bankruptcy court had jurisdiction pursuant to 28 U.S.C. §§ 1334 and 157(b)(2)(I) to construe the scope of the discharge injunction. For the reasons discussed below, we conclude that the bankruptcy court did not have jurisdiction over NCHOA's claims for setoff and recoupment. We have jurisdiction under 28 U.S.C. § 158.

ISSUES

Whether the bankruptcy court erred in granting summary judgment in favor of NCHOA on the basis that NCHOA's Fee Award was excepted from discharge under the return to the fray doctrine;

Whether the bankruptcy court had jurisdiction to determine NCHOA's claims for setoff and recoupment.

STANDARDS OF REVIEW

We review summary judgment orders de novo. *Tobin v. San Souci Ltd. P'ship (In re Tobin)*, 258 B.R. 199, 202 (9th Cir. BAP 2001). Viewing the evidence in the light most favorable to the non-moving party, we must determine "whether there are any genuine issues of material fact and whether the trial court correctly applied relevant substantive law." *Id.*

When reviewing an order granting summary judgment, we may neither weigh the evidence nor determine the truth of the matter, but only determine whether there is a genuine issue for trial. *Abdul–Jabbar v. Gen. Motors Corp.*, 85 F.3d 407, 410 (9th Cir. 1996). We may affirm an order granting summary judgment on any ground supported by

the record. *Simo v. Union of Needletrades, Indus. & Textile Employs.*, 322 F.3d 602, 610 (9th Cir. 2003).

Summary judgment may be appropriate when a mixed question of law and fact involves undisputed underlying facts. *Citicorp Real Estate, Inc. v. Smith*, 155 F.3d 1097, 1103 (9th Cir. 1998). "[W]here the underlying facts are undisputed, a [bankruptcy] court is free, on a motion for summary judgment, to determine whether the established facts satisfy the statutory standard." *Miller v. Schuman (In re Schuman)*, 81 B.R. 583, 586 n.1 (9th Cir. BAP 1987). Summary judgment is improper, however, if material factual issues exist for trial. *Simo*, 322 F.3d at 610.

Whether a debtor's post-discharge conduct exposes him or her to attorney's fees liability arising from a prepetition contract is a mixed question of law and fact that "require[s] the consideration of legal concepts and involve[s] the exercise of judgment about the values underlying legal principles," and is therefore subject to de novo review. *Suzy's Zoo v. Comm'r*, 273 F.3d 875, 878 (9th Cir. 2001) (a mixed question "exists when primary facts are undisputed and ultimate inferences and legal consequences are in dispute").

We review the bankruptcy court's subject matter jurisdiction over NCHOA's claims for setoff and recoupment de novo. *Harris v. Wittman (In re Harris)*, 590 F.3d 730, 736 (9th Cir. 2009). We also review de novo whether the bankruptcy court had supplemental jurisdiction under 28 U.S.C. § 1367(a) over NCHOA's claims for setoff and recoupment. *Trs. of the Constr. Indus. and Laborers Health and Welfare Trs. v. Desert Valley Landscape & Maint., Inc.*, 333 F.3d 923, 925 (9th Cir. 2003).

DISCUSSION

A. Exception to Discharge: Return to the Fray Doctrine

Section 727 discharges the debtor from all debts that arose before the date of the order for relief. The Code defines "debt" as "liability on a claim." § 101 (12). "Claim" is defined as a "right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal equitable, secured, or unsecured." § 101(5)(A). Whether a claim exists generally is determined as of the date of the bankruptcy petition. This "broadest possible definition" of claim is designed to ensure that "all legal obligations of the debtor, no matter how remote or contingent, will be able to be dealt with in the bankruptcy case." *SNTL Holdings Corp. v. Centre Ins. Co. (In re SNTL Corp.)*, 571 F.3d 826, 839 (9th Cir. 2009) (citing *Cal. Dep't of Health Servs. v. Jensen (In re Jensen)*, 995 F. 2d 925, 929 (9th Cir. 1993)).

***7** Under Ninth Circuit law, "[a] claim is 'contingent' when 'the debtor will be called upon to pay [it] only upon the occurrence or happening of an extrinsic event which will trigger the liability of the debtor to the alleged creditor,' " and "[a] claim is 'unliquidated' when it is not 'subject to ready determination and precision in computation of the amount due.' " *Piceme Constr. Corp. v. Castellino Villas, A.K.F. LLC (In re Castellino Villas, A.K.F. LLC)*, 836 F.3d 1028, 1033 (9th Cir. 2016) (citing *Fostvedt v. Dow (In re Fostvedt)*, 823 F.2d 305, 306 (9th Cir. 1987)). The Ninth Circuit applies the "fair contemplation" test for determining whether a contingent or unmatured claim has sufficiently arisen as of the petition date to constitution a pre-petition claim. *Id.* at 1034.

Under this test, "a claim arises when a claimant can fairly or reasonably contemplate the claim's existence even if a cause of action has not yet accrued under nonbankruptcy law." *Id.* (*quoting In re SNTL Corp.*, 571 F.3d at 839).

Here, NCHOA acknowledges that prior to the petition date it could reasonably contemplate that it would have claims for attorney's fees and costs in the pending appeal of the dismissal of the First Lawsuit and in the Second Lawsuit if it was a prevailing party in either matter. Therefore, these attorney's fee claims were contingent claims as of the petition date under the fair contemplation test.

Section 542(a) prescribes the legal effect of a discharge:

> (a) A discharge in a case under this title—... (2) operates as an injunction against the commencement or continuation of an action, the employment of process, or an act, to collect, recover or offset any such debt as a personal liability of the debtor, whether

> or not discharge of such debt is waived[.]

"The purpose of the discharge injunction is to protect the debtor from having to put on a defense in an improvident state court action or otherwise suffer the costs, expense and burden of collection activity on discharged debts." *Emmert v. Taggart (In re Taggart)*, 548 B.R. 275, 286 (9th Cir. BAP 2016) (citing *In re Eastlick*, 349 B.R. 216, 229 (Bankr. D. Idaho 2004), *aff'd* 888 F.3d 438 (9th Cir. 2018).

While a discharge in bankruptcy generally relieves a debtor from all prepetition debts, the Ninth Circuit has adopted a different standard for determining for discharge purposes when an attorney's fee claim arises. "Under that standard, even if the underlying claim arose prepetition, the claim for fees incurred postpetition on account of that underlying claim is deemed to have arisen postpetition if the debtor 'returned to the fray' postpetition by voluntarily and affirmatively acting to commence or resume the litigation with the creditor." *Id.* at 288-89 (citing *Bechtold v. Gillespie (In re Gillespie)*, 516 B.R. 586, 591 (9th Cir. BAP 2014) (citing *Boeing N. Am., Inc. v. Ybarra (In re Ybarra)*, 424 F.3d 1018, 1026-27 (9th Cir. 2005)). The rule prevents a debtor from using the discharge injunction as a sword that enables him or her to undertake risk-free postpetition litigation at others' expense. Id. "The *Ybarra* rule applies regardless of whether the litigation begins prepetition or postpetition, regardless of the nature of the underlying claim, and regardless of the forum in which the postpetition litigation takes place." *Id.*

Here, NCHOA's contingent attorney's fee claims, whether in connection with the First Lawsuit or the Second Lawsuit, were discharged and subject to the discharge injunction. However, the undisputed facts show that Ms. Adams voluntarily and affirmatively resumed the litigation with NCHOA postpetition in connection with her appeal of the state court's order dismissing her First Lawsuit. The record shows that Ms. Adams filed her reply brief in the appeal postpetition. After her discharge, she opposed NCHOA's motion for attorney's fees. After the trial court awarded NCHOA's its attorney's fees, Ms. Adams appealed that decision. She ignored her discharge and voluntarily and affirmatively sought relief by objecting to NCHOA's request for fees and seeking to overturn those fees in her appeal. In other words, she returned to the fray.

***8** Likewise, the undisputed facts show that Ms. Adams resumed her efforts in prosecuting the Second Lawsuit against NCHOA postpetition. While Ms. Adams' discharge did not prevent NCHOA from putting on a defense in the Second Lawsuit, it did prevent NCHOA from seeking affirmative relief on prepetition claims such as prevailing party attorney's fees based on the parties' prepetition settlement agreement. After NCHOA won its demurrer and successfully moved for attorney's fees and costs, Ms. Adams pursued an appeal and voluntarily and affirmatively took actions to resume the litigation with NCHOA and otherwise return to the fray. Ultimately, Ms. Adams was successful in the Second Lawsuit.

Based on the undisputed facts, we conclude that Ms. Adams returned to the fray by continuing her litigation against NCHOA postpetition. Therefore, under the *Ybarra* rule, NCHOA's Fee Award in the First Lawsuit is deemed to have arisen postpetition and is excepted from her discharge. NCHOA's award of attorney's fees and costs in the Second Lawsuit is also deemed to have arisen postpetition. But for the reversal of that award by the state appellate court, it would be excepted from her discharge thereby negating any potential violation of the discharge injunction. Accordingly, the bankruptcy court properly granted summary judgment on NCHOA's first claim for relief. [2]

2 Because we affirm the bankruptcy court's grant of summary judgment on NCHOA's first claim for relief under the return to the fray doctrine it is unnecessary to reach the court's ruling based on preclusion, on the dismissal of Ms. Adams' first counterclaim for violation of the discharge injunction.

B. Setoff And Recoupment

We may raise the question of the bankruptcy court's jurisdiction at any time sua sponte during the pendency of the action, even on appeal and when not raised by the parties. *See Snell v. Cleveland, Inc.*, 316 F.3d 822, 826 (9th Cir. 2002).

1. Subject Matter Jurisdiction

A bankruptcy court's subject matter jurisdiction is established by statute. Under 28 U.S.C. § 1334(b),

a bankruptcy court has jurisdiction over "all civil proceedings arising under title 11, or arising in or related to cases under title 11." "Arising under title 11" describes those proceedings that involve a cause of action created or determined by a statutory provision in the bankruptcy code. *In re Harris*, 590 F.3d at 737. "Proceedings 'arising in' a bankruptcy are generally referred to as 'core' proceedings, and essentially are proceedings that would not exist outside of bankruptcy...." *Montana v. Goldin (In re Pegasus Gold Corp.)*, 394 F.3d 1189, 1193 (9th Cir. 2005); *see also Battleground Plaza, LLC v. Ray (In re Ray)*, 624 F.3d 1124, 1131 (9th Cir. 2010). A nonexhaustive list of core proceedings is set out in 28 U.S.C. § 157(b)(2).

The bankruptcy court also has jurisdiction over "those proceedings that are 'related to' a bankruptcy case." *In re Pegasus Gold Corp.*, 394 F.3d at 1193. "[T]he test is whether ... the outcome of the proceeding could conceivably have any effect on the estate being administered in bankruptcy. Thus, the proceeding need not necessarily be against the debtor or against the debtor's property. An action is related to bankruptcy if the outcome could alter the debtor's rights, liabilities, options, or freedom of action (either positively or negatively) and which in any way impacts upon the handling and administration of the bankrupt estate." *Id.* (quoting *Fietz v. Great W. Savings (In re Fietz)*, 852 F.2d 455, 457 (9th Cir. 1988)) (adopting the "Pacor test" derived from *Pacor, Inc. v. Higgins*, 743 F.2d 984, 994 (3d Cir. 1984)). The United States Supreme Court endorsed Pacor's conceivability standard with the caveats that "related to" jurisdiction "cannot be limitless," and that the critical component of the Pacor test is that "bankruptcy courts have no jurisdiction over proceedings that have no effect on the estate of the debtor." *Celotex Corp. v. Edwards*, 514 U.S. 300, 308 & n.6 (1995).

***9** Although the bankruptcy court plainly had core jurisdiction to interpret and enforce the discharge order, we consider whether the bankruptcy court had jurisdiction over NCHOA's claims to allow setoff and recoupment of its Fee Award against Ms. Adams' judgment awarded against NCHOA in the Second Lawsuit.

The lawsuits which resulted in the Fee Award and Ms. Adams' judgment claim were abandoned to Ms. Adams under § 554(c). Thus, Ms. Adams' judgment claim belongs to her personally and, as explained above, the Fee Award has not been discharged and thus NCHOA may pursue collection of that award against Ms. Adams. Therefore, NCHOA's claims for setoff and recoupment do not impact the handling and administration of Ms. Adams' estate and are easily separable from the bankruptcy case.

Furthermore, NCHOA's claims for setoff and recoupment did not require the bankruptcy court to interpret or enforce the discharge order. Valid prepetition rights to setoff survive the general discharge of debts. *See Carolco Television, Inc. v. Nat'l Broad. Co. (In re De Laurentiis Entm't Group Inc.)*, 963 F.2d 1269, 1276 (9th Cir. 1992); *Camelback Hosp., Inc. v. Buckenmaier (In re Buckenmaier)*, 127 B.R. 233, 237 (9th Cir. BAP 1991). In addition, as recoupment is neither a claim nor a debt, it is unaffected by the debtor's discharge. *Oregon v. Harmon (In re Harmon)*, 188 B.R. 421, 425 (9th Cir. BAP 1995). In short, Ms. Adams' discharge would not be a bar to NCHOA's defensive use of setoff or recoupment.

In addition, NCHOA's substantive right to setoff and recoupment under § 553 is governed by California law. California law clearly recognizes the right to setoff, setting forth procedures for setoff in Cal. Code Civ. Proc. § 431.70, and a defense of equitable recoupment is a species of setoff. Simply put, NCHOA's setoff and recoupment rights are recognized in California and exist independent of Ms. Adams' bankruptcy case.

Against this background, we conclude that the bankruptcy court did not have subject matter jurisdiction over NCHOA's claims for relief on setoff and recoupment. Those claims did not arise under title 11 nor can they be considered core proceedings "arising in" the bankruptcy as the claims exist outside the bankruptcy as California state law affirmative defenses. The claims also do not fall within the "related to" category for noncore proceedings. The setoff and recoupment claims could not have any conceivable effect on Ms. Adams' estate. Regardless whether NCHOA is successful or not with its claims of setoff and recoupment in the state court, Ms. Adams' estate is not impacted. Her case is closed and there is no estate to administer.

2. Supplemental Jurisdiction

Although not discussed or determined by the bankruptcy court, we also consider whether the bankruptcy court had supplemental jurisdiction over the setoff and recoupment

claims. 28 U.S.C. § 1367, entitled "Supplemental jurisdiction," states:

> (a) Except as provided in subsections (b) and (c) or as expressly provided otherwise by Federal statute, in any civil action of which the district courts have original jurisdiction, the district courts shall have supplemental jurisdiction over *all other claims that are so related to claims in the action within such original jurisdiction that they form part of the same case or controversy under Article III of the United States Constitution.* [Emphasis added.] Such supplemental jurisdiction shall include claims that involve the joinder or intervention of additional parties.

***10** This provision codified the Supreme Court's holding in *United Mine Workers v. Gibbs* that federal courts have jurisdiction over a state law claim where it and the federal claim "derive from a common nucleus of operative fact," so "the relationship between [the federal] claim and the state claim permits the conclusion that the entire action before the court comprises but one constitutional 'case.' " 383 U.S. 715, 725 (1966); *City of Chicago v. Int'l Coll. of Surgeons*, 522 U.S. 156, 164–65 (1997).

The court must weigh "considerations of judicial economy, convenience and fairness to the litigants; if these are not present a federal court should hesitate to exercise jurisdiction over state claims." *Gibbs*, 383 U.S. at 726. However, "[n]eedless decisions of state law should be avoided both as a matter of comity and to promote justice between the parties, by procuring for them a surer-footed reading of applicable law." *Id.* If "state issues substantially predominate, ... the state claims may be dismissed without prejudice and left for resolution to state tribunals." *Id.* at 726–27. Moreover, where a bankruptcy court has no statutory or constitutional authority to hear a claim, the interest of judicial economy cannot create jurisdiction. *In re Pacor, Inc.*, 743 F.2d at 994.

The Ninth Circuit has applied 28 U.S.C. § 1367 to bankruptcy claims, even when the subject matter jurisdiction is based on "related to" bankruptcy jurisdiction. *In re Pegasus Gold Corp.*, 394 F.3d at 1195; *Sec. Farms v. Int'l Bhd. of Teamsters*, 124 F.3d 999, 1008 n.5 (9th Cir. 1997); *see also Davis v. Courington (In re Davis)*, 177 B.R. 907 (9th Cir. BAP 1995) (holding that the bankruptcy court had supplemental jurisdiction over debtor's prepetition state law cause of action against a creditor bank because there was a common nucleus of facts between the prepetition state action and the bank's postpetition breach of the automatic stay).

Under the plain language of 28 U.S.C. § 1367(a), the setoff and recoupment claims must be "so related" to the scope of the discharge injunction inquiry (core jurisdictional issue) such that they form part of the same case or controversy under Article III of the United States Constitution. A state law claim is part of the same case or controversy when it shares a "common nucleus of operative fact" with the federal claims and the state and federal claims would normally be tried together. *Bahrampour v. Lampert*, 356 F.3d 969, 978 (9th Cir. 2004).

Here, NCHOA's claims for setoff and recoupment do not meet this standard. The facts necessary to establish whether the attorney's fee award in the First Lawsuit was subject to the discharge injunction differs from the factual background necessary to establish setoff and recoupment claims under California law. For the violation of the discharge injunction, NCHOA needed to show that the discharge did not apply to the postpetition attorney's fee award under the return to the fray doctrine - a factual inquiry here resolved by undisputed facts on summary judgment. For the setoff and recoupment claims, NCHOA had to show facts that established the elements of setoff (and recoupment) of its attorney's fee award against Ms. Adams' judgment under California law. The facts relating to proving the elements of those claims would not assist the bankruptcy court in determining whether the attorney's fee award was subject to the discharge under the return to the fray doctrine. Further, the determination of setoff and recoupment rights does not require an interpretation of or enforcement of the discharge injunction as did the return to the fray doctrine. In short, NCHOA must show different facts which independently establish that it is entitled to setoff and recoupment under California law.

***11** Therefore, we conclude that NCHOA's setoff and recoupment claims are too disparate to form part of the "same case or controversy." The facts and related evidence for proving that Ms. Adams returned to the fray do not overlap with the facts and the evidence needed to prove the elements for setoff and recoupment. The legal theories to be litigated with respect to those claims are wholly different. There is no common nucleus of operative facts.

In sum, the essential facts of the various claims are not logically connected such that considerations of judicial economy and fairness dictate that all the issues be resolved in one lawsuit. Accordingly, supplemental jurisdiction did not empower the bankruptcy court to decide the setoff and recoupment claims.

CONCLUSION

For the reasons explained above, we AFFIRM the bankruptcy court's grant of summary judgment on NCHOA's first claim for relief on the basis that the Fee Award was excepted from discharge under the return to the fray doctrine. We VACATE the bankruptcy court's grant of summary judgment on NCHOA's claims for setoff and recoupment and remand with instructions to dismiss these claims without prejudice for lack of subject matter or supplemental jurisdiction.

All Citations

Slip Copy, 2018 WL 3748816

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A true and correct copy of the foregoing document entitled (*specify*):

LOCAL INITIATIVE HEALTH AUTHORITY FOR LOS ANGELES COUNTY OPERATING AS L.A. CARE HEALTH PLAN'S APPENDIX OF UNPUBLISHED CASES IN SUPPORT OF MEMORANDUM OF POINTS AND AUTHORITIES REGARDING NON-CORE DESIGNATION
will be served or was served **(a)** on the judge in chambers in the form and manner required by LBR 5005-2(d); and **(b)** in the manner stated below:

1. **TO BE SERVED BY THE COURT VIA NOTICE OF ELECTRONIC FILING (NEF)**: Pursuant to controlling General Orders and LBR, the foregoing document will be served by the court via NEF and hyperlink to the document. On February 26, 2019, I checked the CM/ECF docket for this bankruptcy case or adversary proceeding and determined that the following persons are on the Electronic Mail Notice List to receive NEF transmission at the email addresses stated below:

Steven J Kahn skahn@pszyjw.com
United States Trustee (LA) ustpregion16.la.ecf@usdoj.gov

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2. SERVED BY UNITED STATES MAIL:
On February 26, 2019, I served the following persons and/or entities at the last known addresses in this bankruptcy case or adversary proceeding by placing a true and correct copy thereof in a sealed envelope in the United States mail, first class, postage prepaid, and addressed as follows. Listing the judge here constitutes a declaration that mailing to the judge will be completed no later than 24 hours after the document is filed.

Honorable Judge Ernest M. Robles
U.S. Bankruptcy Court
Roybal Federal Building
255 E. Temple Street
Suite 1560
Los Angeles, CA 90012

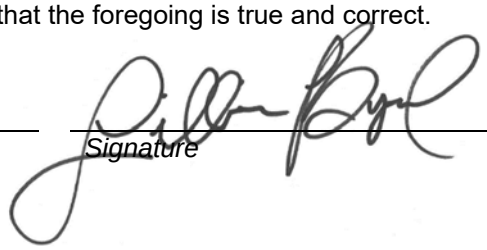
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3. SERVED BY PERSONAL DELIVERY, OVERNIGHT MAIL, FACSIMILE TRANSMISSION OR EMAIL (state method for each person or entity served): Pursuant to F.R.Civ.P. 5 and/or controlling LBR, on (*date*) _____, I served the following persons and/or entities by personal delivery, overnight mail service, or (for those who consented in writing to such service method), by facsimile transmission and/or email as follows. Listing the judge here constitutes a declaration that personal delivery on, or overnight mail to, the judge will be completed no later than 24 hours after the document is filed.

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I declare under penalty of perjury under the laws of the United States that the foregoing is true and correct.

February 26, 2019	LILLIAN A. BYRD	
Date	*Printed Name*	*Signature*



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