UNITED STATES BANKRUPTCY COURT

CENTRAL DISTRICT OF CALIFORNIA

In re: Jose Antonio Zamora, Martha Delia Zamora, Debtor(s), Rosendo Gonzalez, Plaintiff(s), Vs. Danniel De La Madrid, an individual dba Llamas Estate, LLC, dba Muzikneum, Ltd., dba Castizo Holdings, LLC; Elize Villareal, an individual; and Martha Lizeth Perez, an individual Defendant(s).	Case No.: 2:17-bk-22698-BB Chapter: 7 Adversary No.: 2:19-ap-01139-BB **REPORT AND RECOMMENDATION TO THE DISTRICT COURT RE ENTRY OF DEFAULT JUDGMENT AS AGAINST ALL DEFENDANTS** Date: June 22, 2022 Time: 10:00 AM Location: Courtroom 1539 and Zoom for Government

Chapter 7 trustee Rosendo Gonzalez ("Plaintiff" or “Trustee”) has filed an amended motion for entry of default judgment [Docket No. 143] (the “Motion”) against all defendants. Following a hearing held June 22, 2022 on the Motion, pursuant to 28 U.S.C. § 157(c)(1), the

Court submits to the District Court the following proposed findings of fact and conclusions of law and recommends that the District Court enter judgment as against all defendants on the terms set forth below.

I

BANKRUPTCY COURT AUTHORITY

Pursuant to Exec. Benefits Ins. Agency v. Arkison (In re Bellingham Ins. Agency, Inc.), 702 F.3d 553 (9th Cir. 2012), cert. granted, 133 S. Ct. 2880, 186 L. Ed. 2d 908, 2013 WL 3155257 (2013), bankruptcy courts lack constitutional authority to enter final judgments on fraudulent transfer claims against parties who have not filed proofs of claim in the underlying bankruptcy case. 702 F.3d at 565. Although this right may be waived, either expressly or impliedly (id. at 566, 569 ("[A] litigant's actions may suffice to establish consent" to adjudication by a non-Article III court)), defendant Danniel de la Madrid ("De La Madrid") is not a creditor in the above bankruptcy case (the "Case") and has repeatedly objected to the entry of final orders by this Court in the above adversary proceeding (the "Action"). Therefore, the Court does not have authority to enter a final judgment on Plaintiff's fraudulent transfer claims as against De La Madrid. As none of the remaining defendants has appeared in the Action or filed a proof of claim in the Case, to avoid any issues concerning the extent to which these other defendants have impliedly consented to the entry of final orders in the Action, the Court submits the following as its proposed findings of fact and conclusions of law, together with its recommendation, to the District Court, with regard to the disposition of the Action as against all defendants (collectively, the "Defendants").

II

PROCEDURAL HISTORY

The Case was commenced by debtors Jose A. Zamora and Martha D. Zamora (jointly, the "Debtors") by the filing of a voluntary chapter 7 petition on October 17, 2017 (the

"Petition"). [Case Docket[1] No. 1.] Plaintiff is the chapter 7 trustee appointed in the Case. [See Case Docket No. 2, at ¶ 5.]

Plaintiff commenced the Action by filing his original complaint for the avoidance of fraudulent transfers on May 10, 2019 and filed a First Amended Complaint for the avoidance of fraudulent transfers [Docket No. 7] (the "Amended Complaint") on July 29, 2019. As the Action arises in and is related to the Case, this Court has jurisdiction over the Action pursuant to 28 U.S.C. §§ 157 and 1334. Venue of the Action is proper in this district under 28 U.S.C. § 1409.

Although the Action is a core proceeding under 28 U.S.C. §§ 157(b)(2)(A) and (b)(2)(H), Plaintiff has alleged fraudulent transfer claims against the Defendants, and De La Madrid has not filed a proof of claim or consented to the entry of final orders by the Bankruptcy Court in the Action. Thus, this Court lacks constitutional authority to enter final judgments in the Action against him.

A. The Trustee's First Default Judgment Motion

When none of the Defendants filed a response to the Amended Complaint in a timely manner, Plaintiff requested the entry of default as against all Defendants, and the Court granted that request. [See Docket Nos. 19, 20 and 29.] Thereafter, De La Madrid moved to dismiss the Action [Docket No. 35], and the Plaintiff filed a motion for default judgment as against all Defendants [Docket No. 36]. The Court entered an order granting the Plaintiff's motion for default judgment as against all Defendants on January 30, 2020 [Docket No. 47] and an order denying De La Madrid's motion to dismiss on January 31, 2020 [Docket No. 49]. De La Madrid filed a motion to vacate the default judgment against him on February 14, 2020 [Docket No. 54]. The Court entered an order denying that motion on February 25, 2020 [Docket No. 55].

On March 10, 2020, De La Madrid appealed the default judgment entered against him and the order denying his motion to vacate that judgment. He elected to have that appeal heard by the District Court rather than the Bankruptcy Appellate Panel [see Docket Nos. 57 and 58]. The District Court dismissed that appeal for failure to prosecute based upon De La

[1] References to "Case Docket" refer to the docket in the underlying chapter 7 bankruptcy case. References to the docket that omit the word, "Case," refer to entries on the docket in the instant adversary proceeding, the Action.

Madrid's failure to file a transcript in a timely manner by order entered April 20, 2020 [Docket No. 69], but subsequently vacated that dismissal on June 11, 2020 [Docket No. 71] and issued an order to show cause why the appeal should not be dismissed for failure to prosecute based on De La Madrid's failure to order a transcript on July 21, 2020 [Docket No. 74].[2]

A transcript was eventually provided, and the District Court vacated the default judgment entered against De La Madrid and remanded the Action to the Bankruptcy Court for further findings. [See USDC Appeal Judgment (Corrected), Docket No. 81 (the "USDC Judgment").] In the USDC Judgment, the District Court held that, because De La Madrid had not consented, either expressly or impliedly, to the Bankruptcy Court's entry of final orders in the Action, the Bankruptcy Court exceeded its powers under Article III of the constitution by entering a default judgment against him. Instead, the Bankruptcy Court should have issued proposed findings of fact and conclusions of law and submitted them to the District Court for a de novo review. Construing the Bankruptcy Court's judgment as proposed findings of fact and conclusions of law, the District Court agreed with the Bankruptcy Court's resolution of one of the issues raised by De La Madrid and remanded for further consideration of the remaining issues.

The District Court agreed with the Bankruptcy Court's rejection of De La Madrid's proffered defense based on his contention that the debtors were ineligible to file bankruptcy in the United States not only on the procedural ground cited by the Bankruptcy Court but also on the merits, as the debtors had personal property in the United States. But it found that the Bankruptcy Court had failed to consider the proper factors in assessing whether or not De La Madrid had been properly served with the Amended Complaint and whether his default should have been set aside. Accordingly, the District Court remanded the Action to the Bankruptcy Court for further proceedings consistent with the USDC Judgment.

B. Proceedings After Remand

On remand, rather than incur the expense of litigating with De La Madrid as to whether service of the Amended Complaint on De La Madrid had been proper, the Plaintiff elected to

[2] The Bankruptcy Court issued a second notice of deficiency for failure to file transcript on August 27, 2020 [Docket No. 75].

request the issuance of a new summons and re-serve De La Madrid and the other names under which he had been doing business (collectively, the "De La Madrid Defendants").[3] At a status conference in the Action held July 27, 2021, then counsel of record for Defendants (Chad Thomas William Pratt, Sr.) appeared and agreed to accept service of process on behalf of the De La Madrid Defendants. The Court announced on the record at that status conference that it would conduct a continued status conference in the Action on September 28, 2021 at 2:00 p.m. and that the parties should file their joint status report not later than September 14, 2022.[4]

The Plaintiff re-served the Amended Complaint on the De La Madrid Defendants in care of Mr. Pratt on August 3, 2021.[5] [See Docket No. 87.] Neither De La Madrid nor any of the other De La Madrid Defendants has contested the adequacy of this service of process.

C. De La Madrid's Answer to Complaint

On September 2, 2021, De La Madrid filed a Substitution of Attorney [Docket No. 89] that was signed on September 1, 2021, in which he substituted himself as his counsel of record in the Action in lieu and instead of Mr. Pratt. On September 2, 2021, De La Madrid filed an answer to the Amended Complaint [Docket No. 88] on his own behalf and not on behalf of any of the other Defendants (the "Answer"). The body of the Answer reads in its entirety as follows:

> Comes now Defendant Danniel De La Madrid to Answer the adversary Complaint on file herein as follows:
>
> 1. Defendants avers that he is a bona fide purchaser for value ("BFP") of the subject property and paid fair market value ("FMV') for such property, that he thereafter invested additional amounts of approximately two hundred thousand dollars ($200,000.00) rehabilitating the property, which was extremely

[3] The De La Madrid Defendants are identified in the Amended Complaint as "Danniel De La Madrid, An Individual, dba Llamas Estate, LLC, dba Muziknewum, Ltd dba Castizo Holdings, LLC."

[4] The Bankruptcy Court's Local Bankruptcy Rule ("LBR") 7016-1(a)(2) provides that, "Unless otherwise ordered by the court, at least 14 days before the date set for each status conference the parties are required to file a joint status report using the mandatory court form F 7016-1.StatusReport (and F 7016-1.Status.Report.Attach, if applicable)."

[5] The Trustee did not reserve the Amended Complaint on the other individual defendants, Eliza Villareal ("Villareal") and Martha Lizeth Perez ("Perez"), as these defendants had already been served on August 2, 2019 [see Docket No. 10] and had never contested the effectiveness of this service.

dilapidated; and that the instant Action is wholly frivolous and is prosecuted maliciously.

2. Defendant avers he paid full FMV in an arm's length transaction with a seller with whom he had no prior relationship.

3. Defendant denies the whole of paras. 1-90 inclusive and the whole.

4. Defendant avers that Debtors are not eligible to be debtors within the meaning of 11 U.S.C. 109(a) in that neither was domiciled within the United States at the time they filed their bankruptcy petition and they then had no property in the United States.

5. Defendant does not consent to jurisdiction of the bankruptcy court or to it entering final orders.

6. Defendant demands both an art. III judge and trial by jury pursuant to the seventh amendment.

First Affirmative Defence[6]

7. Defendant is a BFP who purchased the subject property for full FMV.

Second Affirmative Defence

8. Debtors acted with unclean hands as they are not eligible to be debtors under 11 U.S.C. 109(a).

Third Affirmative Defence

9. Defendant asserts the defences of laches and waiver.

Fourth Affirmative Defence

10. Defendant asserts contributory negligence against all other parties herein, including Debtors.

Fifth Affirmative Defence

11. Defendant asserts fraud by all other parties herein, including Debtors.

[6] De La Madrid explained in a later pleading that the word processor that he uses to draft documents is set to British English.

Sixth Affirmative Defence

12. Defendant asserts he paid FMV as a BFP in the total amount of $396,175.58 (para. 55).

Seventh Affirmative Defence

13. If a balance of $3,824.42 is due on the contract per para. 58, Defendant will promptly pay such amount.

Eighth Affirmative Defence

14. There may be such other and further affirmative defences, unknown at this time, and Defendant reserves the right to amend this Answer to submit such further affirmative defences when ascertained at a later date.

Answer, Docket No. 88. As none of the other De La Madrid Defendants[7] filed an answer to the Amended Complaint, the Plaintiff again requested the entry of their defaults. The defaults of the remaining De La Madrid Defendants were entered on November 1, 2021. [See Docket Nos. 108, 109 and 110.]

D. De La Madrid's Repeated Failures to Participate in Pretrial Proceedings

The Court conducted a continued status conference in the Action on September 28, 2021. Attorney Azuoma Anugom ("Anugom") specially appeared at that status conference on behalf of De La Madrid, even though she had not substituted in as his attorney of record in the Action as of that date. De La Madrid attended the hearing as well (via Zoom for Government).

Notwithstanding the requirement of this Court's Local Bankruptcy Rule ("LBR") 7016-1 that the parties file a joint status report not less than 14 days prior to the status conference, De La Madrid failed to participate in the preparation of a joint status report in connection with the September 28, 2021 status conference. Instead, the Plaintiff filed a unilateral status report, and a supporting declaration, as required by the LBRs [Docket Nos. 90 and 91], stating that, because De La Madrid had substituted in as his own counsel of record in the Action on September 2, 2021, on September 3, 2021, the Plaintiff "wrote and sent via email and first

[7] As the remaining De La Madrid Defendants are alleged in the Amended Complaint to be names under which De La Madrid is doing business, it may well be that there are no De La Madrid Defendants other than De La Madrid himself.

class mail, a letter to De La Madrid identifying the defects of the general answer and requesting to promptly 'meet and confer' to prepare and submit by no later September 14, 2021, a joint status conference report for the September 28, 2021 status conference. With my September 3, 2021 letter, I also enclosed a copy of the proposed joint status conference report." A copy of the Plaintiff's September 3, 2021 letter was attached to the declaration. The declaration explained further that, as of the date of the declaration (September 13, 2022), the Plaintiff had not received a response to his September 3, 2021 letter.[8]

Plaintiff's September 3 letter also reminded De La Madrid that Mr. Pratt had accepted service of the Amended Complaint on behalf of all the De La Madrid Defendants, and that, unless the remaining De La Madrid Defendants filed an answer to the Amended Complaint, the Plaintiff intended to request the entry of their defaults (again). With regard to the Answer filed by De La Madrid, the Plaintiff's September 3, 2021 letter explained that the general denials that it contained (see paragraph 3, denying the allegations of paragraphs 1 through 90 of the Amended Complaint) were not proper under Federal Rule of Civil Procedure 8(b), made applicable to adversary proceedings by Federal Rule of Bankruptcy Procedure 7008,[9] and that certain of the "affirmative defenses" alleged in the Answer are not permitted or do not exist.[10]

Although the Court's tentative ruling in connection with the September 28, 2021 status conference was to impose monetary sanctions on De La Madrid based on his failure to participate in the preparation of a joint status report, the Court elected not to impose sanctions at that time. Instead, the Court reminded the parties, again, that they are required by the Court's local rules to file a joint status report two weeks before every status conference and that it expected compliance with this rule, even from parties who are representing themselves. At the September 28, 2021 status conference, the Court announced that it would conduct a

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[8] Paragraph 15 of the declaration notes further that "This is *not* the first time in this adversary proceeding that De La Madrid has failed to cooperate and 'meet and confer' to submit a joint status report." (Emphasis in original.)

[9] Under Rule 8, a party may only use a general denial in response to a complaint if he genuinely disputes in good faith each and every allegation of the complaint. There are many allegations of the Amended Complaint that De La Madrid cannot in good faith dispute. See, for example, paragraphs 12 through 24 of the Amended Complaint, in which the Plaintiff alleges when the Case was filed, that he was appointed trustee in the Case and that the debtors gave certain responses on the schedules and statement of financial affairs that were filed in the Case.

[10] See, e.g., De La Madrid's second, third, fourth, fifth and eighth affirmative defenses.

continued status conference on December 14, 2021 at 2:00 p.m. and that the parties' joint status report should be filed not later than November 30, 2021.

The Court conducted a continued status conference in the Action on December 14, 2021 at 2:00 p.m. Anugom appeared for De La Madrid at that status conference, although, this time, she represented to the Court that she had been retained that same day and would thereafter be serving as De La Madrid's counsel of record in the Action.[11] Again, De La Madrid had failed to meet and confer with the Plaintiff concerning the preparation of the joint status report that should have been filed by November 30, 2021. Instead, on November 29, 2021, the Plaintiff again filed a unilateral status report [Docket No. 114] and the required supporting declaration [Docket No. 115], attesting to De La Madrid's failure to participate in the process of preparing a joint status report.

E. The December 15, 2021 Order to Show Cause

In light of De La Madrid's repeated failures to participate in the preparation of a joint status report and the various defects contained in the Answer, following the December 14, 2021 status conference, the Court prepared and issued its December 15, 2021 order to show cause and scheduling order (the "OSC") [Docket No. 117]. In the OSC, the Court advised De La Madrid that it would conduct a hearing on January 25, 2022 at 2:00 p.m. to decide whether to strike the Answer and permit the Plaintiff to proceed by way of default based on (i) De La Madrid's repeated failure to participate in the preparation of a joint status report, (ii) his failure to meet and confer with counsel for the trustee and (iii) the failure of the Answer to include specific admissions and denials of the allegations of the complaint. The OSC advised De La Madrid that responses to the OSC must be in writing and were to be filed on or before January 11, 2022.

Anugom filed and served a response to the OSC on behalf of De La Madrid on January 11, 2022 [Docket No. 121] (the "January 11 Response"). She also filed and served a motion to dismiss the Amended Complaint on De La Madrid's behalf on January 7, 2022 [Docket No. 120] and noticed a hearing on that motion (the "Second Motion to Dismiss") for April 5, 2022 at

[11] Anugom eventually filed a substitution of attorney, substituting herself in as counsel for De La Madrid only, on January 7, 2022 [Docket No. 119]. All of the signatures on that document are dated December 14, 2021.

2:00 p.m. As the Court explained in detail on the record at the January 25 hearing on the OSC, the January 11 Response does not contain a declaration from De La Madrid as to what he knew or didn't know or why he did or didn't do anything during the period in which he was representing himself. Instead, the January 11 Response was supported only by a declaration from Anugom, explaining that she hadn't learned of any problems in this case until she started representing De La Madrid on December 14, 2022 (which was false, as she had attended the status conference on his behalf on September 28, 2021 and had therefore heard the Court identify these problems at that conference) and that any filings would have been taken care of in a timely manner if the Court had issued a written order in which it repeated the obligations that were already imposed on De La Madrid under the LBRs and Federal Rules of Bankruptcy Procedure.

F. The January 25, 2022 Hearing

The Court conducted the first hearing on its OSC on January 25, 2022. The Court issued the following tentative ruling in advance of the hearing[12] and read the tentative ruling into the record at the commencement of the January 25 hearing:

> The court conducted a status conference in this adversary proceeding on December 14, 2021 at 2:00 p.m. The trustee appeared, and Azuoma Anugom appeared on behalf of defendant Danniel de la Madrid ("DDLM") at that status conference. Because DDLM had failed (for at least the second time) to participate in the preparation of a joint status report, had failed to meet and confer with opposing counsel and had filed an answer that failed to include specific admissions and denials of the allegations of the trustee's latest complaint, the Court issued its December 15, 2021 Order to Show Cause (the "OSC")[13] directing DDLM to appear and show cause why his answer to complaint should not be stricken and the trustee permitted to proceed by way of default. Responses to the OSC were due by January 11, 2022.
>
> On January 11, 2022, DDLM filed his response to the OSC.[14] That response consists of an introductory statement that DDLM does not consent to the bankruptcy court's hearing this action and that he demands a trial by jury and a declaration from Ms. Anugom. In that declaration, Ms. Anugom explains that when she appeared at a

[12] Tentative rulings prepared by the Court are posted on the Court's website not later than the day preceding the hearing and remain available for public review thereafter. Thus, even if Anugom failed to take adequate notes of what the Court said or what instructions the Court gave her or De La Madrid at a status conference, she could refer back to any information contained in any of the Court's tentative rulings at her convenience.

[13] Docket No. 117.

[14] Docket No. 121.

status conference for DDLM in September (the September 28, 2021 status conference), she only made a special appearance because Chad Thomas William Pratt, Sr., Esq. was representing DDLM and that she didn't think she had to do anything after that status conference because she assumed that Mr. Pratt would handle it.

The declaration explains further that, "as it turns out" (which the Court understands to mean, as she later learned), Mr. Pratt wasn't merely too busy to attend the September 28 status conference. In fact, he had been suspended from the practice of law, with the result that DDLM needed to find replacement counsel. She then goes on to explain that DDLM didn't hire her to replace Pratt until December 14, 2021. Ms. Anugom states that only then did she learn of the deficiencies (i.e., what DDLM had failed to do) and goes on to point a finger at the court for DDLM's failure to take these actions because this court did not issue a minute order or other document after the September status conference to tell DDLM what he should have done. She then requests that, hereafter, the Court put everything that DDLM is supposed to do in writing so that she doesn't have to remember anything told to her orally at a status conference.

There are several problems with this response to the OSC. First, the issue is not whether Ms. Anugom should be sanctioned for failing to take action in this adversary proceeding. The Court takes judicial notice of the fact that she was not counsel of record until December 14, 2021. The issue is whether sanctions should be imposed on DDLM for failing to take action in this proceeding and Ms. Anugom's declaration tells us nothing about why DDLM failed to act.

The Court takes judicial notice of the fact that DDLM filed an answer to the trustee's latest complaint in propia persona on September 2, 2021 (docket no. 88). He filed a substitution of attorney on September 1, 2021 (docket no. 89)[15] substituting himself in as counsel of record in lieu and instead of Mr. Pratt on that date. Perhaps Ms. Anugom was confused as to whether Pratt was representing DDLM as of September 28, 2021, but DDLM could not have been. He signed the substitution of attorney some time before it was filed on September 1, 2021. Why did he do nothing from September 1, 2021 until December 14, 2021 to fulfill his obligations in connection with this adversary proceeding?

Moreover, the actions in question are not merely those that the court directed the parties to perform orally at a status conference, they are obligations imposed by the local rules of this Court and the Federal Rules of Bankruptcy Procedure. LBR 7016-1(a)(2), for example, requires the parties to file a joint status report at least 14 days prior to the date set for a status conference using the court's mandatory status report form. LBR 7026-1 requires the parties to meet and confer and exchange the information required by Fed. R. Bankr. Proc. 7026 within the time limits set forth therein. The Court would have to issue an order to relieve the parties of these obligations. It does not have to put them in writing in order to impose them. Yet the Court did specifically advise the parties orally at the September 28, 2021 status conference that their joint status report for the December 14, 2021 status conference needed to be filed not later than

[15] The Substitution was actually filed on September 2, 2021, but the signatures bear the date, September 1, 2021.

November 30, 2021 as a courtesy to the parties and to ensure that the parties were not under the impression that this requirement had been waived.

Parties appearing before this court in adversary proceedings are expected to comply with the local rules of this bankruptcy court. Sanctions may be imposed if they fail to do so. See generally Local Bankruptcy Rule 9011-(d) ("Any person appearing without counsel must comply with the F.R.Civ.P., F.R.Evid., F.R.App.P., FRBP, and these rules. The failure to comply may be grounds for dismissal, conversion, appointment of a trustee or an examiner, judgment by default, or other appropriate sanctions") and Local Bankruptcy Rule 9011-3(a) ("The violation of, or failure to conform to, the FRBP or these rules may subject the offending party or counsel to penalties, including monetary sanctions, the imposition of costs and attorneys' fees payable to opposing counsel, and/or dismissal of the case or proceeding").

And, more specifically, see Local Bankruptcy Rule 7016-1(f), which provides as follows:

In addition to the sanctions authorized by F.R.Civ.P. 16(f), if a status conference statement or a joint proposed pretrial stipulation is not filed or lodged within the times set forth in subsections (a), (b), or (e), respectively, of this rule, the court may order one or more of the following:

(1) A continuance of the trial date, if no prejudice is involved to the party who is not at fault;
(2) Entry of a pretrial order based conforming party's proposed description of the facts and law;
(3) An award of monetary sanctions including attorneys' fees against the party at fault and/or counsel, payable to the party not at fault; and/or
(4) An award of non-monetary sanctions against the party at fault including entry of judgment of dismissal or the entry of an order striking the answer and entering a default.

If Ms. Anugom intends to serve as counsel of record for a party in an adversary proceeding pending before this Court, the Court strongly recommends that she familiarize herself with, and make it a point of complying with, the local rules of this Court.

As DDLM's response to the OSC provides no information whatsoever as to why HE, DDLM, after signing a substitution of attorney in which he agreed to represent himself from and after September 1, 2021, failed to participate in the preparation of a joint status report in connection with either the September 28 or the December 14 status conference, failed to meet and confer with the trustee or his counsel as required by this court's local rules and the Federal Rules of Bankruptcy Procedure and filed an answer to complaint that does not contain specific admissions and denials of the trustee's allegations, continue the hearing to give DDLM yet one more opportunity to provide the court with this information.

> NOTE: DDLM cannot merely state that he objects to this court's exercise of jurisdiction over this action and then choose not to participate. This will result in the entry of an order striking his answer and the entry of a(nother) default judgment in favor of the trustee. This court has jurisdiction over this adversary proceeding pursuant to 28 U.S.C. sections 157 and 1334 and this district's general order of reference. The court understands this objection as an objection to the court's entry of final orders in this adversary proceeding, as that is the appropriate form of objection. (After trial, this Court would make proposed findings of fact to the district court.) If DDLM would like this matter to be heard by the district court rather than the bankruptcy court, he will need file a motion for withdrawal of the reference, but if the basis for that motion is that he wants to have this matter heard by a jury, DDLM should be aware that the established practice in this district is to have the bankruptcy court conduct all pretrial matters up through and including the pretrial conference and then to have the matter sent to the district court when it is ready for trial.

In light of the discussions on the record at the time of the January 25, 2022 hearing, Anugom could not possibly have missed the fact that the Court was insisting on a declarartion ***from De La Madrid*** – and not an attorney for him – explaining why ***De La Madrid*** (who was representing himself from September 1, 2021 through December 14, 2021) failed to meet and confer with the Plaintiff, to participate in the preparation of joint status reports or to take any action to remedy the defects in the Answer. The Court emphasized this point on the record at the January 25 hearing no fewer than four times and set a continued hearing on the OSC for April 5, 2022 at 2:00 p.m. on the OSC. The Court gave De La Madrid until February 22, 2022 to file and serve his supplemental opposition to the OSC. Responses from the Plaintiff were due by March 15, 2022. Replies to the Plaintiff's responses were due by March 22, 2022.

G. <u>De La Madrid's Second and Third Failures to Provide a Declaration</u>

Notwithstanding the Court's explicit instructions that it wanted a declaration *from De La Madrid himself*, Anugom's February 22, 2022 response to the OSC [Docket No. 123] again consists of an objection to this Court's exercise of jurisdiction and a declaration from Anugom. **There was no declaration from De La Madrid.** After three opening paragraphs in which she testifies that she is over 18, is not a party to the Action and is representing De La Madrid and that the declaration was filed in response to the OSC, Anugom offers the following explanation

for De La Madrid's inaction. **This is the only information contained in the entire response on this topic:**[16]

> 4. The only correspondence I received from Gonzalez [the Plaintiff] prior to the hearing in this Court this past November[17] is dated "October 15, 2021," and I have attached it hereto. It is addressed to me, am the intended recipient, am the owner and custodian thereof, and I authenticate it. As can be seen, while it's a two-page letter which addressed to both my client and myself, **he nowhere therein makes any reference to a joint status report**.

Docket No. 123, at ¶ 4. This declaration tells the Court absolutely nothing about what De La Madrid did or didn't know about his obligations under the LBRs and the Federal Rules of Bankruptcy Procedure. It does not explain why De La Madrid did not meet and confer with the Plaintiff in an effort to prepare the required joint status reports or why he did not take any steps to remedy the defects in the Answer.

Notwithstanding the Court's admonition at the September 28, 2021 status conference that the parties' were mutually obligated to file a joint status report two weeks before every status conference, as required by the Court's local rules – *which admonition both Anugom and De La Madrid heard at that status conference* – the entirety of De La Madrid's second response to the OSC was to note that a letter that De La Madrid and Anugom had received from the Plaintiff did not mention a joint status report. Is Anugom trying to say that De La Madrid was not required to comply with the Court's local rules or the Federal Rules of Bankruptcy Procedure – *or explicit instructions given to him by the Court* -- because the Plaintiff's October 15 letter did not remind Anugom and her client of these obligations?

On March 4, 2022, in his written response to De La Madrid's February 22 filing [Docket No. 125], Plaintiff noted that Anugom had failed to follow the Court's explicit instructions to file a **declaration from De La Madrid** explaining his inaction. The Court had authorized the filing of a reply to the Plaintiff's opposition by March 22, 2022. Having been reminded by Plaintiff in writing of what the Court had instructed De La Madrid to file, Anugom could have used her March 22 filing to finally supply the document the Court had been requesting -- a declaration

[16] The balance of the declaration contains argument directed toward the merits of the claims alleged in Action.
[17] Perhaps this should be December? There was no hearing in November of 2021.

from De La Madrid explaining why he did not meet and confer with the Plaintiff or participate in the preparation of a joint status report in connection with either the September or December, 2021 status conferences. Instead and inexplicably, she failed to do so. (De La Madrid did not file a reply of any kind to the Plaintiff's March 4, 2022 papers.)

The Court recognizes that parties representing themselves may be confused as to the requirements of the Court's local rules or the Federal Rules of Bankruptcy Procedure and makes an extra effort to ensure that such parties understand what is required of them. However, for reasons that remain entirely unclear, De La Madrid is apparently unwilling to tell the Court under penalty of perjury whether or not he understood his obligations and why he failed to comply with them. The Court may well have been satisfied with whatever explanation he provided – if only he had provided an explanation. Any explanation. But De La Madrid has never provided an explanation of any kind, notwithstanding his having been given multiple opportunities to do so.[18]

H. Final Hearing on the OSC

The Court conducted a continued hearing on the OSC on April 5, 2022 at 2:00 p.m. At the commencement of that hearing, the Court read the following tentative ruling into the record, which it adopted as the basis for its final ruling, striking De La Madrid's Answer and permitting the Plaintiff to proceed by way of default:

> As the court explained at the January 25, 2022 hearing, the defendant was representing himself from the time he substituted himself in place of Mr. Pratt on September 1, 2021 until Ms. Anugom became his counsel of record on December 14, 2021. The court wants to know why ***Mr. De La Madrid himself*** did not participate in the preparation of a joint status report for either the September 28 or December 14 status conferences, failed to meet and confer with the trustee or his counsel as required by this court's local rules and the Federal Rules of Bankruptcy Procedure and filed an answer to complaint that does not contain specific admissions and denials of the trustee's allegations.
>
> The first response that the court received, as discussed in the prior tentative ruling, contained **no information whatsoever** about why the defendant failed to do

[18] Moreover, De La Madrid, unlike many other self-represented parties, had the benefit of counsel appearing on his behalf at the July 27, September 28 and December 14 status conferences whose duty, at a minimum, and even while only "specially appearing," would have included communicating to De La Madrid what the Court had instructed him to do at that status conference.

> anything. The only declaration filed was that of counsel who was not representing the defendant until December 14, 2021. It was for this reason that the Court continued the hearing on the OSC to April 5, 2022 **"to give DDLM yet one more opportunity to provide the court with this information."**
>
> Yet, inexplicably, once again, defendant has provided **no information whatsoever** on the only issue the court directed him to address. Again, there is no declaration from the defendant. The only declaration is that of his attorney -- again. And the substance of the declaration has nothing to do with the issues raised by the OSC.
>
> Strike defendant's answer to complaint and permit plaintiff to proceed by way of default judgment.

The Court entered a written order to this effect on April 7, 2022 [Docket No. 129].

I. <u>Denial of De La Madrid's Second Motion to Dismiss</u>

Notwithstanding its ruling in response to the OSC, the Court nevertheless considered the Second Motion to Dismiss on the merits at the April 5, 2022 hearing and denied that motion by order entered April 7, 2022 [Docket No. 130]. The Court set forth the basis for its ruling on the Second Motion to Dismiss in the tentative ruling that it read into the record at the commencement of the hearing on that motion:

> Deny motion on both procedural and substantive grounds. Defendant filed an answer to the complaint on September 2, 2021. He filed this motion to dismiss on January 7, 2022. This motion should have been brought **before** an answer was filed, not after. Now that an answer has been filed, if defendant wants to see the action dismissed, he should bring a motion for summary judgment or perhaps a motion for judgment on the pleadings, but it is too late for this motion.
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> However, even if the court were to construe the motion as a motion for judgment on the pleadings, it would should [sic] be denied. Before it may grant a defendant's motion for judgment on the pleadings, it must find that the facts alleged in the complaint, when taken as true, do not entitle the plaintiff to a legal remedy. But defendant's motion is not based on the facts alleged in the complaint. The motion seeks to introduce additional facts by way of declarations from the defendant and that of Kenneth Adler and exhibits thereto. This would only be appropriate in the context of a motion for summary judgment and defendant has not complied with the applicable procedures for bringing a motion for summary judgment.
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> And even in the context of a motion for summary judgment, the motion should be denied. The trustee did name De La Madrid doing business as "Llamas Estate, LLC" in the complaint and has alleged that there are no records with the New Mexico Secretary of State or with any Secretary of State in the United States regarding the formation or existence of such an entity. Defendant concedes in the motion that the LLC did not even exist as of the time of the transfer. Defendant contends that, even prior to its

> formation, the LLC was an unincorporated association that is a suable entity in its own right; however, even if the court were to accept that proposition as true, it does not mean that, prior to incorporation (or formation of an LLC), an individual who intends to form an LLC is protected from personal liability for actions he takes on behalf of a then nonexistent entity. The corporate veil or limited liability aspect of an LLC is not retroactive to a date prior to its existence.
>
> Deny motion.

J. De La Madrid's Reconsideration Motion

On April 21, 2022, De La Madrid filed a motion for reconsideration [Docket No. 133] (the "Reconsideration Motion"). Although what the motion asks the Court to reconsider is unclear from the body of the motion, based on the substance of the arguments advanced in the motion and the proposed form of order lodged in connection therewith, the Court interpreted the Reconsideration Motion as a motion for reconsideration of Docket No. 130 -- its April 7, 2022 order denying the Second Motion to Dismiss. (The Reconsideration Motion does NOT include a declaration from De La Madrid explaining why he failed to participate in pretrial proceedings.) On April 27, 2022, the Court entered an order [Docket No. 137] denying the Reconsideration Motion. That order sets forth in detail the basis for the Court's ruling, which had nothing to do with the OSC or De La Madrid's failure to participate in pretrial proceedings.

K. The Plaintiff's Second Motion for Default Judgment

At the status conference held in the Action on April 5, 2022, the Court instructed the Plaintiff to file and serve a motion for entry of default judgment not later than April 26, 2022 and to notice a hearing on the motion for May 17, 2022 at 2:00 p.m. Pursuant to the Court's local rules, oppositions to the motion were due on May 3, 2022. Plaintiff filed his motion for default judgment against De La Madrid dba Llamas Estate, LLC, dba Muzikneum, Ltd dba Castizo Holdings, LLC on April 25, 2022 [Docket No. 135] (the "DJM"). None of the Defendants filed an opposition to the DJM.

The Court conducted a hearing on the DJM at 2:00 p.m. on May 17, 2022. Anugom represented the interests of De La Madrid at that hearing. The Court noted a number of problems with the DJM at the May 17 hearing, including references to missing exhibits and the

lack of evidence as to the value of the underlying real property at the time of the transfer.[19] The Court, therefore, continued the hearing on the DJM to June 22, 2022 at 10:00 a.m. and directed the Plaintiff to file and serve not later than June 1, 2022 an amended motion that included the missing information. (The Court also suggested that, if the Plaintiff so desired, he could include in his amended motion a request for entry of default judgment as against the two remaining individual defendants, Villareal and Perez). The Court set a deadline of June 8, 2022 for oppositions to the amended motion and a deadline of June 15, 2022 for replies.

The Plaintiff filed and served his amended DJM (the "ADJM") and an appendix of exhibits on June 1, 2022 [Docket Nos. 143 and 140, respectively]. None of the Defendants filed an opposition to the ADJM. The Court conducted a hearing on the ADJM on June 27, 2022 at 2:00 p.m. Anugom again represented De La Madrid at that hearing.[20] Based on the evidence contained in the ADJM and the Court's records and files in the Action, the Court granted the ADJM in part and agreed to submit this report and recommendation to the District Court. The substance of this Court's recommendations are set forth in section IV below.

III

FACTUAL BACKGROUND

1. In the Petition filed October 17, 2017, the Debtors represented[21] that they were the sole proprietors of a business under the name "Las Palomas Night Club" operating at 7220 S. Western Avenue, Los Angeles, California 90047 (the "Property"). [See Case Docket No. 1, page 4, part 3, question 12.]

2. On the Schedules the Debtors filed in the Case, the Debtors represented that they did not own any real property. [Case Docket No. 1, page 10, part 1, question 1(a); Case Docket No. 1, page 12, part 1, question 1.]

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[19] The Plaintiff remedied the problem of the missing exhibits by filing an appendix with the missing exhibits on May 16, 2022 [Docket No. 139].

[20] When the Court noted at that hearing that Anugom had not filed an opposition to the ADJM, Anugom claimed that she had not received a copy of the ADJM; however, she confirmed on the record at the time of hearing when questioned by the Court on the subject that the address shown on the proof of service attached to the ADJM was her correct mailing address.

[21] The Debtors signed the Petition [Case Docket No. 1] and all of the schedules and statements that they filed when they commenced the Case under penalty of perjury.

3. In response to question no. 18 on their Statement of Financial Affairs, the Debtors represented that they had not sold or transferred any property to anyone within 2 years before the bankruptcy filing, other than property transferred in the ordinary course of business. [Case Docket No. 1, page 33, part 7, question 18.]

4. Although they disclosed having received wages for calendar years 2015 and 2016 in response to question 4 in part 2 of their Statement of Financial Affairs, the Debtors did not disclose having received any income from the operation of a business for this period and did not disclose having received either wages or income from the operation of a business for the period from January through October of 2017. [Case Docket No. 1, pp. 30-31.]

5. The Debtors represented on their Statement of Current Monthly Income that the average of all income that they received from all sources for the 6 months preceding the bankruptcy filing was $0 per month. [Case Docket No. 1, p. 41.]

6. The only source of income shown on the Debtors' Statement of Current Monthly Income is $200 per month "from children." [Case Docket No. 1, p. 42.]

7. Although they had described themselves as the sole proprietors of Las Palomas Night Club (the "Business") on the Petition, on their Schedule I, both Debtors list their occupation as "UNEMPLOYED." [Case Docket No. 1, p. 25.]

8. On their Schedule A/B, the Debtors list total assets consisting of personal property with a value of $1,200. [Case Docket No. 1, p. 16.] The Debtors claimed that all of this personal property was exempt on their Schedule C. [Case Docket No. 1, p. 17.]

9. A grant deed was recorded with the Los Angeles County Recorder's Office (the "Recorder's Office") on May 6, 2015 in which the Property was transferred to "Jose Antonio Zamora, a married man as his sole and separate property." [ADJM, Docket No. 143, Exhibit 1.]

10. Also on May 6, 2015, DV Financial Group ("DV Financial") recorded with the Recorder's Office a deed of trust against the Property to secure the repayment of a loan in the original principal amount of $162,000. [ADJM, Docket No. 143, Exhibit 2.]

11. On February 12, 2016, Coastal Capital Group LLC ("Coastal Capital") recorded with the Recorder's Office a deed of trust against the Property to secure the repayment of a loan in the original principal amount of $45,000. [ADJM, Docket No. 143, Exhibit 3.]

12. On February 12, 2016, Jose Antonio Zamora recorded with the Recorder's Office a Request for Notice of Default, requesting copies of any notices of default or notices of trustee sale that had been recorded with regard to the Property by Coastal Capital. [ADJM, Docket No. 143, Exhibit 4.]

13. On February 21, 2017, Rosario Torres, Sandra Torres and Gerardo Barrios, the defendants and cross-complainants in a state court action brought by debtor Antonio Zamora (Case No. BC612275), recorded a Notice of Pending Action with the Recorder's Office affecting the Property. [ADJM, Docket No. 143, Exhibit 5.]

14. On August 7, 2017, Coastal Capital recorded with the Recorder's Office a Substitution of Trustee and Deed of Reconveyance with regard to the Property pursuant to which, among other things, Coastal Capital transferred its interest in the Property to FCI Lender Services, Inc. ("FCI Lender"). [ADJM, Docket No. 143, Exhibit 6.]

15. On July 31, 2017, Jose Antonio Zamora executed a Quit Claim deed (the "Quit Claim") in which he transferred to "Llamas Estates, LLC, a New Mexico limited liability company," all of this right, title and interest in and to the Property. The Quit Claim was recorded with the Recorder's Office on October 12, 2017 (five days before the bankruptcy Case was filed). [ADJM, Docket No. 143, Exhibit 7.]

16. The Quit Claim represents that there is no documentary transfer tax due because the transfer is exempt from such tax under Revenue & Taxation Code section 11925(d) because the grantor and the grantee in this conveyance are comprised of the same party who continues to hold the same proportionate interest in the property.

17. Although Llamas Estates, LLC was identified in the Quit Claim as a New Mexico limited liability company, there are no records with the New Mexico Secretary of State or any Secretary of State in the United States reflecting the formation or existence of an entity by this name. [Declaration of Rosendo Gonzales in Support of ADJM ("Gonzales Declaration"), Docket No. 143, p. 33 at ¶ 18.]

18. On or about July 29, 2017, Jose Antonio Zamora and De La Madrid entered into an agreement entitled "Subscription Agreement to Llamas Estates, LLC" (the "Subscription Agreement"). [Gonzales Declaration, Docket No. 143, p. 35 at ¶ 26 and Exhibit 11 thereto ("Subscription Agreement").]

19. Pursuant to the Subscription Agreement, in exchange for a transfer of title to the Property and the bar and grill named "Las Palomas" to an LLC to be known as Llamas Estates, LLC, for which articles of organization would later be filed with the Secretary of State for New Mexico, De La Madrid was to pay the lesser of $400,000 or the appraised value of the Property. [Subscription Agreement, p. 1, at second paragraph.]

20. The Subscription Agreement also required Jose Antonio Zamora to transfer the ABC license that permitted him to serve beer and wine for the night club he operated on the Property to "Muzikneum, LTD," which the agreement identifies as a "business trust settled by Danniel for the benefit of" Castizo Holdings, LLC. [Subscription Agreement, p. 1, fourth paragraph, item .01.]

21. Pursuant to the Subscription Agreement, De La Madrid was to cause articles organization to be filed with the Secretary of State for the State of New Mexico for Llamas Estates, LLC and to have an operating agreement prepared for that entity. Initially, Jose Antonio Zamora was to be the manager of that entity; however, once all amounts due Zamora had been paid in full, De La Madrid was to become the sole manager of that entity and would be entitled to have the membership interest issued in the name of an LLC by the name of Castizo Holdings, LLC. [Subscription Agreement, p.1, second, third and final paragraph; p. 2, carryover paragraph.]

22. Issues concerning the manner in which a corporation or limited liability company are to be created and the laws that govern the extent to which its members, shareholders, officers, directors, etc., can be held liable for conduct that occurs in connection with the operation of that company are ordinarily decided under the laws of the state of incorporation. See Uno Broad. Corp., 167 B.R. 189, 196 (Bankr. D. Ariz. 1994) ("It is well established that the law of the state of incorporation should determine issues relating to a corporation's internal affairs. *First Nat'l City Bank v. Banco Para El Comercio Exterior de Cuba,* 462 U.S. 611, 621,

103 S. Ct. 2591, 2597, 77 L. Ed. 2d 46 (1983); *Rogers v. Guaranty Trust Co. of New York,* 288 U.S. 123, 130, 53 S. Ct. 295, 297, 77 L. Ed. 652 (1933); *Restatement (Second) of Conflicts of Laws,* § 302 (1971)").

23. The Subscription Agreement provides that "The terms and provisions of this Subscription Agreement, and any dispute arising thereunder, shall be governed by the internal law, and not the conflicts of law, of the state of New Mexico." [Subscription Agreement, p. 2, first full paragraph.]

24. In New Mexico, an LLC is formed when the articles of organization are filed with the Secretary of State or on any later date specified in the articles of organization. NMSA 1978, § 53-19-10(A) (1993); see NMSA, § 53-19-2(I). See also Casias v. N.M. Taxation & Revenue Dep't, No. A-1-CA-36316, 2019 N.M. App. Unpub. LEXIS 109, at *8 (Ct. App. Mar. 25, 2019) (taxpayer who tried to avoid personal liability for taxes by arguing that taxes were incurred by LLC he had created and not by him in his personal capacity was personally liable for taxes because he failed to offer a copy of the articles of incorporation stamped "filed" and marked with the filing date, which would have been conclusive evidence that the LLC had been organized and formed pursuant to New Mexico's limited liability act at the time the taxes were incurred).

25. Articles of organization were not filed for Llamas Estate, LLC with the Secretary of State for the State of New Mexico until November of 2017, after both execution and recordation of the Quit Claim. Articles of organization were never filed under the name of the grantee shown on the Quit Claim, Llamas Estates, LLC. [Defendant's Motion for Reconsideration, Docket No. 133, at p. 5, lines 15-22.] Thus, no entity bearing the name Llamas Estates, LLC was ever created and, at the time of the Sale, neither Llamas Estates, LLC nor Llamas Estate, LLC had been created under the laws of the State of New Mexico.

26. The Plaintiff has been unable to locate any escrow used in connection with the transfer of the Property reflected on the Quit Claim (the "Sale"). [Gonzales Declaration, Docket No. 143, p. 34 at ¶ 21.]

27. Although the Subscription Agreement contemplated that an appraisal of the Property would be obtained, the Plaintiff has been unable to locate any evidence that an appraisal was ever obtained. [Gonzales Declaration, p. 36, at ¶¶ 30-31.]

28. Although the Subscription Agreement contemplated that an operating agreement would be prepared that would appoint Jose Antonio Zamora as the manager of Llamas Estates, LLC, the Plaintiff has been unable to locate any evidence that such an agreement was ever prepared. [Gonzales Declaration, p. 36, at ¶ 33.]

29. The Plaintiff has been unable to locate any records from any secretary of state within the United States evidencing the existence of an entity known as Muzkneum, Ltd. or Castizo Holdings, LLC. [Gonzales Declaration, p. 35-36, at ¶ 28-29.]

30. In connection with the Sale, De La Madrid caused the following payments, totalling $396,175.58, to be made as consideration for the transfer of the Property, the Business and any associated liquor licenses (collectively, the “Transferred Assets”):

a. $162,000 via cashier's check no. 234809, dated July 26, 2017, payable to DV Financial;

a. $47,695.58 via cashier's check no. 118263, dated July 26, 2017, payable to FCI Lender;

b. $6,480 via cashier's check no. 118263, dated July 26, 2017, payable to FCI Lender;

c. $80,000 via cashier's check no. 118625, dated July 26, 2017, payable to Wescom Credit Union ("Wescom"), with a reference to an account ending in the numbers “8012” (the “Perez Check"); and

d. $100,000 via cashier's check no. 118266, dated July 26, 2017, payable to Chase with a reference to “Eliza Villareal" inserted in the memo section of the cashier's check) (the “Villareal Check").

[Gonzales Declaration, Docket No. 143, p. 34 at ¶ 23 and Exhibit 9 thereto.]

31. The Villareal Check was a transfer to or for the benefit of Villareal. [Gonzales Declaration, Docket No. 143, p. 34 at ¶ 24 and Exhibit 9 thereto.]

32. The Perez Check was a transfer to or for the benefit of Perez and was deposited into her checking account at Wescom on July 29, 2017. [Gonzalez Declaration, Docket No. 143, p. 35 at ¶ 25 and Exhibits 9 & 10 thereto.]

33. In the declaration that he filed in support of the Reconsideration Motion, De La Madrid offered the following description of the Sale transaction:

> 4. I am a dedicated do-it-yourselfer. One day in February of 2017, I was driving through the neighbourhood [footnote omitted; see supra note 6] and saw a "for sale" sign posted at the subject property, so I stopped, and met the owner Jose Zamora ("Debtor") for the very first time. The premises were extremely dilapidated and Jose told me that the business was failing, he was having trouble paying the mortgages against the property, and he wanted to retire and return to his native Mexico. I did not ask if he didn't have any financial problems, although of course by purchasing the property and paying off those mortgages, I knew I was helping to improve his financial condition.
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> 5. I had previously worked as a loan officer for a real estate broker and believe that brokers are exorbitantly overpaid for very little work, especially in those cases where they do not even find the buyer. By not bringing in a broker, this put another 6% on the table and helped in my negotiations with him. To be sure, not obtaining a title insurance policy turned out to be a mistake, as I only learnt much later.
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> * * * *
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> 7. I insisted that all mortgages be satisfied, and I paid some other bills of his that were in arrears. However, he asked that the remaining balance be paid to his daughters because by then he was retiring and moving back to Mexico. I had been involved in innumerable escrows during my time as a loan officer and it was common for the seller to direct some or all of the proceeds to be paid to someone other than the seller or title holder, so my suspicions not only were not aroused, but his explanation that he wanted his daughters – who remained in Los Angeles – to have the money made perfect sense to me. Nor did I see any basis to refuse his request. So I paid the balance to them per his directions.

Reconsideration Motion, Docket No. 133, pp. 25-26.

34. The Plaintiff attempted to obtain documentation from De La Madrid as to the nature and value of any liquor licenses that he acquired from the Debtor, but De La Madrid refused to provide any such documentation. [Gonzales Declaration, Docket No. 143, p. 42 at ¶ 68.]

35. The Plaintiff attempted to obtain documentation from De La Madrid as to the value of the Business operated by the Debtors on the Property, but De La Madrid refused to provide any such documentation. [Gonzales Declaration, Docket No. 143, p. 42 at ¶ 69.]

36. The Plaintiff attempted to inspect the Property to examine the assets of the business, such as equipment, fixtures, furniture, etc., but De La Madrid refused to permit the Plaintiff or his broker to enter the Property. [Gonzales Declaration, Docket No. 143, p. 42 at ¶ 70.]

37. According to the Declaration of Rene Mexia filed in support of the ADJM, the Property had a value (excluding the value of the Business and any liquor licenses(s)) at the time of the Sale of approximately $415,000. [Mexia Declaration, Docket No. 143, p. 44 at ¶ 7.]

38. De La Madrid was the initial transferee of the Transferred Assets within the meaning of Bankruptcy Code section 550(a)(1).

39. Villareal and Perez, having received payment of the net proceeds generated by the Sale of the Transferred Assets to De La Madrid, can be characterized as the immediate or mediate transferees of the Transferred Assets from De La Madrid within the meaning of Bankruptcy Code section 550(a)(2). Alternatively, if De La Madrid was obliged to make the payments to or for the benefit of Villareal and Perez pursuant to his agreement with the Debtors, Villareal and Perez could be characterized as the initial transferees of the funds paid to them within the meaning of Bankruptcy Code section 550(a)(1).

IV

ANALYSIS AND RECOMMENDATIONS

A. Allegations of the Amended Complaint

The Plaintiff's First Amended Complaint contains nine claims for relief:

1. breach of contract as against De La Madrid only (on the theory that he was supposed to pay $400,000 and only paid $396,175.58);

2. avoidance of transfers to De La Madrid, Villareal and Perez made with actual intent to hinder, delay or defraud creditors pursuant to Bankruptcy Code sections 544(b)[22] and 548(a)(1)(A);
3. avoidance of transfers made to De La Madrid, Villareal and Perez for less than reasonably equivalent value at a time when Debtors were insolvent or were rendered insolvent under Bankruptcy Code sections 544(b) and 548(a)(1)(B);
4. avoidance of transfers made to De La Madrid, Villareal and Perez for less than reasonably equivalent value at a time when the Debtors were engaged in or about to engage in business for which they retained unreasonably small capital under Bankruptcy Code sections 544(b) and 548(a)(1)(B);
5. avoidance of transfers made to De La Madrid, Villareal and Perez for less than reasonably equivalent value at a time when the Debtors intended to incur, or believed they would incur, debts beyond their ability to pay as they matured under Bankruptcy Code sections 544(b) and 548(a)(1)(B);
6. recovery of the avoided transfers from De La Madrid, Villareal and Perez as the initial transferees thereof pursuant to Bankruptcy Code section 550(a)(1);
7. recovery of the avoided transfers from De La Madrid, Villareal and Perez as the secondary (immediate or mediate) transferees thereof pursuant to Bankruptcy Code Section 550(a)(2);
8. request that any transfers avoided under any of the above theories be preserved for the benefit of the Debtor's estate pursuant to Bankruptcy Code section 551; and
9. unjust enrichment/restitution as against all Defendants.

Amended Complaint, Docket No. 7.

[22] Bankruptcy Code section 544(b) permits a trustee in bankruptcy to avoid any transfer of an interest of the debtor in property that is voidable under applicable law by a creditor holding an unsecured claim that is allowable under section 502 of the bankruptcy code. Relying on this section, a trustee may avoid transfers under state law by using the fraudulent transfer provisions of the California Civil Code. This may become useful as state law has a longer "reachback" period than the comparable section of the Bankruptcy Code that permits the avoidance of fraudulent transfers under federal law, Bankruptcy Code section 548.

B. Recommended Judgments

For the reasons set forth below, the Bankruptcy Court recommends that judgment be entered in favor of the Plaintiff as follows:

1. as against De La Madrid on Plaintiff's Second, Sixth and Eighth claims for relief for avoidance and recovery of the Transferred Assets, subject to an equitable lien in favor of De La Madrid for the amount of $396,175.58;
2. as against Villareal on Plaintiff's Second, Third, Fourth, Fifth, Seventh and Eighth Claims for relief for recovery of the sum of $100,000; and
3. as against Perez on Plaintiff's Second, Third, Fourth, Fifth, Seventh and Eighth Claims for relief for recovery of the sum of $80,000.

C. Propriety of Entering Default Judgments

Defendants Villareal and Perez were served with a valid summons and the Amended Complaint on August 2, 2019. [See Docket No. 10.] The De La Madrid Defendants were served with a valid summons and the Amended Complaint on August 3, 2021. [See Docket No. 87.] No issues have been raised by any party as to the validity of either instance of service. Only De La Madrid filed an Answer to the Amended Complaint within the time provided under Fed. R. Bankr. P. 7012(a) or at all.

Obtaining a default judgment is a two-step process. See Eitel v. McCool, 782 F.2d 1470, 1471 (9th Cir. 1986). First, when a party fails to file a timely response to a complaint, and that failure is established by affidavit or otherwise, the clerk of the court enters the default of the party who has failed to file an answer or otherwise defend the action. Second, either the clerk or the court, depending on the nature of the plaintiff's claim, then enters a default judgment in the action. Fed. R. Civ. P. 55(a) and (b), made applicable herein by Fed. R. Bankr. P. 7055.

In response to declarations filed by the Plaintiff, the Clerk entered the defaults of Perez and Villareal on September 4, 2019. [See Docket Nos. 19 and 20, respectively.] Plaintiff obtained a default judgment against these two individuals as part of the original default judgment entered by this Court on January 30, 2020 [Docket No. 47] (the "Original Judgment"). Perez and Villareal never appealed the Original Judgment; however, De La Madrid did appeal

that judgment, and the Original Judgment was reversed and remanded insofar as it pertained to De La Madrid, as discussed in section II(A) above. To avoid any confusion as to the validity of the Original Judgment as against Perez and Villareal, and to permit the Court to enter a single judgment disposing of the entire Action, the Plaintiff has renewed his request for entry of a default judgment as against Perez and Villareal.

In response to a declaration filed by the Plaintiff [Docket No. 107], the Clerk entered the defaults of all of the De La Madrid Defendants other than De La Madrid himself (the "Remaining Defendants")[23] on November 1, 2021. [See Docket Nos. 108, 109 & 110.] The Plaintiff did not request the entry of De La Madrid's default following remand, as De La Madrid filed a timely Answer to the Amended Complaint on September 2, 2021, but the Answer that he filed was defective in a number of respects. And, thereafter, De La Madrid repeatedly failed to cooperate in moving this Action forward in the manner required by the Court's local rules.

The Answer, the text of which is quoted in its entirety in section II(C) of this report and recommendation, did not comply with FRCP 8(b), made applicable herein by FRBP 7008: it includes a general denial of allegations that cannot in good faith be disputed by De La Madrid and includes several affirmative defenses that have no application in this context. Moreover, as discussed in detail in Section II of this report and recommendation, although De La Madrid attended (with the assistance of counsel) all of the status conferences scheduled in the Action, he failed to take any steps to remedy the defects in his Answer and failed, repeatedly, to participate in the preparation of a joint status report. This conduct, standing alone, would not have been sufficient to persuade the Court to take the extreme step of striking De La Madrid's Answer and permitting the Plaintiff to proceed by way of default, but his repeated refusal to provide any explanation whatsoever for this conduct left the Court with no alternative but to permit Plaintiff to move forward without De La Madrid's continued participation.

For reasons that this Court still does not understand, De La Madrid refuses to comply with basic instructions provided by this Court. He knows what a declaration is and how to file

[23] As discussed supra in note 7, the Remaining Defendants were identified in the caption of the Action as names under which De La Madrid was doing business rather than as separate legal entities. Therefore, it may well be unnecessary or meaningless for the Plaintiff to have defaults entered or to obtain judgments against fictitious business names.

one with the Court, as evidenced by the fact that he has prepared and filed such a document, for example, in support of his Second Motion to Dismiss. Yet he will not file one, despite this Court's repeated requests, discussing why he failed to comply with the Court's pretrial procedures during the period from September 1, 2021 to December 14, 2021. Perhaps he initially misunderstood the need for him to provide his own declaration in response to the Court's December 15, 2021 OSC [Docket No. 117], but any such misunderstanding could not have persisted after the January 25, 2022 hearing on the OSC, in connection with which the Court, both in its written tentative and in its oral remarks at the hearing, explained in no uncertain terms that it would require a declaration executed *by De La Madrid himself and not by his attorney*. If any confusion or misunderstanding as to what the Court required somehow remained after De La Madrid filed his second opposition to the OSC on February 22, 2022, Plaintiff's March 4, 2022 response to that opposition would have cleared up that confusion or misunderstanding. That response reiterated that the Court had instructed De La Madrid to provide *his own declaration*, and not that of his attorney, as to why he didn't comply with this Court's pretrial procedures while he was representing himself in the Action. Yet De La Madrid still did not file the requested declaration and has not to this day provided any explanation for his inaction.

The bar set by this Court for De La Madrid to avoid having the Answer stricken was exceedingly low, yet, after having been given at least three opportunities, he still failed to make the minimal effort necessary to maintain his ability to defend the Action on the merits. From this Court's perspective, attempting to move this Action forward with De La Madrid and his counsel participating in the litigation has been, to use a colorful metaphor, like trying to nail Jello to the wall. It simply cannot be done, and this Court should not be required to continue its efforts to do so.

Moreover, it is worthy of note that the facts on which the Plaintiff has based the Amended Complaint are not in dispute. There is no dispute as to the terms of the Sale, the amount of consideration paid or where the sales proceeds went. There is no dispute that articles of organization for the entity identified on the Quit Claim as the transferee had not been filed with any Secretary of State at the time the Quit Claim was executed or recorded, and that

no entity by this name was ever created. Articles of organization for an entity with a slightly different name were filed three or four months after the Quit Claim was signed and approximately a month or so after the Quit Claim was recorded. De La Madrid advanced certain legal arguments based on these undisputed facts in his Second Motion to Dismiss. The Court considered these arguments on the merits and found them lacking.

The Court set forth its reasons for rejecting the legal arguments advanced by De La Madrid in detail in its April 27, 2022 order denying the Reconsideration Motion, Docket No. 137 (the "April 27 Order"), as follows:

> 26. The gist of the argument advanced in the Motion for Reconsideration is that, because DDLM [Danniel De La Madrid] subsequently formed an LLC under a name that is different from that set forth on the quit claim deed, the Trustee must sue only the LLC that DDLM eventually created and cannot sue DDLM in his personal capacity. In support of this argument, DDLM cites California authorities for the proposition that "a de facto corporation" constitutes an association, which is a legal entity that may be sued. See, e.g., People v. Montecito Water Co., 97 Cal. 276, 277 (1893), cited at page 3 of the Motion for Reconsideration. DDLM also offers authorities for the proposition that the defendant in an action brought by a corporation cannot defend that action by showing that the charter of the entity was obtained by fraud or that the charter was forfeited by misuser or nonuser. See County of Macon v. Shores, 97 U.S. 272, 277 (1877), cited at page 4 of the Motion for Reconsideration. DDLM asserts further that a de facto corporation exists if there has been a colorable attempt to comply with the laws governing the organization of corporations: "where such an organization has thus attempted to be created and has in fact organized and entered upon the transaction of business in good faith, the validity of its existence ought not to be inquired into collaterally." See Westlake Park Investment Co. v. Jordan, 198 Cal. 609, 614-15 (1926), cited at page 6 of the Motion for Reconsideration.
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> 27. From these authorities, DDLM concludes that the Trustee is required to name an entity that did not legally exist at the time of the Transfer and was not the named transferee in the quitclaim deed – and that the Amended Complaint must be dismissed because the Trustee failed to do so. DDLM has offered no support whatsoever for this conclusion.
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> 28. It is one thing to say that an entity that has not yet been incorporated **may** sue or be sued in its own name. It is quite another thing to say that that entity **must** be sued: that the plaintiff cannot sue the individual who later set up that entity; and that the individual has no personal liability for actions he took before the entity was created. None of the authorities that DDLM has cited stand for these propositions or anything remotely like them.
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> 29. An individual may obtain limited liability by setting up a legal entity that has its own separate corporate existence and having that entity execute contracts and create

its own liabilities. That did not happen here. The entity named in the quit claim deed did not legally exist at the time of the Transfer and never came into existence. A different entity with a different name came into existence later. DDLM offers no authority for the proposition that an individual cannot be sued in his personal capacity when he executes a document on behalf of a legal entity that does not exist. Nor has DDLM offered support for the proposition that an individual can obtain the benefit of limited liability if he enters into a contract on behalf of an entity that does not exist at that point in time but comes into existence later. This is not a defect in the manner in which the corporation was created within the meaning of the cited authorities. DDLM took no action to create the entity until after he had entered into an agreement with the debtors on its behalf (or, more accurately, on behalf of an nonexistent entity with a slightly different name).

30. The Motion for Reconsideration is also based on California law. (See Motion for Reconsideration, p. 4 at lines 24-26 ("Here Debtor and Defendant were both then California residents. [Footnote omitted.] Debtor filed his bankruptcy petition as such. [Footnote omitted.] The LLC's only activity has been holding title to the subject property. Hence California law is controlling here as California is the state with the most ties to the LLC . . . .["])). However, issues concerning the manner in which a corporation or limited liability company are to be created and the laws that govern the extent to which its members, shareholders, officers, directors, etc., can be held liable for conduct that occurs in connection with the operation of that company are ordinarily decided under the laws of the state of incorporation. Therefore, it may well be that the law of New Mexico should govern here, not the law of California, but the Motion for Reconsideration says nothing about what the law of New Mexico has to say on this subject.

April 27 Order, pp. 6-9, ¶¶ 26-30 (footnotes omitted).[24] The April 27 Order then cited the same New Mexico authorities referenced in Section III above for the proposition that an LLC does not come into existence under New Mexico law until articles of organization have been filed with the Secretary of State and that, prior to that point in time, the individual acting as an agent for the LLC can be held personally liable for the obligations that he purports to create on its behalf.

Having stricken De La Madrid's Answer to the Amended Complaint, the Court invited the Plaintiff to file a motion for entry of default judgment against the Defendants. Neither De La Madrid nor any of the other Defendants filed an opposition to the ADJM. [See supra note 21.] The Court conducted a hearing on the ADJM on June 22, 2022 at 10:00 a.m.

[24] The omitted footnotes point out that De La Madrid has never conceded that the Debtors are residents of California and has, in fact, repeatedly asserted that the Debtors were not eligible to file bankruptcy in California precisely because they were not residents of California or the United States. (The District Court previously rejected that argument in the USDC Judgment.)

Courts should consider a variety of factors in deciding whether or not to grant a plaintiff's motion for entry of default judgment. These factors include: (1) the possibility of prejudice to the plaintiff; (2) the merits of plaintiff's substantive claim; (3) the sufficiency of the complaint; (4) the sum of money at stake in the action; (5) the possibility of a dispute concerning material facts; (6) whether the default was due to excusable neglect; and (7) the strong policy underlying the Federal Rules of Civil Procedure favoring decisions on the merits. See Eitel, supra, 782 F.2d at 1471-72. Resolution of disputes on their merits is generally favored over default judgments. See id. at 1472. According to Moore's Federal Practice, when faced with the decision to render a default judgment in the first place, it is logical for a court to consider whether factors are present that would later oblige a court to set that default judgment aside. Those factors include: (1) whether the default was willful or culpable; (2) whether granting relief from the default would prejudice the opposing party; and (3) whether the defaulting party has a meritorious defense. 10 Moore's Federal Practice § 55.31[2] (Matthew Bender 3d. ed. 2012). The Court is persuaded that these above factors weigh heavily in favor of the entry of judgment by default in favor of the Plaintiff in the Action.

1. Possibility of Prejudice to Plaintiff

Plaintiff will be prejudiced if default judgment is not granted. Plaintiff, as trustee of a chapter 7 bankruptcy estate, has a duty to administer assets of this bankruptcy estate. As there are limited assets available to fund a potential recovery for creditors in the Case[25], the Plaintiff has not retained counsel to represent him in connection with this litigation. He is acting as his own counsel of record in the Action. As a result, the only compensation he will receive for his services will be capped at a percentage of the amount he is able to distribute from any recoveries obtained, yet the manner in which De La Madrid has chosen to handle the Action has made this process extremely difficult and time-consuming. Rather than participate in pretrial procedures set forth in the Court's local rules designed to facilitate and streamline the process of preparing a case for trial, De La Madrid has failed to provide requested information and documentation, has failed to permit the Plaintiff to inspect the Property, has

[25] The only assets disclosed on the Debtors' schedules were items of personal property valued at $1,200, all of which the Debtors claimed as exempt. [See Case Docket No. 1, pp. 13 & 16-17.]

failed to meet and confer and has generally acted in such a way as to make it impossible for the Plaintiff to move this matter toward trial in a timely and cost-effective manner. Even when given explicit instructions as to what is required of him, he does not comply. Unless the Plaintiff is permitted to obtain a resolution of this matter without further participation from De La Madrid, the delay and expense associated with adjudication of this matter will be increased substantially.

Villareal and Perez have taken no actions whatsoever to appear or defend themselves in connection with the Action. The Plaintiff has no meaningful alternative other than to seek judgment against them by way of default.

2. The Merits of Plaintiff's Claims

The facts outlined in Section III above were not in dispute even before the Court entered its order striking the Answer. With regard to Defendants Villareal and Perez, the facts are straightforward. Rather than retaining the net proceeds generated by the Sale after satisfaction of secured debts against the Property, the Debtors arranged for the full balance of the proceeds to be paid to or for the benefit of Villareal and Perez. Neither has come forward with any evidence to show that the Debtors received any value, such as the satisfaction of an antecedent debt, in exchange for these payments, and the few facts available to the Court from which it can assess the Debtors' financial condition at the time of the Sale are sufficient to demonstrate that they were either insolvent at the time of the Sale or that they were rendered insolvent thereby.

Given Villareal's and Perez's failure to respond to the Amended Complaint, the facts pleaded therein are taken as true, and the Plaintiff has provided evidentiary support for these allegations in the ADJM. These facts are sufficient to support the entry of default judgment in the Plaintiff's favor under both actual and constructive fraud theories as against both Villareal and Perez. Although an exception to liability exists in 11 U.S.C. § 548(c) for a defendant who takes in good faith and gives new value, "the defendants' good faith is an affirmative defense under Section 548(c) which must be pleaded in the first instance as a defense by the defendants. It is not incumbent on the plaintiff to plead lack of good faith on the defendants' part because lack of good faith is not an element of a plaintiff's claim under

Section 548(a) (1)." Bayou Superfund, LLC v. WAM Long/Short Fund II, L.P. (In re Bavou Grp., LLC), 362 B.R. 624, 639 (Bankr. S.D.N.Y. 2007). As defendants Villareal and Perez did not file a response in this action, they have not met the burden of proof required to successfully assert a "good faith" defense to Plaintiff's fraudulent transfer claims.[26]

With regard to Plaintiff's claims against defendant De La Madrid, since service of the Amended Complaint, there have been only two areas of dispute concerning the merits of Plaintiff's prima facie case: (a) whether De La Madrid can be held liable in his individual capacity for actions that he took on behalf of an entity that he intended to form at some point in the future but never formed; and (b) whether De La Madrid paid fair market value for the Property. Notably, De La Madrid never even raised the first of these issues in his Answer. To the contrary, in that document, De La Madrid acknowledged that *he* purchased the Property from the Debtors. [See Answer, Docket No. 88, ¶ 1.] The argument that the Trustee is precluded from proceeding against De La Madrid in his individual capacity was advanced instead in the motions to dismiss that he filed, both of which have been denied on the merits.

With regard to the second of these issues, in the view of this Court, the Plaintiff failed to carry his burden to prove that the purchase price that De La Madrid paid for the Transferred Assets was less than reasonably equivalent value. The only evidence Plaintiff provided as to the value of the Transferred Assets was that the Property had a value of $415,000 at the time of the Sale. The Plaintiff was not able to provide evidence as to the likely value of the Business or the associated liquor licenses at the time of the Sale. De La Madrid paid slightly less than $400,000 for the Transferred Assets, which sum the Court found was reasonably equivalent to $415,000. The Court, therefore, recommends that Plaintiff's default judgment against De La Madrid should not include recovery under any theory that relies upon a finding that the Sale was for less than reasonably equivalent value. Thus, this Court is

[26] This is true whether Villareal and Perez are characterized as initial transferees within the meaning of Bankruptcy Code section 550(a)(1) only entitled to assert a good faith defense under section 548(c) or whether they are immediate or mediate transferees from De La Madrid within the meaning of section 550(a)(2), who may also assert an affirmative defense under section 550(b).

satisfied that the default judgment that it recommends as against De La Madrid does not exceed that to which the Plaintiff is entitled on the merits.[27]

Although the Plaintiff did not sufficiently prove-up that the Sale to De La Madrid was made for less than reasonably equivalent value, the facts and circumstances of the Sale are sufficient to show that the Sale should be avoided as an actual fraud fraudulent transfer. As there is rarely direct evidence of a transferor's intent to hinder, delay or defraud his creditors, a court needs to look to "badges of fraud," from which it may infer actual fraudulent intent. These badges can vary from case to case and not all factors identified in any given case need be present to permit the Court to infer the existence of an actual intent to hinder, delay or defraud. In United States v. 5208 Los Franciscos Way, 385 F.3d 1187 (9th Cir. 2004), the Ninth Circuit supplied the following examples of factors that may support such an inference:

(a) whether the transfer was to an insider;

(b) whether the debtor retained possession or control of the property transferred after the transfer;

(c) whether the transfer or obligation was disclosed or concealed;

(d) whether the debtor was sued or threatened with suit before the transfer was made or obligation was incurred;

(e) whether the transfer was of substantially all the debtor's assets;

(f) whether the debtor has absconded;

[27] Arguably, the judgment recommended by the Court is less generous than that to which the Plaintiff is likely entitled on these facts. In order to be entitled to an equitable lien for the purchase price paid for the Property, Bankruptcy Code section 548(c) would require De La Madrid to plead as an affirmative defense and prove that he took title to the Property for value and in good faith, and the resultant lien would only be for the value that he gave *to the debtor*, not the amounts that were paid to Villareal and Perez. However, inasmuch as the Plaintiff requested in both the Amended Complaint and the ADJM that the transfer of the Property to De La Madrid be avoided, subject to De La Madrid's retention of an equitable lien for the full purchase price, it would be inappropriate for the Court to grant the Plaintiff a remedy that is broader than that for which he has prayed. And, although De La Madrid never pleaded this as an affirmative defense either, De La Madrid alleged in the first paragraph of his Answer that he put more than $200,000 into repairs or improvements to the Property after the Sale. Pursuant to Bankruptcy Code section 550(e), a good faith transferee of an avoidable transfer may assert an equitable lien against property recovered by the trustee to secure the lesser of the cost of any improvements and any increase in value resulting from the improvements, but any costs must be reduced by the amount of any profit realized by or accruing to the transferee from the transferred assets. However, neither of these lien defenses is available to a transferee who was aware of the Debtors' failing financial condition at the time of the transfer and of the fact that all of the net proceeds of sale were to be paid to the Debtors' daughters, as such a transferee cannot be said to be a transferee in good faith.

(g) whether the debtor removed or concealed assets;

(h) whether the value of the consideration received by the debtor was reasonably equivalent to the value of the asset transferred or the amount of the obligation incurred;

(i) whether the debtor was insolvent or became insolvent shortly after the transfer was made or the obligation was incurred;

(j) whether the transfer occurred shortly before or shortly after a substantial debt was incurred;

(k) whether the debtor transferred the essential assets of the business to a lienor who then transferred the assets to an insider of the debtor.

Id. at 1191-92. Many of these badges are present in the instant case -- enough to leave the Court with the unmistakable impression that the purpose of the Sale was to enable the Debtors to keep all of the equity in their assets out of the reach of their unsecured creditors:

a. All of the net proceeds of sale were transferred to insiders of the Debtors, namely, the debtor's daughters.

b. The Sale was made on the eve of the Debtors' bankruptcy filing, the Quit Claim having been recorded only 5 days before the Debtors' bankruptcy filing;

c. The Debtors concealed the Sale by not disclosing it on their statement of financial affairs;

d. The Debtors concealed the income that they had made from operating a business on the Property until shortly before the filing, by failing to disclose any income received from the Business during calendar year 2017;

e. At the time of the sale, the Debtors were in default on the loan due Coastal Capital and were in litigation with the Rosario Torres, Sandra Torres and Gerardo Barrios concerning the Property;

f. The Sale was of substantially all of the assets of the Debtors: following the Sale, the Debtors' had no source of income, were unemployed and had only $1,200 in assets, all of which they claimed as exempt;

g. The Sale was consummated without the assistance of brokers, the use of an escrow or the acquisition of title insurance;

h. The parties never procured the appraisal that was supposed to have determined the value of the Property; and

i. The Sale was accomplished through the use of a quitclaim deed that falsely represented that no transfer tax was due with regard to the transaction.

Based on these facts and circumstances, the Court is satisfied that the Debtors sold the Transferred Assets to De La Madrid with the actual intent to hinder, delay and defraud their creditors. The fact that the Plaintiff failed to establish to the Court's satisfaction that the transfer was for less than reasonably equivalent value as against De La Madrid is beside the point: the plaintiff need not allege and prove that the transfer was for less than fair value if actual intent is alleged and proven under Section 548(a)(1)(A). See Sharp Int'l Corp. v. State Street Bank and Trust Co. (In re Sharp Int'l Corp.), 403 F.3d 43, 56 (2d Cir. 2005) (citing United States v. McCombs, 30 F.3d 310, 328 (2d Cir. 1994)) ("[W]here actual intent to defraud creditors is proven, the conveyance will be set aside regardless of the adequacy of consideration given"); see also Scholes v. Lehmann, 56 F.3d 750, 757 (7th Cir. 1995), reh'g en banc denied, 1995 U.S. App. LEXIS 17088 (7th Cir. 1995), cert. denied sub nom.

Pursuant to Bankruptcy Code section 548(c), even if a transfer is made with the actual intent to hinder, delay or defraud creditors, the initial transferee may retain an equitable lien on the transferred assets to the extent of any value that he gave to the transferors in exchange for the assets. As De La Madrid paid $180,000 of the purchase price for the assets to parties other than the Debtors, the maximum amount of the equitable lien that De La Madrid should be able to obtain under this section would be $216,175.58 ($396,175.58 minus the $180,000 paid to Villareal and Perez). However, in the ADJM, the Plaintiff has expressly requested that avoidance of the Transferred Assets to De La Madrid be subject to a setoff (or equitable lien) for the $396,175.58 paid by De La Madrid in connection with the Sale. Thus, the fact that the Court struck De La Madrid's Answer to the Amended Complaint did not deprive De La Madrid of the ability to advance this defense or increase the recovery obtained by the Plaintiff beyond that to which he would otherwise have been entitled.

With regard to both the transfers to Villareal and Perez and the transfers to De La Madrid, Plaintiff's complaint adequately alleges that Plaintiff is entitled to recover the transfers made to defendant. Under Bankruptcy Code section 550(a), "[T]o the extent that a transfer is avoided under section . . . 548, . . . the trustee may recover, for the benefit of the estate, the property transferred . . . from (1) the initial transferee of such transfer or the entity for whose benefit such transfer was made or (2) any immediate or mediate transferee of such initial transferee." 11 U.S.C. § 550(a)(1) & (2). Therefore, Plaintiff's sixth and seventh claims for relief are meritorious.

Bankruptcy Code section 551 provides that any transfer avoided under section 522, 544, 545, 547, 548, 549 or 724(a) is preserved for the benefit of the estate. Thus, the Plaintiff's eighth claim for relief, requesting that the transfers avoided by way of the Amended Complaint be preserved for the benefit of the Debtors' bankruptcy estate, is meritorious as well.

3. Sufficiency of Plaintiff's Complaint

The Court finds that Plaintiff's complaint is well-pleaded and sets forth plausible facts and does not merely repeat statutory language or conclusory allegations. The Amended Complaint alleges with particularity facts sufficient to show that the Sale to De La Madrid and the subsequent transfer of all net proceeds of the Sale to Villareal and Perez are avoidable transfers within the meaning of Bankruptcy Code sections 544(b), 548(a) and 550(a).

4. The Amount at Stake

Pursuant to Bankruptcy Code section 550(a), once the trustee establishes that a transfer is avoidable, the trustee may recover for the benefit of the estate either the property transferred or the value of such property. As against De La Madrid, the Plaintiff has elected to avoid the transfer, subject to an equitable lien in favor of De La Madrid for the amount he paid in connection with the Sale. With regard to Villareal and Perez, as money is fungible, there is no meaningful difference between recovering the value of the property transferred ($100,000 to Villareal and $80,000 to Perez) and the recovering the property itself. In neither instance is the amount at stake a particularly large number. Thus, this factor weighs in favor of entry of a default judgment.

5. Possibility of Dispute as to Material Facts

As Villareal and Perez have never appeared, and the facts supporting the claims against them are straightforward and supported by the available documentation, it seems highly unlikely that there is a meaningful prospect of a dispute as to a material fact with regard to the Plaintiff's claims against them. With regard to De La Madrid, as discussed above, the Court has already considered on the merits and rejected (twice) the legal arguments that he has advanced, and none of the facts upon which the Plaintiff's claim are based were in dispute even before the Court struck De La Madrid's Answer. Under the circumstances, there do not appear to be any genuine disputes of material fact that would preclude a default judgment as against De La Madrid either.

6. Excusable Neglect

Defendants Villareal and Perez were served with the summons and complaint pursuant to Fed. R. Bankr. P. 7004 on August 2, 2019 [Docket No. 10] and have never contested the effectiveness of this service. It is therefore unlikely that their failure to respond to the complaint was due to excusable neglect. De La Madrid filed a timely Answer to the Amended Complaint. That Answer was only stricken as a sanction after De La Madrid refused to provide his own declaration explaining his failure to participate in required pretrial procedures between September 1, 2021 and December 14, 2021. De La Madrid has never argued that that failure was due to excusable neglect. And it is difficult if not impossible to see how it could have been. The Court repeatedly instructed De La Madrid to file ***his own declaration*** explaining his inaction. Instead, De La Madrid's counsel repeatedly filed papers that did not address the relevant issues and were supported only by a declaration from counsel. This was not excusable neglect. This was willful disregard of the Court's instructions. Thus, this factor weighs in favor of entry of default judgment as well.

7. Policy in Favor of Deciding on the Merits

Cases should be decided upon their merits whenever reasonably possible. Eitel, 782 F.2d at 1472. However, it is impossible for this Court to conduct an adjudication on the merits in light of (1) the complete inaction of two of the defendants (Villareal and Perez) and (2) De La Madrid's repeated and willful failures to comply with this Court's pretrial procedures. On

these facts, the only way for this Court to adjudicate the merits of the Action is in response to a motion from the Plaintiff for entry of default judgments.

8. Factors That Weigh Against Setting Aside Default Judgment

None of the factors referenced above that would oblige a court to set aside a default judgment are present in the instant case. Both with regard to Villareal and Perez, on the one hand, and De La Madrid, on the other, the Court is satisfied that the conduct that led to the entry of their defaults was willful and culpable. The Court has considered all of the facts and circumstances of this case, and, notwithstanding its decision to strike the Answer, has considered on the merits the arguments advanced by De La Madrid by way of defense to this Action. Based on this review, the Court is persuaded that there is little prospect that granting the ADJM would result in prejudice to the opposing parties or that De La Madrid would be able to mount a meritorious defense if he were permitted to proceed to a trial on the merits in the Action.

V

CONCLUSION

Debtors Jose Antonio Zamora and Martha Delia Zamora decided to protect the equity in their assets from being distributed to creditors by selling their only assets of value to De La Madrid for the sum of $396,175.58[28] and arranging for all of the net proceeds to be paid to their daughters, Villareal and Perez. This left the Debtors with no employment, no earned income[29] and no assets other than $1,200 of personal property that they claimed as exempt. This fact pattern represents a classic example of a transfer made with the actual intent to hinder, delay and defraud creditors.

The Trustee appointed in the Debtor's bankruptcy Case brought an Action against Villareal, Perez and De La Madrid to avoid this transaction. Villareal and Perez never answered and have not participated in any way in this Action. De La Madrid filed an Answer,

[28] The contract they signed actually called for the purchase price to be the lesser of $400,000 and the appraised value of the Property, but the records obtained by the Trustee reflect that De La Madrid paid this amount and that the Debtors accepted this as payment in full. See ADJM, Exhibit 12.

[29] The only income reflected on the Debtors' schedules was $200 per month given to them by their children.

but that Answer was defective in a variety of respects, and De La Madrid has failed and refused to remedy these defects or to participate in the pretrial procedures set forth in this Court's Local Bankruptcy Rules. This Court would not ordinarily go so far as to strike a defendant's answer for failing to file joint pretrial statements, but this is not an ordinary case of a defendant's neglecting to comply with the Court's local rules. The Court issued an OSC and expressly instructed De La Madrid and his counsel repeatedly to file a declaration from De La Madrid himself explaining his inaction, and De La Madrid has failed to comply. Under the circumstances, the Court is persuaded that this failure was not the result of excusable neglect. It is impossible on these facts for there to have been a misunderstanding of what this Court expected or required. De La Madrid has simply refused to comply.

Nevertheless, the Court has considered all of the arguments advanced by De La Madrid by way of defense to this Action and has recommended a result that is no less generous to De La Madrid or the other Defendants than that which they would otherwise have been able to obtain had this matter proceeded to a trial on the merits. For these reasons, the Court respectfully recommends that the District Court enter a judgment in the Action in favor of Plaintiff and against all Defendants that provides for the following forms of relief:

1. As against defendant Danniel De La Madrid, an individual, doing business as Llamas Estate, LLC, doing business as Muzikneum, Ltd., and doing business as Castizo Holdings, LLC, on Plaintiff's Second, Sixth and Eighth claims for relief, a judgment avoiding the transfer of the Property, the business operated thereon and any associated liquor licenses and returning title to these asset to the Plaintiff for the benefit of the estate, subject to an equitable lien in favor of De La Madrid for the sum of $396,175.58;
2. As against defendant Elize Villareal, an individual, on Plaintiff's Second, Third, Fourth, Fifth, Seventh and Eighth Claims for relief for a money judgment in Plaintiff's favor in the amount of $100,000;
3. As against defendant Martha Lizeth Perez, an individual, on Plaintiff's Second, Third, Fourth, Fifth, Seventh and Eighth Claims for relief for a money judgment in Plaintiff's favor in the amount of $80,000; and

4. As against all defendants, for a declaration that all transfers avoided in the judgment are preserved for the benefit of the estate.

In addition, any judgment entered in the Action should include provisions sufficient to clarify that, should recoveries under the judgment exceed the amounts necessary to pay in full all allowed claims and expenses of administration in the Case, the amount of any such overage should be returned to De La Madrid. It should not under any circumstances be used to pay a surplus to the Debtors: "the general rule, that courts will . . . extend no remedy to a grantor or vendor of property to recover back from the grantee or vendee the property thus transferred . . . is too well settled to be now called in question." Pattison v. Pattison, 301 N.Y. 65, 73, 92 N.E.2d 890 (1950). "History and the plain language of the ancient statute's offspring leave no doubt that a transferor cannot set aside a disposition of assets on the ground that the disposition allegedly constituted a fraudulent transfer. This is so for good reason. Were transferors allowed to assert fraudulent conveyance claims against those to whom they transfer property, transferors would be empowered to rescind transactions by virtue of their own fraudulent or deceptive designs. Such empowerment would be perverse." Eberhard v. Marcu, 530 F.3d 122, 131 (2d Cir. 2008). The right to avoid a transfer made with the actual intent to hinder, delay or defraud creditors was created to benefit creditors, not the debtor who voluntarily engaged in the transfer. Therefore, any judgment entered by the District Court should be limited accordingly.

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Date: July 13, 2022

Sheri Bluebond
United States Bankruptcy Judge