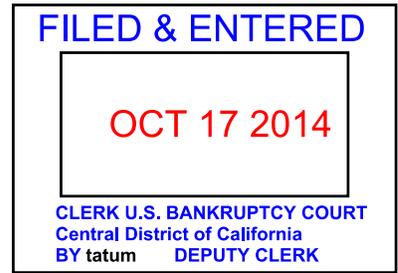


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**UNITED STATES BANKRUPTCY COURT  
CENTRAL DISTRICT OF CALIFORNIA  
LOS ANGELES DIVISION**

In Re )  
MARTIN PEMSTEIN, DIANA PEMSTEIN, )  
Debtors. )  
HAROLD PEMSTEIN, )  
Plaintiff, )  
Vs. )  
MARTIN PEMSTEIN, DIANA PEMSTEIN, )  
Defendants. )

**Case No. 2:12-bk-15900 RK**  
**Chapter 11**  
**Adv. No. 2:12-ap-01291 RK**  
**FINDINGS OF FACT AND**  
**CONCLUSIONS OF LAW AFTER TRIAL**  
**ON 11 U.S.C. § 523(a)(4) CLAIM AND**  
**ORDER THEREON**  
**DATE: May 29 and 30, 2014**  
**TIME: 8:00 A.M.**  
**CTRM: 1675**

Trial of this matter after remand commenced on May 29, 2014, and continued on May 30, 2014. Plaintiff, Harold Pemstein (“Plaintiff” or “Harold”), appeared and was represented by attorney Christopher L. Blank. Defendant, Martin Pemstein (“Defendant” or “Martin”), appeared and represented himself.

The following constitutes the court’s findings of fact and conclusions of law in compliance with Federal Rule of Bankruptcy Procedure 7052. Any finding of fact that should be properly characterized as a conclusion of law and any conclusion of law that should be properly characterized as a finding of fact should be considered as such.

This court has reviewed the proposed findings of fact and conclusions of law submitted by the parties after trial at the court’s request and the objections thereto. Having considered the

1 evidence received at trial, and the written and oral arguments of the parties, the court has  
2 exercised independent review of the proposed findings of fact and conclusions of law, and finds  
3 that it substantially agrees with the proposed findings of fact and conclusions of law submitted  
4 by Plaintiff, so that it can and does adopt a number of such proposed by Plaintiff as its own as  
5 discussed herein.

6 **I. FINDINGS OF FACT**

7 1. Martin and Harold are brothers and were business partners with respect to a  
8 partnership known as HMS Properties. *Joint Pre-Trial Order, Statement of Admitted Facts,*  
9 *Docket 16, Paragraph 4, Page 2, line 4* (“Plaintiff and Defendant Martin are brothers, and were  
10 business partners”). *Defendant Martin Pemstein’s Trial Declaration, Docket 25, Paragraph 2,*  
11 *page 2, line 7* (“Harold and I are brothers and former business partners”).

12 2. The debt arose out of Martin’s service as a general partner for HMS. *Defendants’*  
13 *Post-Trial Brief, Docket 34, Page 3, lines 18 -22* (“At trial, Martin and Harold testified they were  
14 50% owners of HMS Properties, a general partnership. ‘California partners are fiduciaries within  
15 the meaning of § 523(a)(4)’ *In re Lewis*, (9th Cir. 1996) 97 F.3d 1182, 1186. Thus, the Judgment  
16 [referring to the 2010 Judgment of the Superior Court of California for the County of Orange, the  
17 Honorable Peter Polos, Judge, presiding] would be non-dischargeable if it were the result of  
18 Martin’s ‘**fraud or defalcation**’ while acting as a partner of HMS Properties.” *Emphasis*  
19 *added.*).

20 3. Harold obtained a judgment against Martin for \$696,218.03 on January 5, 2010  
21 (“2010 Judgment”). *Joint Pre-Trial Order, Statement of Admitted Facts, Docket 16, Paragraph*  
22 *5, page 2, lines 7-8; 2010 Judgment, Exhibit P-1.*

23 4. The 2010 Judgment is final and has *res judicata* effect. *Joint Pre-Trial Order,*  
24 *Statement of Admitted Facts, Docket 16, Paragraphs 11 and 12, page 2, lines 19 and 20.*

25 5. The 2010 Judgment states that “Martin Pemstein breached his duty of due care to  
26 Harold in the collection of rent on behalf of HMS Properties.” *2010 Judgment, Exhibit P-1;*  
27 *Defendant Martin Pemstein’s Trial Declaration, Docket 25, Paragraph 3, page 2, lines 14–16.*

28 6. The 2010 Judgment was based on the Superior Court’s finding that Martin

1 breached his “duty of care” in the collection of rent. That is the equivalent of a finding that  
2 Martin engaged in “grossly negligent or reckless conduct, intentional misconduct, or a knowing  
3 violation of law” while acting as a trustee over partnership assets. *Bankruptcy Appellate Panel*  
4 (*“BAP”*) *Statement of Decision*, Docket 69, page 5, lines 7-15.

5 **A. Facts Established at Trial after Remand.**

6 7. Martin had sole and actual control of the collection of rents of HMS and acted  
7 intentionally with respect to the collection of rent of HMS. *Trial Testimony of Martin Pemstein*,  
8 May 30, 2014, 11:00 A.M. – 11:08 A.M. and 12:02 P.M. – 12:03 P.M.

9 8. Martin acted knowingly with respect to the collection of rent of HMS. *Trial*  
10 *Testimony of Martin Pemstein*, May 30, 2014, 11:00 A.M. – 11:08 A.M. and 12:02 – 12:03 P.M.

11 9. Martin knowingly and intentionally acted for the benefit of Pemma Corporation  
12 (“Pemma”), the tenant of HMS, to the detriment of HMS and his brother Harold, with respect to  
13 the collection and expenditure of rent owed by Pemma to HMS and by HMS to Harold. *Trial*  
14 *Testimony of Martin Pemstein*, May 30, 2014, 11:05 A.M. – 11:08 A.M. and 11:46 A.M. – 11:58  
15 A.M. and 12:02 P.M. – 12:05 P.M. Martin made intentional and conscious decisions not to  
16 collect higher rent for HMS from Pemma despite the requests of his brother and partner, Harold,  
17 considering the interests of Pemma over HMS, both of which he controlled, leading to the  
18 damages incurred by Harold as determined by the Superior Court. *Id.*

19 10. Martin has a background and college coursework in accounting as well as work  
20 experience as a staff accountant. *Trial Testimony of Martin Pemstein*, May 29, 2014, 12:02 P.M.  
21 to 12:04 P.M.

22 11. During the relevant period, Martin was in charge of the operations and finances of  
23 both Pemma and HMS. *Trial Testimony of Martin Pemstein*, May 29, 2014, 12:04 P.M. to 12:05  
24 P.M., May 30, 2014, 11:00 A.M. – 11:08 A.M.

25 12. The state court found that Martin Pemstein “breached his duty of care to Harold  
26 Pemstein in the collection of rent on behalf of HMS Properties. *2010 Judgment*, Exhibit P-1.

27 13. Exhibit 107 is the Plaintiff’s Brief in Lieu of Closing Argument which was  
28 submitted by Harold’s attorney to Judge Polos after the conclusion of testimony in the State

1 Court trial.

2 14. Exhibit 107 was submitted not to prove any of the facts stated in the brief, but to  
3 explain the basis for the state court judgment by Judge Polos, who adopted the computations of  
4 damages of the state court expert witness.

5 15. In his state court Brief in Lieu of Closing Argument, Harold stated that the State  
6 Court's appointed expert Jamie Holmes had concluded that HMS had actual profits from rental  
7 income of **\$384,124.00** during the relevant period, and Harold's unpaid share of that income was  
8 **\$192,062.00**. *Plaintiff's Brief in Lieu of Closing Argument*, Exhibit 107, pg 134:15-18; *State*  
9 *Court Reporter's Transcript, September 15, 2009*, Exhibit 110 pg. 103-105; *see also, Trial*  
10 *Testimony of Martin Pemstein*, May 30, 2014, 11:17-11:25 A.M.

11 16. In his state court Brief in Lieu of Closing Argument, Harold stated that expert  
12 witness David Hahn concluded that Martin did not collect a market rate of rent from the tenant  
13 Pemma, which was controlled by Martin. Harold's closing brief says that David Hahn testified  
14 that the shortfall in fair rental value for HMS properties was **\$207,618.00**. Harold's share of that  
15 forgone profit was **\$103,809.00**. Harold then combined those numbers to establish that Martin  
16 owed Harold **\$295,871.00**. *Plaintiff's Brief in Lieu of Closing Argument*, Exhibit 107 pg 135-  
17 136.

18 17. The Superior Court by Judge Polos awarded Harold against Martin damages of  
19 **\$295,871.00** in principal and **\$400,347.03** in interest in the 2010 Judgment. 2010 Judgment,  
20 *Exhibit P-1*; *see also, Defendant Martin Pemstein's Trial Declaration*, Docket 25, Exhibit A,  
21 Opinion of the District Court of Appeal at page 6 ("In its judgment, the court gave Harold  
22 exactly what he requested in his closing argument brief with respect to the collection of rent  
23 (\$295,871.00 in principal and \$400,347.03 in interest for a total of over \$696,000).").

24 18. Martin testified that the Superior Court by Judge Polos found him to have been  
25 negligent in the handling of the rents. *Defendant Martin Pemstein's Trial Declaration*, Docket  
26 25, Paragraph 3, page 2, line 16 ("The Court found that I was negligent in my duty to collect  
27 rent."); *see also, Trial Testimony of Martin Pemstein*, May 29, 2014, 12:05 P.M. to 12:07 P.M.

28 19. At trial, Martin has specifically testified that he was NOT negligent in his

1 handling of the rents of HMS. *Trial Testimony of Martin Pemstein*, May 30, 2014, 12:02 P.M.

2 20. Martin testified that it would be wrong to make distributions to one partner and  
3 not the other. *Trial Testimony of Martin Pemstein*, May 30, 2014, 12:18 P.M. – 12:21 P.M.

4 21. Martin acknowledged that it would be unfair to HMS and its partners for Pemma  
5 to pay less than a market rate of rent. *Trial Testimony of Martin Pemstein*, May 30, 2014, 11:07  
6 A.M. – 11:11 A.M.

7 22. Martin testified at trial that he acted deliberately and knowingly with respect to  
8 the way he handled the collection of rents of HMS. *Trial Testimony of Martin Pemstein*, May  
9 30, 2014, 12:02 P.M. – 12:04 P.M.

10 23. Martin testified that he was aware that he had a fiduciary duty to both Pemma and  
11 HMS to treat each one fairly. *Trial Testimony of Martin Pemstein*, May 30, 2014, 11:46 A.M.

## 12 II. CONCLUSIONS OF LAW

13 24. Issue preclusion applies in bankruptcy debt dischargeability proceedings to  
14 preclude relitigation of nonbankruptcy court findings that are relevant to dischargeability of debt.  
15 *Grogan v. Garner*, 498 U.S. 279, 284 n. 11, 111 S.Ct. 654, 112 L.Ed.2d 755 (1991); *Pemstein v.*  
16 *Pemstein (In re Pemstein)*, 492 B.R. 274, 281 (9th Cir. BAP 2013).

17 25. Issue preclusion bars relitigation of an issue or fact that (1) is identical to a fact or  
18 issue determined in an earlier proceeding, (2) was actually decided by a court in an earlier action,  
19 (3) was necessary to the judgment in such action, (4) there was a final judgment on the merits,  
20 and (5) the parties were the same or in privity. *Lopez v. Emergency Service Restoration, Inc. (In*  
21 *re Lopez)*, 367 B.R. 99, 104 (9th Cir. BAP 2007), citing *Harmon v. Kobrin (In re Harmon)*, 250  
22 F.3d 1240, 1245 (9th Cir.2001); *In re Pemstein*, 492 B.R. at 281.

23 26. The Full Faith and Credit Act, 28 U.S.C. § 1738, requires that federal courts give  
24 state court judgments the same preclusive effect those judgments would enjoy under the law of  
25 the state in which the judgment was rendered. *Lopez, supra*, 367 B.R. at 105, citing 28 U.S.C. §  
26 1738; *In re Pemstein*, 492 B.R. at 281.

27 27. California law applies issue preclusion based on the establishment of the same  
28 five elements listed above. *Baldwin v. Kilpatrick (In re Baldwin)*, 249 F.3d 912, 917–918 (9th

1 Cir.2001), citing *Lucido v. Superior Court*, 51 Cal.3d 335, 340 (1990); *In re Pemstein*, 492 B.R.  
2 at 281.

3 28. “Once a party... has won a final victory on an issue, it is entitled to avoid  
4 relitigation of that issue in any other forum. The bankruptcy court's otherwise broad powers do  
5 not include the power to reject a party's invocation of collateral estoppel on an issue fully and  
6 fairly litigated in another court.” *In re Bugna*, 33 F.3d 1054, 1058 (9th Cir. 1994).

7 29. In the prior trial of this matter, all of the elements of issue preclusion were  
8 established as to the amount of the debt, the identity of the debtor, the identity of the creditor,  
9 and that the debt arose out of the debtor’s breach of his duty of care owed to his partner Harold  
10 with respect to the collection of rent of HMS.

11 30. Therefore, Martin is precluded in the trial on remand from asserting that no debt  
12 was owed to Harold.

13 31. Martin is precluded in the trial on remand from asserting that he did not breach  
14 his duty of care with respect to the collection of rent of HMS.

15 32. Martin is precluded in the trial on remand from asserting that Harold was not  
16 damaged by Martin’s breach of his duty of care.

17 33. Martin is precluded in the trial on remand from asserting that he did not owe a  
18 fiduciary duty to Harold.

19 34. Martin is precluded in the trial on remand from asserting that he did not breach  
20 his fiduciary duty of care to Harold with respect to the collection of rents of HMS.

21 35. Martin is precluded in the trial on remand from asserting that the debt owed to  
22 Harold based on Martin’s breach of his duty of care was anything other than the \$696,218.03  
23 amount of the 2010 Judgment.

24 36. On remand, the only unresolved issue after applying the doctrine of issue  
25 preclusion that this court must determine is whether Martin’s misconduct amounted to  
26 defalcation.<sup>1</sup> See *In re Pemstein*, 492 B.R. at 281-284.

27 \_\_\_\_\_  
28 <sup>1</sup> The court does not reach the alternative theory argued by Harold that issue preclusion applies to the determination  
of Martin’s scienter to establish a defalcation based on the state court’s judgment. Although not reaching the  
alternative theory, the court is not sufficiently persuaded that the state court’s judgment under California

1 37. In *Bullock v. BankChampaign, N.A.*, 133 S.Ct. 1754 (2013) the United States  
2 Supreme Court held that some level of culpable knowledge is necessarily a part of the definition  
3 of defalcation. Proof of *scienter* is required. “[K]nowledge of, or gross recklessness in respect  
4 to, the improper nature of the relevant fiduciary behavior” is required. *Id.* at 1757.

5 38. The 2010 Judgment was based on the finding that Martin had breached his duty of  
6 care to Harold. Under California law, this finding necessarily means that the state court found  
7 that Martin had engaged in “grossly negligent or reckless conduct, intentional misconduct, or a  
8 knowing violation of law” while acting as a trustee over partnership assets. California  
9 Corporations Code § 16404(c). And, as specifically stated in the 2010 Judgment, that conduct  
10 related to the “collection of rent on behalf of” the partnership. *BAP Statement of Decision*,  
11 Docket 69, page 5, lines 7-15; *In re Pemstein*, 492 B.R. at 278. “Defalcation includes the failure  
12 by a fiduciary to account for money or property that has been entrusted to him.” *In re Pemstein*,  
13 492 B.R. at 282 (citations omitted).

14 39. This court determines that the preponderance of the evidence received at the trial  
15 of this matter on remand establishes that Martin’s breach of his duty of care to Harold in the  
16 collection of rent amounted to defalcation based on his intentional acts.

17 40. Because Martin has specifically testified that (1) he was NOT negligent in his  
18 handling of the rents of HMS, (2) if he had done the things that Judge Polos determined he had  
19 done, those things would be wrongful, and (3) he acted deliberately and knowingly with respect  
20 to the way he handled the collection of rents of HMS; therefore, there is no basis for determining  
21 that Martin’s conduct with respect to the collection of rent was innocent or merely negligent, and  
22 based on the findings of facts described above, the court finds that his conduct was intentional.

23 41. Therefore, the debt represented by the 2010 Judgment against Martin is  
24 nondischargeable pursuant to 11 U.S.C. § 523(a)(4).

25 42. Although Diana Pemstein is named as a defendant in this adversary proceeding,  
26 she was not named in the 2010 Judgment, and she has no personal liability for this debt.

27  
28 Corporations Code, § 16404(c), implicitly finding that Martin was at least grossly negligent in the collection of rent  
satisfies the *scienter* standard of gross recklessness to establish a defalcation under 11 U.S.C. § 523(a)(4) as set forth  
in *Bullock v. BankChampaign, N.A.*, 133 S.Ct. at 1757. This determination is best left for another day.

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**III. ORDER**

Counsel for Harold is ordered to submit a proposed judgment consistent with these findings of fact and conclusions of law within 30 days of the date of entry of these findings of fact and conclusions of law.

IT IS SO ORDERED.

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Date: October 17, 2014



Robert Kwan  
United States Bankruptcy Judge