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JAN 13 2025
CLERK U.S. BANKRUPTCY COURT
Central District of California
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UNITED STATES BANKRUPTCY COURT
CENTRAL DISTRICT OF CALIFORNIA
SAN FERNANDO VALLEY DIVISION

In re:
MICHAEL A. DI BACCO,

Debtor(s).

Michael Kline,

Plaintiff(s).
vs.
Michael A. Di Bacco,

Defendant(s).

Case No.: 1:20-bk-11952-VK
Adv. No.: 1:21-ap-01010-GM
Chapter 7

MEMORANDUM OF OPINION

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1 **I. INTRODUCTORY COMMENTS**

2 This has been a particularly hard case to handle. During the bulk of the trial, each party
3 represented himself and made it difficult to move forward. Because of the parties' animosity
4 towards one another and difference in personalities, I experimented with methods for taking
5 evidence. From the experience on December 20, 2023, when the hostility and lack of control of
6 these two men triggered a panic attack of Kline's counsel and his withdrawal from the case, it
7 was clear that I needed to be able to control their examination of each other and perhaps of other
8 witnesses. At first, I used Zoom so that I could mute either or both of them as needed. Muting a
9 party is an extraordinary action, but fortunately it did not continue to be necessary.

10 However, I also thought that I would have to conduct some of the direct examination and
11 cross-examination of each party as needed both for clarity and because of issues that they raised
12 in their comments. But again, they generally allowed me to keep control and although I was
13 often required to rephrase a question – particularly since Kline tended to ask them in the form of
14 a paragraph of his own testimony – we got through it. But just in case, I was fortunate that at first
15 our Court Security Officer team made sure that one of our officers was always present in the
16 back of the courtroom to maintain decorum. Though the parties periodically started screaming at
17 each other, my worst fears were not realized, even on the last day of trial. Admonishments did
18 not have a lasting effect. Each apologized at the end of the trial for his behavior. This was likely
19 strategic, but at least each acknowledged his disruptive behavior on the record.

20 Another problem was that some of the testimony was clearly inadmissible as hearsay,
21 inflammatory, or irrelevant. Periodically, I would interrupt and rule such testimony out of order,
22 particularly on matters that were prejudicial, dealt with character, etc. But I let much of this pass
23 without comment, though I did warn them that I would be removing such testimony from

1 consideration as it was a violation of the Federal Rules of Evidence. Ruling on every
2 inadmissible statement would have extended this trial by at least two more days and frustrated
3 the parties. As it was, the trial took about fourteen days or partial days. Had we had competent
4 counsel on each side throughout the case, it would have concluded in five days at the most.

5 I gave great leeway in the order of presentation of the evidence and of witnesses. I was
6 aware that the parties had discovery battles in the State Court Action with Di Bacco refusing to
7 turn over documents or doing only a partial production. I allowed the parties to introduce new
8 documents throughout the trial in an attempt to ascertain the actual facts. I would would never
9 have allowed this if each side had an attorney.

10 Considering that the State Court Action would continue as to post-petition matters, I felt
11 it appropriate to develop the facts in as detailed a manner as possible.

12 The constant flow of new documents from Di Bacco required me to order Kline to recall
13 his prior expert witnesses Alison Freebairn-Smith and Jeffrey Neumeister so that they could
14 examine the new records that they should have had an opportunity to review before their initial
15 testimony. This gap partially occurred because the State Court Action is taking place parallel to
16 this adversary proceeding. While I cannot be sure, it also seems that Di Bacco reluctantly, but
17 actually, turned over some records to Mr. Lally (counsel for Kline until he withdrew in
18 December 2023). Some of these apparently were not given to the experts to review prior to their
19 testimony. While I am comfortable with math, I am not an accountant and do not have the ability
20 to enhance the expert reports with this new information. Thus, I ordered Kline to provide the new
21 information to his experts and recall them to testify. *See Order To Provide Witnesses With*
22 *Certain Documents* [dkt. 203].

1 I could have prevented new documents, new witnesses, and new issues from arising
2 during the trial. But it seemed to me that the time had come to get as clear an evidentiary record
3 as possible, particularly because there were no attorney fees to pay. These two men have been
4 battling in state court through two civil cases (the State Court Action and the Tony Action), in
5 addition to a criminal matter currently pending.¹ It was time for someone to review as much of
6 the evidence as possible and make the necessary findings of fact.

7 In summary, during my forty years on the bench, having tried hundreds of adversary
8 proceedings and thousands of motions and other disputes, I have never been faced with this kind
9 of behavior. Nonetheless, I am doing my best to make sense of the evidence and arrive at factual
10 and legal determinations based on that evidence. Fortunately, as a judge on recall, I have the time
11 to do this. Because I only have periodic law clerk support, this process has been extended much
12 longer than I wished.

13 Having said all of this, very few facts are in dispute. But the relationship between these
14 two men makes it difficult to wade through the evidence to root out the disputed facts. However,
15 at about 2:18 p.m. on April 24, 2024, and at about 2:05 p.m. on May 22, 2024, I was able to
16 summarize a group of facts that are now undisputed.²

17 For example, part of the disputed facts deals with the formation documents of Two
18 Michaels, LLC (TMLLC) and whether Di Bacco and Kline were equal partners, or partners at
19 all, from the beginning of that enterprise. Di Bacco kept raising this, even though the initial
20 agreements (oral and written) make clear that the parties' intent was to create an equal
21 partnership in which each had his own responsibilities.

¹ The criminal action concerns Di Bacco's obtaining one or more of the COVID Loans without Kline's consent. It is for identity theft, grand larceny, and other counts.

² For clarity, when the Court makes findings of specific facts agreed to on the record on a certain date and time, the Court will footnote it as "Agreed to fact, [date, time]."

1 Di Bacco kept insisting that Kline was not a partner until later in the enterprise. He used
2 the term “legal partner” as though it had some meaning in this case. It does not. It is clear to the
3 Court that these two entered into a business relationship which resulted in the formation of
4 TMLLC and that each had a 50% interest in that entity. So, while the formation documents are
5 acceptable as evidence, they need not be picked apart. In fact, eventually they both agreed on the
6 record that they were equal partners from the beginning.³

7 Another method that I used prior to the trial was to create a table of undisputed facts,
8 document #165, that each party completed. This was done while Kline was still represented by
9 counsel and the final and complete versions are on the docket as documents #173 and #174.
10 These facts are no longer in dispute.⁴

11 In preparing this analysis and decision, I created a chronological timetable [dkt. 212], the
12 final version of which is being entered as a separate document on the docket. I gave each party a
13 chance to review it and to comment and add items, but I told them that I may not include their
14 items and that this was within my discretion. Thus, the chronological timetable, which is
15 incorporated herein, is helpful in making sense of the hundreds of exhibits that were admitted in
16 this trial and which should assist any appellate authority which reviews this case.

17 While I would normally write this in a narrative form, in order to assist the triers of fact
18 in the State Court Action and the Tony Action and for clarity if any party files an appeal from this
19 adversary proceeding, I will use a combination of a numbered “Findings of Fact” and
20 “Conclusions of Law” and a narrative format.

³ Agreed to fact, April 24, 2024, at about 2:18 p.m.

⁴ A fact that is undisputed from the table of undisputed facts that each party completed is identified as “undisputed fact # ____ [dkt. 165, 173, 174].”

1 **II. FINDINGS OF FACT⁵**

2 1. Michael Di Bacco and Michael Kline (collectively, the “parties”) met at a bar in
3 about 2001.

4 2. Michael Di Bacco had a background in bartending, although he is also an actor.
5 This is not an unusual combination of jobs and skills in the Los Angeles area.

6 3. Michael Kline was a veterinarian, but no longer practiced in that profession. His
7 dream was to become a chef.

8 4. Through the years, the parties became close friends, even though they have two
9 very different personalities. At least Kline considered Di Bacco to be his “best friend.” A driving
10 force in the unrelenting nature of the litigation surrounding their partnership seems to be Kline’s
11 feeling of betrayal by Di Bacco’s actions starting in 2018.

12 5. Robano’s was a pizzeria located at 10057 Riverside Drive, Toluca Lake, CA (the
13 “Premises”). Robano’s faced Riverside Drive. The Premises featured a kitchen and a back
14 portion with a separate entrance (a red door). Ronald Romanowski owned Robano’s and leased
15 the Premises.

16 6. At some point, Kline filled in to temporarily run the kitchen in Robano’s. Rather
17 than being paid for that work, Kline asked Romanowski to give him the option to buy Robano’s
18 should Romanowski ever decide to sell it. When that opportunity arose, Kline contacted Di
19 Bacco to partner with him and purchase it.

20 7. It is unclear, but it is possible that Kline and Di Bacco had looked at other
21 restaurants prior to Robano’s becoming available.

⁵ The Court may take judicial notice of the bankruptcy and adversary proceeding dockets. Unless this decision cites a pleading from these dockets or an exhibit, all facts are derived from testimony at trial.

1 8. In about 2011, Kline and Di Bacco agreed to become partners and purchase
2 Robano's from Romanowski. Initially, the parties wanted to purchase Robano's in its entirety.

3 9. Kline and Di Bacco formed Two Michaels LLC ("TMLLC") for the purpose of
4 purchasing Robano's.⁶ The parties chose TMLLC's name because of their common first name.

5 10. On January 14, 2011, Di Bacco, Kline, and Romanowski entered into a five-year
6 lease of Robano's for \$200,000 with monthly rent for the landlord of \$6,700 payable to
7 Romanowski (the "Purchase Agreement").⁷ Thereafter, Romanowski decided that his daughter
8 would instead run Robano's.

9 11. Instead of taking over Robano's, Di Bacco, Kline, and Romanowski agreed that
10 the back portion of the Premises would be built out as a bar and restaurant operating under the
11 name "The Red Door," a reference to the back portion's entrance. Di Bacco, Kline, and
12 Romanowski would share expenses of the Premises, with Di Bacco and Kline to contribute an
13 amount not to exceed \$5,000 per month. Robano's and The Red Door would share the kitchen.
14 To accomplish this, on March 15, 2011, Di Bacco, Kline, and Romanowski executed a
15 handwritten and notarized partnership agreement (the "Partnership Agreement").⁸

16 12. As a convicted felon, Romanowski could not own a liquor license. Thus,
17 Robano's used a liquor license owned by MRRS Co. LLC ("MRRS").⁹ Robert "Bob" Percel was
18 the manager of MRRS.¹⁰ To acquire a liquor license faster, rather than apply for its own liquor

⁶ Undisputed fact #5 [dkt. 165, 173, 174].

⁷ Exhibit 75 [dkt. 184, at 14]. Although it is not clear, this appears to be a sublease of Romanowski's lease of the entire building.

⁸ Exhibit 3; Undisputed fact #15 [dkt. 165, 173, 174]. This was done as a partnership agreement due to the liquor license, but the agreement limited Romanowski's distributions to \$5,000 per month.

⁹ Undisputed fact #6 [dkt. 165, 173, 174].

¹⁰ Exhibit 7.

1 license, TMLLC paid Percel \$19,000 to take his name off the license and substitute Di Bacco as
2 the manager.¹¹

3 13. To start business as The Red Door, various steps needed to be taken, which
4 included the following:

5 a. On January 25, 2011, TMLLC filed its articles of incorporation with the
6 California Secretary of State.¹²

7 b. In May 2011, Di Bacco opened a bank account ending in 7884 at U.S.
8 Bank for The Red Door (the “The Red Door Bank Account”). Kline and Di Bacco agreed
9 that Kline’s name would not be on the The Red Door Bank Account because a lien
10 encumbered Kline’s house and the parties did not want Kline’s creditor collecting from
11 The Red Door Bank Account.¹³

12 c. Percel transferred the liquor license to The Red Door so it could begin
13 serving alcoholic beverages.¹⁴

14 14. To proceed, the parties needed to raise initial capital, later operating capital, and
15 purchase money for Romanowski and Percel. Neither Kline nor Di Bacco put in his own money.

16 15. The initial investment to open The Red Door was a loan of \$10,000 from Don
17 Clickner, who was Di Bacco's childhood friend.¹⁵ Thereafter, Di Bacco’s brother, Anthony
18 “Tony” Di Bacco (hereinafter, “Tony”), loaned TMLLC \$10,000, \$20,000, and \$100,000.¹⁶ Di

¹¹ Agreed to fact, April 24, 2024, at about 2:18 p.m. Under the Purchase Agreement, TMLLC would have paid Percel \$25,000 for the liquor license owned by MRRS.

¹² Exhibit 7.

¹³ Agreed to fact, April 24, 2024, at about 2:18 p.m. Undisputed Fact #26 [dkt. 165, 173, 174]. The reason for the lien is unclear, though it appears to be for a tax assessment from Kline’s time as a veterinarian. But neither the lien’s basis nor its enforceability is relevant; the lien is relevant only insofar as both Kline and Di Bacco thought that it might cause a problem if Kline was on the bank account as either an owner or a signatory.

¹⁴ Exhibit 7.

¹⁵ Undisputed fact #7 [dkt. 165, 173, 174].

¹⁶ The Tony Action asserts that there were two loans: one on 8/20/11 for \$32,000 and the other on 4/19/13 for \$100,000. The promissory notes are attached to the lawsuit, so the Court finds this to be more credible than the testimony of the above dates.

1 Bacco's sister loaned TMLLC \$10,000 and \$5,000. Over time Di Bacco's family made two other
2 loans of \$24,000 and \$14,000.¹⁷ In general, this money was used for construction of The Red
3 Door in 2011 and the renovation of Riverside in 2013–2014. Some money also covered operating
4 expenses.¹⁸ No other outside money was put into TMLLC (except for the COVID Loans
5 discussed later), so all other income came from operations.

6 16. Before the The Red Door Bank Account was opened (and maybe for some time
7 thereafter), the money from the loans was placed in Di Bacco's personal account at SAG-
8 AFTRA Federal Credit Union. Later loans went into one of the Bank Accounts.

9 17. During construction and periodically thereafter, Di Bacco also used his personal
10 money to pay for labor and other expenses. Before The Red Door opened for business, Di Bacco
11 contributed as much as \$23,742 of his personal money. To the extent that he contributed his
12 personal money, Di Bacco later reimbursed himself from the Bank Accounts. Kline was also
13 reimbursed for money that he spent, which was in a lesser amount.¹⁹

14 18. Although the evidence is incomplete, at least in 2011, Di Bacco paid Romanowski
15 \$6,700 from an account in Di Bacco's name.²⁰ This money was presumably from one of the
16 aforementioned loans.

17 19. From the beginning and throughout the partnership, the parties agreed that Kline
18 would run the kitchen and that Di Bacco would handle the bar, the restaurant, and most or all of
19 the business affairs of TMLLC.²¹ Kline did not want to be involved in the day-to-day operation

¹⁷ Undisputed facts ##12, 13, 14 [dkt. 165, 173, 174].

¹⁸ These loans do not appear in the Freebairn-Smith Summary, nor are the costs of construction reflected there or anywhere else except the Brown Book (Exhibit EEEE).

¹⁹ Exhibit EEEE.

²⁰ Exhibit V.

²¹ Agreed to fact, April 24, 2024, at about 2:18 p.m.

1 of the business except opening up for the day and as it involved the kitchen. At times, Kline
2 closed up at night or perhaps oversaw service if Di Bacco was not available.

3 20. After a few years, Romanowski's daughter no longer wished to run Robano's, so
4 on June 20, 2013, Di Bacco and Kline signed a purchase agreement with Romanowski to
5 purchase Robano's for \$250,000.²² About eighteen months later, on January 28, 2015, Di Bacco
6 and Kline executed a \$250,000 promissory note in favor of Romanowski (the "Promissory
7 Note"), with Ronald Romanowski, Jr. to carry out the seller's duties.²³

8 21. Percel transferred his interest in MRRS through an assignment and transfer
9 agreement (the "Assignment Agreement") that was signed by Percel on November 19, 2014, by
10 Di Bacco on November 12, 2014, by Kline on November 19, 2014, and by Romanowski on
11 January 28, 2015, but these dates are not material.²⁴

12 a. On November 19, 2014, Percel also resigned from MRRS and this made
13 Di Bacco and Kline the managing members.²⁵

14 b. There is some confusion in the documents because Percel did not resign
15 from MRRS until November 19, 2014, and the Promissory Note and the Assignment
16 Agreement were not signed until January 28, 2015.²⁶

17 22. On August 10, 2015, Kline and Di Bacco signed a TMLLC Operating Agreement
18 showing each as having a 50% interest and this was filed with the California Secretary of State.²⁷

19 23. By the time that Romanowski died, all but \$60,000 had been paid on the
20 Promissory Note.²⁸

²² Exhibit 2.

²³ Exhibit 9.

²⁴ Exhibit 2.

²⁵ Exhibit 2.

²⁶ Exhibits 2 and 9.

²⁷ Exhibits 5 and 7.

²⁸ Undisputed fact #87 [dkt. 165, 173, 174].

1 24. TMLLC took over Robano's from Romanowski's daughter and renamed it
2 Riverside, continuing its operation as a pizzeria ("Riverside," and together with The Red Door,
3 the "Restaurants"). Meanwhile, the parties continued to run The Red Door from the back portion
4 of the Premises. The Restaurants each had its own entrance and continued to share a kitchen.²⁹

5 25. To compensate themselves, the parties each took a weekly "draw" in the
6 following amounts: \$500 per week from September 2011 to June 2013; \$750 per week from June
7 2013 to July 2016; \$1000 per week from July 2016. Di Bacco and Kline started taking the
8 weekly payments as salary in the form of checks on March 3, 2017, and April 28, 2018,
9 respectively.³⁰

10 a. The parties dispute whether the transfer of Kline's weekly payment from a
11 "draw" to a "salary" was consensual and what exactly this means as to tax reporting,
12 etc.³¹ Because each partner undisputedly received the same amount of money each week,
13 the form of payment is irrelevant to this adversary proceeding.

14 26. In 2013, Di Bacco opened an account ending in 7484 at U.S. Bank for Riverside
15 (the "Riverside Bank Account," and together with the The Red Door Bank Account, the "Bank
16 Accounts"). TMLLC also had a credit line ending in 7968 (the "Credit Line") and a savings
17 account ending in 6968. Apparently, both were tied to The Red Door Bank Account.³² There
18 were no other business bank accounts. The Neumeister Report³³ includes payments for

²⁹ Undisputed fact #19 [dkt. 165, 173, 174].

³⁰ Undisputed facts ## 82, 83, 84 [dkt. 165, 173, 174].

³¹ It seems that the difference between a "draw" and "salary" is whether taxes and/or social security payments were withheld. But this may not be correct for an owner of the business as opposed to an employee. It appears that prior to the above dates, the weekly money was usually paid in cash rather than by check.

³² Exhibit 21.

³³ Exhibit 86.

1 “unknown credit line 7968” with most payments in the amount of \$504.01 and some of \$1,000 or
2 other amounts. Neumeister includes this under “draws” that Di Bacco took, which is incorrect.³⁴

3 27. The parties agreed that Kline’s name would not be on the Bank Accounts because
4 of the lien. But Kline had an ATM card (he refers to this as a “debit card”) and a credit card to
5 use for business purposes. The debit card was tied to The Red Door Bank Account, which did not
6 always have sufficient funds to cover a proposed charge or withdrawal. However, the Riverside
7 Bank Account probably contained enough money for this purpose.

8 28. In May 2015, Di Bacco added Kline as a signatory to the Riverside Bank Account
9 rather than as a co-owner. Apparently, the reason for this method was because Di Bacco would
10 have had to change the account if Kline was a co-owner as opposed to being a signatory. After a
11 slight delay to fill out a second form, Di Bacco added Kline as a signatory on the The Red Door
12 Bank Account.³⁵ There is no evidence that Kline was ever a signatory on the Credit Line.

13 29. Things seemed to go pretty well between the parties until 2017. The evidence
14 shows that difficulty was building because of both the division of labor and the lack of cashflow.
15 There were payments due to Romanowski, Jr. on the Purchase Agreement in the amount of
16 \$4,000 per month. To cover the capital costs of the build-out of Riverside, TMLLC borrowed
17 another \$14,000 from Don Clickner. As of August 2017, the parties owed over \$230,000,
18 \$150,000 of which came from Tony, who was pressuring the parties to start making payments.³⁶

19 30. Tony (and perhaps other lenders) were pressing Di Bacco to expand the
20 Restaurants’ hours to offer lunch as well as dinner, which would have resulted in higher revenue.
21 Di Bacco also wanted to offer catering for the nearby studios, but Kline did not because of the

³⁴ See *Neumeister Report*, Exhibit C thereto (“Transactional Ledger for ‘Draws – Michael DiBacco’”).

³⁵ *Di Bacco Clarifications* [dkt. 219], ¶ 5.

³⁶ See Exhibit 77.

1 extra hours of work that this would entail. Di Bacco was carrying all the business responsibilities
2 and found that to be wearing.

3 31. In 2018, Kline asked Di Bacco for a complete accounting and did not receive it
4 until trial in this adversary proceeding. It is unclear what records, if any, Di Bacco offered Kline
5 for review. Both refer to the “cash crunch” mails from 2018, although most of these are not in
6 evidence as they are inadmissible hearsay.³⁷ However, because both parties referred to the entire
7 email conversation in their testimony and argument, I have quickly reviewed the entire exhibit
8 and find that the 2018 emails show that Kline was frustrated because he was not getting an
9 accounting from Di Bacco, but he was not undertaking any efforts to obtain it or conduct an
10 accounting on his own using the bank and credit card records. They also show that Di Bacco was
11 insisting on opening for lunch, but Kline was not agreeing to do so. But the most important thing
12 is that these two men were communicating only by email rather than sitting down together or
13 with a business advisor, that each got more and more angry and frustrated, and that no progress
14 was being made.

15 32. Kline was urging Di Bacco to straighten out the books and records and give a full
16 accounting of the financial information about the business, but he was not willing to actually
17 participate in that enterprise. Meanwhile, Di Bacco was not willing to undertake the extra work
18 or expense that would be necessary to comply with Kline’s request.³⁸

19 33. TMLLC seems to have had a new accountant/tax preparer every few years. Most
20 or all were recommended by Kline. It appears that the first was Jeffrey Otto, who prepared the
21 2012, 2013 and 2014 tax returns.³⁹

³⁷ Exhibits 42, 78. Only pages 11 and 12 from 2020 about the emergency loans are in evidence.

³⁸ Exhibits 78; CC; 77.

³⁹ Exhibits 97 and 98 do not show a filing date, so they could have been prepared before 2016.

1 a. On July 25, 2016, Otto suggested to Kline that TMLLC needed a
2 bookkeeper.⁴⁰ On August 8, 2016, Otto sent a letter to Kline (the “August 2016 Otto
3 Letter”), stating that TMLLC does not have “legitimate books” and that TMLLC needed
4 “a professional bookkeeper, a real set of books and a real payroll processing company.
5 You can’t keep operating like this. It is literally insane. I wish you the best but I am truly
6 concerned for you and your business.”⁴¹

7 b. Kline had a relationship with Otto that preceded Kline and Di Bacco’s
8 business venture, which is why Otto wrote to Kline, but the Court has no doubt that this
9 information and concern was immediately passed on to Di Bacco.

10 34. In January 2017, TMLLC hired Kevin Nhatho as a CPA to prepare the 2015 tax
11 return. This relationship lasted only a few months; on August 2, 2017, Nhatho resigned as the
12 accountant for lack of documentation.⁴²

13 35. Apparently, the next professional hired was Joe Foster, who prepared the 2015 tax
14 returns. According to Kline, Foster also informed Kline that the back-up documentation was
15 missing and that TMLLC needed a real bookkeeper.

16 36. While Di Bacco testified that he hired a bookkeeper at some time in 2016 or 2017,
17 no evidence exists as to who that was or when that occurred. When he reviewed the Chronology,
18 he corrected the statement of “possibly 2017” to be “2018.” Apparently, this was Daniela
19 Gallego. Up to this time, they had been in business for about five years.

20 37. At first, all business records were kept in Di Bacco’s apartment. But after
21 Romanowski died, TMLLC took over the second floor of the building and used that as an office.

⁴⁰ Exhibit 13.

⁴¹ Exhibit 20.

⁴² Exhibit 15. Although Exhibit 15 was not admitted because Mr. Nhatho did not testify, the parties do not dispute these events which are included in the Chronology that was sent to them for comment.

1 38. By the summer of 2016, Otto informed Kline of the incomplete nature of
2 TMLLC's books and records.⁴³ In response, Kline obtained copies of the bank statements and
3 other bank records and turned them over to Otto to analyze. On December 24, 2016, Otto sent a
4 letter to Kline (the "December 2016 Otto Letter") advising him of the following:

5 I have reviewed counter withdrawals and cancelled checks from US business
6 checking accounts 1534689978874 and 157501857484 and business savings
7 account 253463286968 with respect to cash withdrawn by Michael DiBacco or
8 checks payable to Mr. DiBacco deposited into non-business accounts. I have
9 attached a copy of my recap and annual detail.

10 Based on the records provided the total cash taken out of the business accounts by
11 Mr. DiBacco from 2011 thru October 21, 2016 amounted to \$593,805.15.
12 Additional amounts deposited to non-business bank accounts by Mr. DiBacco
13 amounted to \$166,185 for a grand total of \$759,990.15.

14 A portion of the cash withdrawals could have been used for business purposes but
15 it would not be good business practices. I would deem it highly improbable that this
16 much cash was used for bill payment in a legitimate business. It is in your best
17 interest to demand that cash withdrawals be stopped and that you are given a proper
18 accounting of all prior cash withdrawals (including paid bills and receipts that can
19 be verified with vendors). I noted several payments to credit card(s) going through
20 the bank accounts. I would request an accounting of the credit card charges as well.
21 ⁴⁴

22 39. There is no indication that Kline provided any information to Otto that Kline was
23 paying some employees under-the-table in cash or that he and Di Bacco were taking
24 "supplemental draws."

25 40. Although the December 2016 Otto Letter certainly was a wake-up call to Kline,
26 he continued working in the Restaurants, receiving a draw in the same amount as Di Bacco, and
27 allowing TMLLC to operate. In fact, he opposed moving the form of his draw from cash to a
28 check until April 2018, a year after Di Bacco did this for himself in March 2017, which was a
29 few months after the December 2016 Otto Letter.

⁴³ Exhibits 13, 20.

⁴⁴ Exhibit 21. The recap referred to in the letter is not in evidence.

1 41. By mid-2017, Kline started to demand to see the various books and accounts, but
2 Kline turned a blind eye to what was happening. He continued to run the kitchen, take his draw
3 in cash, and give under-the-table cash payments to some of the kitchen staff.⁴⁵

4 42. On May 7, 2018, Di Bacco removed Kline as a signatory on one or both Bank
5 Accounts.⁴⁶ But Di Bacco left Kline on the company credit card so that Kline could shop for
6 food. The reason is unclear. Di Bacco said that this had to do with Kline’s refusal to take his
7 draw as salary, but that ended about 10 days before Di Bacco removed Kline from the bank
8 account. Di Bacco’s email to Kline dated May 8, 2018, states that the reason was because Kline
9 was receiving a paycheck but was also taking money from the Bank Accounts as a draw.⁴⁷

10 43. In September 2018, Kline filed a complaint against Di Bacco in Los Angeles
11 County Superior Court, case no. EC069334 (the “State Court Action”).⁴⁸

12 44. Thereafter, on January 21, 2019, Di Bacco again added Kline as a signatory on the
13 Bank Accounts and on the credit cards.⁴⁹ During this whole time, Kline kept working in the
14 Restaurants.

15 45. In February 2019, Kline hired Alison Freebairn-Smith, an independent
16 bookkeeper, to prepare an accounting—apparently as part of the State Court Action. Freebairn-
17 Smith accompanied Kline to look at the records and found insufficient information to begin a
18 review. She determined that she was unable to prepare the accounting and sent Kline a letter to
19 this effect on February 13, 2019.⁵⁰

⁴⁵ Exhibits 103, 104, and 105.

⁴⁶ Undisputed facts ##34, 35 [dkt. 165, 173, 174]. See Exhibit 1, ¶¶ 15-16.

⁴⁷ Exhibit 79.

⁴⁸ Facts agreed to on May 22, 2024, starting at about 2:05 pm.

⁴⁹ Undisputed facts ##34, 35 [dkt. 165, 173, 174]. See Exhibit 1, ¶¶ 15-16.

⁵⁰ Exhibit 16.

1 a. Di Bacco testified that Freebairn-Smith only saw part of the files because
2 more were in the second-floor storage/work area. Later, she received the Bank Accounts'
3 records and prepared a bookkeeping summary (the "Freebairn-Smith Summary").⁵¹

4 b. The Freebairn-Smith Summary reflects the records that Freebairn-Smith
5 had, but it does not adjust for incomplete or unidentified papers that logically reflected
6 expenses that the Restaurants incurred. Thus, the Freebairn-Smith Summary is accurate
7 as to some things but inaccurate as to others.

8 c. Both the Freebairn-Smith Summary and the Neumeister Report were done
9 as audits rather than trying to determine the actuality of the business. This substantially
10 limits the Court's ability to determine what money, if any, was removed or
11 misappropriated.

12 46. On February 28, 2019, two weeks after Freebairn-Smith went to the restaurant to
13 do an accounting, Di Bacco obtained an addendum to the lease (the "Lease Addendum") from
14 Burbank Boys II, LLC, the owner of the Premises and the lessor to TMLLC. This states:

15 In the event that Two Michaels, LLC decides to change or dissolve its entity's name
16 for any reason, Lessor Burbank Boys II, LLC agrees by this addendum to continue
17 the existing lease in its entirety by changing lessee name to Michael A. DiBacco
18 [sic] (Two Michaels, LLC member) or any other name of Michael A. DiBacco's
19 [sic] choosing as the lessee.⁵²

20 a. Di Bacco signed the Lease Addendum as an individual.

21 b. It is not clear when Kline became aware of the Lease Addendum, but he
22 did not file his certificate of dissolution of TMLLC until about May 11, 2020—over a
23 year later.⁵³

⁵¹ Exhibit 69.

⁵² Exhibit N.

⁵³ Exhibit 7 is a copy of the certificate of dissolution, but it does not include a date. The California Secretary of State webpage shows the termination date of May 11, 2020, and Mr. Houghnon's letter to that effect is dated May 27, 2020 (exhibits 90, JJJJ).

1 47. On March 27, 2019, Tony filed a complaint seeking an attachment against
2 TMLLC in Los Angeles County Superior Court, case no. 19BBCV00258 (the “Tony Action”).
3 On July 19, 2019, the state court issued the attachment. In January 2020, the Tony Action was
4 consolidated into the State Court Action.

5 48. The parties agreed on the record that the dissolution action was filed in the state
6 court on March 20, 2020. But this is incorrect. No state court dissolution case has been filed. The
7 dissolution was triggered when Kline filed a Notice of Dissolution with the California Secretary
8 of State on May 11, 2020.

9 49. On May 27, 2020, Joseph Hougnon, Kline’s attorney, sent Di Bacco a letter (the
10 “First Hougnon Letter”)⁵⁴ Among other things, the First Hougnon Letter notified Di Bacco that
11 AB1772 [since codified as Cal. Corp. Code § 17707.01] requires a wind-up of TMLLC. On July
12 4, 2020, Hougnon sent Di Bacco a second letter to stop conducting business.⁵⁵

13 50. During all of this, Di Bacco had been seeking some federal loans/grants to pay
14 staff, among other reasons (the “COVID Loans”). On April 6, 2020, Kline refused to consent to
15 these, but TMLLC received them anyway.

16 51. In April 2020, TMLLC received a grant or loan of \$10,000 from the Small
17 Business Administration (SBA).⁵⁶ In July 2020, TMLLC received an SBA loan of \$25,000.⁵⁷

18 52. On June 8, 2020, Di Bacco incorporated VLIET518, Inc.⁵⁸

19 53. On June 20, 2020, Di Bacco took the last step to eject Kline from the Restaurants
20 when he changed the locks.⁵⁹

⁵⁴ Exhibit JJJJ.

⁵⁵ Exhibit 94, which is not admitted into evidence, but is not disputed..

⁵⁶ Undisputed fact #77 [dkt. 165, 173, 174].

⁵⁷ Undisputed fact #78 [dkt. 165, 173, 174].

⁵⁸ Exhibit 92.

⁵⁹ Exhibit 95.

1 54. On July 2, 2020, Di Bacco again removed Kline as a signatory on the Bank
2 Accounts.⁶⁰

3 55. The State Court Action slowly moved forward with amended complaints being
4 filed until it was stayed when Di Bacco filed personal bankruptcy on October 29, 2020.

5 56. After June 20, 2020, Di Bacco operated the Restaurants, using the name of
6 “Michaels on Riverside.”⁶¹

7 57. When the Court granted relief from the automatic stay as to the State Court
8 Action,⁶² the state court issued a preliminary injunction in favor of Kline and ruled that Di Bacco
9 was prevented from doing the business of TMLLC.⁶³ Di Bacco violated this injunction and the
10 state court held two contempt hearings.⁶⁴

11 **A. Record Keeping**

12 58. By the parties’ oral agreement, the record-keeping was the responsibility of Di
13 Bacco, who had no prior experience in running a business.

14 59. In the first years, Di Bacco recorded payments made in a bound notebook which
15 he identified as the Brown Book (the “Brown Book”).⁶⁵

16 60. Di Bacco kept some receipts and other documents, but he did not keep a bank
17 ledger or check register detailing the purpose of the payments other than the payroll reports after
18 TMLLC took over Robano’s.⁶⁶ He did not keep time sheets for the employees showing

⁶⁰ Exhibit 96.

⁶¹ Exhibit 25.

⁶² *Order Granting Motion for Relief From the Automatic Stay Under 11 U.S.C. § 362 (Action in Nonbankruptcy Forum)* [Bankruptcy Case, dkt. 35].

⁶³ Exhibit 68.

⁶⁴ Exhibits 68, 81, 106, 107.

⁶⁵ Exhibit EEEE [dkt. 223].

⁶⁶ Exhibit FFF.

1 beginning and ending of daily work, number of hours, pay rate, etc. If these did exist, they were
2 never presented to the Court even though Di Bacco would have possessed them.

3 61. Kline also bears some responsibility concerning the record-keeping of the kitchen
4 employees because he managed this area and, at least some of the time, paid all or some of the
5 kitchen employees under-the-table in cash.

6 **B. General Statement as to Determining This Adversary Proceeding**

7 Prior to 2018, there are no reliable figures to be used in calculating the income, expenses,
8 and any unaccounted-for money. For the first time, starting in 2018, TMLLC had a bookkeeper, a
9 table of accounts, and a profit and loss statement. Even these are somewhat sketchy in that they
10 give organized figures but not audited ones. The 2018 and 2019 tax returns are based on these
11 figures and are more reliable than the returns of prior years.

12 For example, the August 2016 Otto Letter states that Di Bacco had instructed Otto to add
13 “\$67,000 to income to make the return work.”⁶⁷ However, in his testimony at trial, Otto said that
14 this was just a sarcastic remark.

15 The Court will comment on this lack of reliable information over-and-over again in this
16 Memorandum of Opinion. The Court knows that this leads to uncertain and inaccurate results.
17 BUT THIS IS ALL THAT WE HAVE.

18 The restaurants operated starting on September 23, 2011, and operated in some form until
19 March 16, 2020. The Court does not have specific information as to operations during the Covid
20 shutdown, but apparently, they continued some form of business even before the Riverside patio
21 seems to have officially reopened on September 2, 2020. The inside restaurant reopened at a later
22 date. This bankruptcy case was filed on October 29, 2020. Because the business operated for

⁶⁷ Exhibit 20.

1 only a few months before the bankruptcy was filed, there is no purpose to include 2020 in the
2 financial analysis.

3 **C. Calculating the Amount Not Accounted For**

4 Trying to identify the amounts that are not accounted for is close to impossible. But an
5 estimate must be made. Four spreadsheets or partial accountings have been presented as
6 evidence, as well as the Neumesiter Report based on the Freebairn-Smith Summary:

7 (1) Handwritten lists of expenses for 2014 and 2015, which were prepared by Di Bacco,⁶⁸
8 apparently for the accountant to prepare tax returns for those years;

9 (2) An analysis of deposits for the years 2016 through 2020 prepared by Pam Jennings
10 for Riverside (the “Jennings Riverside Report”)⁶⁹ and The Red Door (the “Jennings
11 Red Door Report”)⁷⁰ (together, the “Jennings Reports”);

12 (3) Two spreadsheets from 2011 through September 2019 prepared by Freebairn-Smith,
13 one as to “Labor by Employee Paid with a Check” (the “Freebairn-Smith Labor
14 Report”)⁷¹ and the other a “Bookkeeping Summary by Year”.⁷² Both of these are
15 limited solely to bank statements, copies of checks, and copies of credit card
16 statements. and

17 (4) Profit and loss statements prepared by Daniela Gallego for the years 2018 through
18 2020:

19 a. a draft of the profit and loss statement for 2018,⁷³ and a final version (the
20 “2018 Gallego P&L”);⁷⁴

⁶⁸ Exhibit 208.

⁶⁹ Exhibit FF.

⁷⁰ Exhibit GG.

⁷¹ Exhibit 85.

⁷² Exhibit 69.

⁷³ Exhibit 52.

⁷⁴ Exhibit CCCCC.

- 1 b. a profit and loss statement for 2019⁷⁵ (the “2019 Gallego P&L”, and together
2 with the 2018 Gallego Report, the “Gallego P&Ls”); and
3 c. a profit and loss statement for 2020 (the “2020 Gallego P&L”).⁷⁶ As noted
4 above and discussed later, this accounting is irrelevant the Court’s ruling.

5 Beyond these four accountings, there is the Brown Book and copies of full or partial tax
6 returns for each year. Each of these items has its own problems and peculiarities.

7 (1) The 2014 and 2015 lists of expenses have no back-up documentation and were
8 prepare by Di Bacco and not by an outside person.

9 (2) The Jennings Reports were admitted without objection, but because Jennings was not
10 called as a witness, the Court has no way to clarify the process that she used to create
11 them. Also, the Jennings Reports are limited to income and do not include expenses
12 or draws. However, they are very helpful in determining the percent of credit card
13 sales and the amount of tips that had to be paid in cash.⁷⁷

14 (3) The Freebairn-Smith Summary is based solely on the checks, credit card statements,
15 and bank statements and therefore gives only a limited view of the financial picture of
16 TMLLC. Also, because it includes only the first three quarters of 2019, for some
17 comparisons the Court must do an estimate of the fourth quarter figures. Although
18 some receipts for cash payments made by Kline for groceries, etc. during 2018-2020
19 are in evidence, it does not appear that these are included in the Freebairn-Smith
20 Summary or the Neumeister Report. It is possible and even probable that there are
21 stacks of additional receipts that were in the 35 boxes that Freebairn-Smith did not

⁷⁵ Exhibit DDDDD.

⁷⁶ Exhibit FFFFF.

⁷⁷ Dkt. 155.

1 review when preparing the Freebairn-Smith Summary; thus, the Neumeister Report
2 did not include them.

3 (4) The Gallego P&Ls are based on the bank records and information Di Bacco gave to
4 Gallego. She testified that after her initial review for 2018, Di Bacco gave her receipts
5 and thus she made a final profit and loss statement and tax returns. She indicated
6 confidence in her figures.⁷⁸ Although the 2018 Gallego P&L is on a cash basis and the
7 2019 Gallego P&L and 2020 Gallego P&L are on an accrual basis, this does not seem
8 to create a substantial issue given the nature of this business. The Freebairn-Smith
9 Summary only includes nine months of 2019 while the 2019 Gallego P&L is for the
10 whole year but is broken down in a different way with much more detail.

11 (5) When the business started, the Brown Book was written by Di Bacco as a
12 contemporaneous journal. It includes some payments by check as well as by cash. It
13 is largely unusable as an accounting but does give some information for 2011 and
14 2012. Much of it concerns the build-out of The Red Door and other expenses prior to
15 the opening of that facility. These were from lender funds and also from loans from
16 Kline and Di Bacco, which were repaid to them at some time. There are notes
17 concerning sums used to repay Kline and Di Bacco, but not what portion of them was
18 from operating money rather than from lender money.

19 (6) Finally, we have copies of the tax returns for each year starting in 2011, but some of
20 these only show the gross receipts and the total cost of goods sold (which includes the
21 salaries to employees).

⁷⁸ Exhibit 52 as compared to Exhibit CCCCC.

1 **Table 1. Financial information availability**

Source	Year								
	2011	2012	2013	2014	2015	2016	2017	2018	2019
Brown Book	EEEE	EEEE	—	—	—	—	—	—	—
Di Bacco	—	—	—	208	208	—	—	—	—
Freebairn-Smith	69, 85	69, 85	69, 85	69, 85	69, 85	69, 85	69, 85	69, 85	69, 85 ⁷⁹
Jennings	—	—	—	—	—	FF, GG	FF, GG	FF, GG	FF, GG
Gallego	—	—	—	—	—	—	—	52, CCCCC	DDDDD
Tax Returns	45	97	98	47, B	49	KK	OO	BB	II

2
3 Each of the three independent accountings includes different things and covers different
4 but overlapping time periods. The Gallego P&Ls are by far the most detailed. Gallego testified
5 that she saw actual bank records and receipts when she prepared these. They reflect a Chart of
6 Accounts and are done contemporaneously and for the purpose of creating the annual tax returns,
7 etc. Unfortunately, the Gallego P&Ls cover only two full years—2018 and 2019. The Freebairn-
8 Smith Summary and the Jennings Reports both attempt to reconstruct the past and are based on
9 bank statements and credit card statements, but do not include receipts or even breakdowns of
10 expenses (e.g., repairs, pest control, merchant fees, etc.). Comparing the three accountings for
11 2018 and 2019 (the only overlapping years), does not create a high level of confidence.

⁷⁹ Freebairn-Smith’s figures for 2019 are through September only.

1 **Table 2. Comparison of accountings for 2018 and 2019**

	2018			2019		
	Freebairn-Smith	Jennings	Gallego	Freebairn-Smith ⁸⁰	Jennings	Gallego
Total income	1,245,599	1,053,867	1,228,301	1,146,926	1,024,452	1,105,846
Total expenses ⁸¹	430,551	—	447,575	310,574	—	423,276
Cost of goods	591,881	—	486,500	587,054	—	437,735
Officers' salaries ⁸²	91,597	—	82,000	75,995	—	95,028
Net income less officers' salaries	223,167	—	97,550	249,298	—	25,822
<i>Net income</i>	131,570	—	15,550	173,302	—	(69,206)

2

3

And comparing the figures in the Freebairn-Smith Summary with those in the 2018

4

Gallego P&L further highlights the differences.

⁸⁰ Adjusted for 12 months.

⁸¹ Less cost of goods and officers' salaries.

⁸² Freebairn-Smith attributes all unaccounted money to a Di Bacco draw. This excess is removed from this table.

1 **Table 3. Comparison of 2018 Figures in Freebairn-Smith Summary and 2018 Gallego**
 2 **Report**

<u>Category</u>	<u>Freebairn-Smith Summary</u>	<u>2018 Gallego P&L</u>
Income	1,245,599	1,228,300
Draws		
For both	48,597 ⁸³	82,000
For Kline	21,500	—
For Di Bacco	127,530	—
Payroll fees and merchant fees	—	9,671
Levy	0 ⁸⁴	5,756
Meals	—	501
Medical	—	42
Outside services ⁸⁵	—	4,436
Rent	—	144,105
Repairs and maintenance	—	4,564
Salaries and wages	—	255,638
Supplies for bar and restaurants	591,881	486,501
Taxes	46,179	104,297 ⁸⁶
Tips	91,860	31,886
Utilities	—	34,800
Miscellaneous/Other	291,255	35,816 ⁸⁷
<i>Total expenses</i>	<i>\$1,069,722⁸⁸</i>	<i>\$1,200,013⁸⁹</i>

3
 4 The 2018 Gallego P&L gives a much more reliable picture of an operating business
 5 because it breaks down the expenses into descriptive categories rather than lumping them all
 6 together. It also has the advantage of having seen receipts and each credit card charge for the
 7 type of item charged. And Di Bacco was able to explain to Gallego how to categorize the
 8 expenses.

⁸³ The Freebairn-Smith Summary lists these draws as salaries.

⁸⁴ The Freebairn-Smith Summary lists a \$2,500 levy in 2017.

⁸⁵ Pest control, professional fees, and waste management.

⁸⁶ The 2018 Gallego P&L further breaks down these tax expenses into the following categories: California, IRS, payroll tax, sales tax, and other taxes and licenses.

⁸⁷ The 2018 Gallego P&L further breaks down these expenses into the following categories: office supplies, advertising, auto, bank charges, cleaning, computer and internet, dues and subscriptions, freight, insurance, interest, postage, and telephone.

⁸⁸ This figure is exclusive of \$149,030 that the Freebairn-Smith Summary lists as draws to Kline and Di Bacco individually.

⁸⁹ This figure is exclusive of \$12,735 that the 2018 Gallego P&L lists as depreciation and amortization expenses.

1 The major differences that stand out in the enumerated categories are supplies for the bar
2 and restaurants (the Freebairn-Smith Summary shows \$105,380 more than the 2018 Gallego
3 P&L), taxes (the Freebairn-Smith Summary shows \$58,118 less than the 2018 Gallego P&L),
4 and tips (the Freebairn-Smith Summary shows \$59,973 more than the 2018 Gallego P&L).

5 As to 2016 through 2017, the only evidence is the Freebairn-Smith Summary and the
6 Jennings Reports. To the extent possible and practical, the Court has compared these to look for
7 trends, overlaps, and differences.

8 Among the unanswerable questions is how much cash was taken in at The Red Door. The
9 Freebairn-Smith Summary apparently does not consider this. According to the Freebairn-Smith
10 Summary, while Riverside (with its point-of-sales machine) took in about \$432,000 in cash from
11 2014 through 2019, The Red Door (with an old-fashioned cash register) took in no cash at all
12 from its opening in 2011. This is not possible. So, the cash had to be used for something else,
13 such as tips or “under-the-table” salaries or “supplemental draws”, and it never went through the
14 The Red Door Bank Account.

15 There is no indication of the method used in the Jennings Reports, but they include
16 certain things that the Freebairn-Smith Summary does not and that do not appear elsewhere. For
17 that reason, the Court started by comparing various items from the Freebairn-Smith Summary
18 with those in the Jennings Reports to validate the Jennings Reports. The charts below show that a
19 0.2% and 4.9% difference exists between figures in the Jennings Reports and those in the
20 Freebairn-Smith Summary. Therefore, the Court accepts the validity of the Jennings Reports.

21 A persistent issue is whether all unallocated bank counter and ATM withdrawals were
22 identified as going to Di Bacco. While there are just a few of such receipts in evidence, they do

1 show that at times Kline withdrew money from the bank with no indication of its purpose.⁹⁰

2 There is no way to be sure that all of the unidentified withdrawals in the Freebairn-Smith
3 Summary went to Di Bacco. And there are unreviewed receipts that both Kline and Di Bacco
4 turned in for reimbursement for cash payments.⁹¹

5 One further general comment: the Freebairn-Smith Summary includes figures for only
6 the first nine months of 2019. When necessary, the Court estimated the fourth quarter and added
7 that amount to create complete annual figures for 2019. This is certainly not accurate because it
8 does not reflect the expected extra income and expenses for the holiday season.

9 The Neumeister Report used the Freebairn-Smith Summary as the basis of his own
10 opinion. He reviewed a substantial portion of the back-up for her spreadsheets. Neumeister
11 considered numerous documents, and the Court assumes that most of these were the basis of the
12 Freebairn-Smith Summary.⁹² Some of the documents are not in evidence, though they might
13 have been helpful. For example, the Neumeister Report considered two January 2011 through
14 September 2019 profit and loss statements.⁹³ It also considered emails and letters with Jeff Otto,
15 Joe Hougnon, and Kevin Ho.⁹⁴

16 Largely based on the Freebairn-Smith Summary, the Neumeister Report found that over
17 \$1.3 million was withdrawn by Di Bacco with no “business records as legitimate business
18 expenses and appear to have been entirely for the personal benefit of Mr. Di Bacco.”⁹⁵ The

⁹⁰ See, e.g., Exhibit YYY (counter withdrawals for May through August 2015); *Neumeister Report*, Exhibit J thereto (counter withdrawals dated May 18, 2015 and June 9, 2015).

⁹¹ Exhibit ZZZZ.

⁹² See *Neumeister Report*, Exhibit B thereto (list of 72 documents considered).

⁹³ *Id.* (items 4 and 5).

⁹⁴ *Id.* (items 38 through 54).

⁹⁵ *Neumeister Report*, at 2.

1 Neumeister Report states that, but for these withdrawals, TMLLC would have been profitable
2 and could have given more substantial draws to the partners.⁹⁶

3 In order to try to ascertain what these proceeds were used for, the first issue addressed is
4 what cash went to pay tips.

5 1. Calculating Tips Paid in Cash

6 Tips paid by cash customers are not included in the cash income of the restaurants and
7 TMLLC has no record of these and did not participate in them. However, tips that the customer
8 adds to a check that is charged to a credit card need to be paid to the server or bartender in cash
9 by TMLLC, either when the server or bartender leaves for the day or the next day. There is
10 unrefuted testimony that a few times this was paid by a TMLLC check so that the recipient could
11 have the money immediately when there was not enough cash in the register to pay him/her.⁹⁷
12 But normally the employee would be paid in cash that evening or the next day when s/he
13 reported for work.

14 At one point, Di Bacco intimated that he would run over to the ATM to get cash to pay
15 the tips if there was not enough cash in the register.⁹⁸ It is possible that this happened
16 occasionally. Although it is not certain, the testimony indicates that money to pay tips and
17 replenish the register was taken by withdrawals from the bank rather than through the ATM. But,
18 again, it is likely that the ATM was used if the bank was not open, such as in the evening or on
19 the weekend.

⁹⁶ *Id.*

⁹⁷ It has become customary to refer to individuals as “they” rather than “him or her” or “he or she” when uncertain of gender. But using “they” is confusing as to whether the Court means a single individual or a group of them. Therefore, the Court will use s/he or him/her when appropriate.

⁹⁸ The cash in the register is referred to as “the bank” by the parties and employees. But for clarity, I will use the word “register” or “pouches” instead.

1 There is no way to determine specifics. The sloppy or non-existent bookkeeping for at
2 least the first 5 or 6 years makes it impossible. So, the Court must estimate to the best of its
3 ability based on the testimony and the evidence.

4 While the Court intends to try to account for the annual cash that was taken from the
5 register to pay tips charged by credit card customers, this is not really a relevant figure. At the
6 hearing on September 24, 2024, both parties agreed that every day that Kline opened the
7 business, he would take any remaining cash from the day before and divide it in two. He would
8 keep half and put the other half in his back pocket to give to Di Bacco when Di Bacco arrived.
9 They considered this a “supplemental draw” and it does not appear on any of the accountings.⁹⁹
10 Nonetheless, the Court will estimate the cash used for tips to try to give a fuller picture of this
11 business.

12 The annual payroll summary by employee report from November 1, 2013, through
13 January 1, 2020 (the “Payroll Summary”)¹⁰⁰ does not help very much because there is no
14 indication it was ever given to Freebairn-Smith, so it is not included in the Freebairn-Smith
15 Summary. There is no evidence as to when it was calculated or how. And it has not been
16 analyzed or summarized for the Court. Further, it certainly does not reflect the under-the-table
17 money that was paid to kitchen staff, servers and bartenders. So, the Court must try another
18 method.

19 Calculating credit card tips for Riverside is simple because that restaurant used a point-
20 of-sales (POS) machine to charge credit card sales. Again, please note that cash sales are not part

⁹⁹ Exhibit CCC is the type of slip that Kline left when cash was taken from the night before and split between Kline and Di Bacco. But neither the other slips nor a summary of them is in evidence.

¹⁰⁰ Exhibit FFF.

1 of this calculation because the cash tip never comes into the hands of TMLLC but is given
2 directly to the server or bartender by the customer.

3 The first step is to calculate the percent of credit card tips relative to credit card sales in
4 Riverside. Using figures for 2016 through 2019 in the Jennings Riverside Report, the Court
5 calculated the percent of credit card receipts that were paid out by TMLLC as tips for those
6 working as servers or bartenders in Riverside.

7 **Table 4. Riverside percent of credit card receipts paid to tips**

Credit card receipts	\$2,485,380
Total tips paid	\$439,108
Percent of credit card receipts paid to tips	17.66%

8
9 The Neumeister Report stated that Riverside and The Red Door each had a POS system,
10 but the only reports that Neumeister was given were from the Riverside POS system.¹⁰¹ This is
11 incorrect and probably threw the accounting off to some extent. In actuality, The Red Door did
12 not have a POS system, so credit card sales were entered in their entirety and the tips were
13 withdrawn from the cash register but not reduced from the gross amount of sales. Di Bacco
14 estimated that the tips that were paid in cash by TMLLC to the servers due to credit card sales at
15 The Red Door and not accounted for in the various reports came to 19.21%.¹⁰² The Court does
16 not accept this figure. There is no evidence to show that tips should average 1.5% higher in The
17 Red Door than at Riverside. And Neumeister agrees that the percentage of tips should be pretty
18 much the same for both Restaurants. Therefore, the Court will rely on the more accurate figure
19 for Riverside to calculate the amount of cash that had to be paid to servers/bartenders who
20 worked at The Red Door—17.66%.

¹⁰¹ See *Neumeister Report*, at 5.

¹⁰² Exhibit AAAAA, at 3.

1 The Freebairn-Smith Summary relies on the POS totals from Riverside and does not
 2 include any tip money from The Red Door.¹⁰³ This is apparent because no “tips payable” are
 3 listed until 2014 when TMLLC began operating Riverside and then it was a very small amount
 4 compared to the later years.¹⁰⁴

5 **Table 5. Comparison of credit card tips in Freebairn-Smith Summary to Court’s estimate**

Credit card sales (2011-2019) ¹⁰⁵	
The Red Door	\$4,274,778
Riverside	\$3,346,761
<i>Total</i>	<i>\$7,621,539</i>
Tips per Court’s estimate at 17.66%	\$1,332,256
Tips per Freebairn-Smith Summary ¹⁰⁶	\$427,090
<i>Difference</i>	<i>\$918,874</i>

6
 7 Because Kline relies on the figures in the Freebairn-Smith Summary (which is the basis
 8 of the Neumeister Report), the Court generally will use those as a basis to its analysis. But
 9 because they are incomplete and based on limited information, the Court will be expanding them
 10 with other evidence in trying to reach some conclusions.

11 While the Freebairn-Smith Summary shows cash sales for Riverside starting in 2014, it
 12 has no cash sales for The Red Door until 2019 and then for \$1,235 only.¹⁰⁷ Except for that single
 13 amount of cash sales for The Red Door, it labels all rows for cash sales as “cash sales (not
 14 deposited).”¹⁰⁸ There is no explanation for this as it includes them in the “total sales income.”
 15 The Riverside cash sales number apparently comes from the POS machine and is accurate.

¹⁰³ See Exhibit 69.

¹⁰⁴ *Id.*

¹⁰⁵ Using the Freebairn-Smith Summary (Exhibit 69) for 2011 through 2018 and the Jennings report for 2019 (Exhibits FF, GG). Where possible, the Court uses the Jennings report for 2019 because the Freebairn-Smith Summary is only through September of that year. If it is not possible because of lack of information, the Court estimates receipts for the fourth quarter of 2019 so that the Freebairn-Smith Summary for that entire year can be used.

¹⁰⁶ Adjusted for 2019.

¹⁰⁷ Exhibit 69.

¹⁰⁸ *Id.*

1 However, The Red Door figure (or lack thereof) cannot be correct because it is impossible that
2 100 percent of those sales were on credit cards.

3 For the period from 2011 through September 2019, the estimated amount of tip money
4 that TMLLC actually distributed to its servers/bartenders was \$1,284,147.22. Adjusting for the
5 full year of 2019, it is \$1,332,256. The Freebairn-Smith Summary accounts for only \$410,788.26
6 (\$427,090 for the full year of 2019). Comparing this with the amount that the Freebairn-Smith
7 Summary traced to checks or withdrawals from the bank or its ATM, labeling this as “less tips
8 payable,” the difference that was paid in cash as tips for credit card sales that is not accounted for
9 in the Freebairn-Smith Summary is \$918,874. Some proportion of this was paid from cash that
10 was taken in during each day of operation. At the hearing on September 24, 2024, the parties
11 agreed that Kline often took the remaining cash when he opened up for the day and left a note as
12 to the amount. Exhibit CCC contains two examples, but this is just the tip of the iceberg. The
13 total amount is not in evidence. Ms. Freebairn-Smith did not have access to this information and
14 therefore she incorrectly concludes that all unaccounted-for remaining cash was kept by Mr. Di
15 Bacco.

16 To estimate that, the next step is to determine the cash shortfall from 2011 to September
17 2019. If all or most of the cash was depleted to pay the tips or was taken by Kline and Di Bacco
18 as “supplemental draws,” a trip to the bank would be needed before the business opened the next
19 day or at least every several days to replenish the back-up pouches.

20 Three former employees described the system as to cash receipts and credit card tips:

21 Robert Rotundo, Jr., who was a bartender from 2014 through 2019 (first at The Red Door,
22 then at both Riverside and at The Red Door, and then back to only The Red Door) testified that
23 each day the register was usually started with \$300 to make change. There were two pouches in

1 the back, each with cash to refresh the register as needed. As time went on, more sales were paid
2 by credit card than in cash. There was usually enough cash in the register to pay the tips, but if
3 they were short, the bartender (presumably) would take money from the \$300 opening pouch or
4 from a back-up pouch. At some point when the money in the pouches got low, they would notify
5 Di Bacco or Kline to replenish them.

6 Maria Abreu also gave a detailed description of how the money was handled. She was a
7 bartender in both Riverside and The Red Door from July 2017 or 2018. Many times the credit
8 card sales would be higher than what was in the register, in which case she would ask Di Bacco
9 or Kline to go get money for the tips. The Court presumes the parties would get money for the
10 tips from the extra pouches kept on the Premises, or perhaps from the ATM because the bank
11 would be closed at that time.

12 Cheryl Doyle worked there, apparently as a server, from 2014 through 2019. Because she
13 worked the 4 p.m. to 8 p.m. shift, there was always money to pay her credit card tips.

14 Neither Ms. Abreu nor Ms. Doyle confirmed that the register or the pouches always or
15 usually contained sufficient cash to pay tips at the time that the restaurants closed for the
16 evening.

17 When The Red Door reopened after the COVID-19 pandemic restrictions, it no longer
18 accepted credit cards; there was an ATM machine on the Premises. Because all payments at The
19 Red Door were in cash, the issue of handling the tips ceased to exist. Also, the reopening was
20 largely after Di Bacco filed bankruptcy, so the Court will not include it in its analysis. But there
21 is testimony that The Red Door credit card sales were processed at Riverside at some point in
22 time, though the explanation and evidence are insufficient to use in the calculations.

The next step is to try to determine whether Di Bacco was truthful when he said that the amount of tips that had to be paid due to credit card sales often or at least periodically exceeded the amount of cash in the register and pouches to pay it. The two multiyear accountings available contain only annual figures, which results in a very rough estimate when it comes to a day-by-day or week-by-week analysis. Nonetheless, a comparison is worthwhile because that is all that the Court has to work with.

Table 6. Comparison of credit card sales in Freebairn-Smith Summary to Jennings Report

Credit card sales	Row/Function	2016	2017	2018
The Red Door				
Freebairn-Smith Summary (Ex. 69)	A	567,417	540,301	505,011
Jennings report (Ex. GG)	B	569,768	537,316	504,571
<i>Difference</i>	C = (A - B)	(2,351)	2,985	440
Riverside				
Freebairn-Smith Summary (Ex. 69)	D	662,084	696,634	646,253
Jennings (Ex. FF, ln. D)	E	642,957	671,417	589,628
<i>Difference</i>	F = (D - E)	19,127	25,217	56,625
Total credit card sales				
Freebairn-Smith	G = (A + D)	1,229,501	1,236,935	1,151,264
Jennings	H = (B + E)	1,212,725	1,208,733	1,094,199
<i>Difference</i>	I = (G - H)	16,776	28,202	57,065
<i>Difference as percentage</i>	J = (I ÷ G)	1.4%	2.3%	5.0%

Comparing the Freebairn-Smith Summary with the Jennings report shows that a high degree of accuracy exists as to the amount of credit card sales from 2016 through 2018, ranging from a 1.4% to 5% difference. To do further calculations involving 2019, it is necessary to only use the Jennings figures because the Freebairn-Smith Summary is limited to the first three quarters of the year. While I tried to estimate the entirety of 2019 for the Freebairn-Smith Summary, the holiday period must have made a difference and thus the Jennings figures for 2019 are more reliable and will be used for that year where possible.

Using figures from the Freebairn-Smith Summary for 2016, 2017 and 2018, and figures from the Jennings report for 2019, the Court estimates the total cash deficiency to pay tips for 2016 through 2019 as \$151,947.¹⁰⁹

Table 7. Calculation of cash deficiency to pay tips

	Row/Function	2016	2017	2018	2019
Total credit card sales	A	1,229,501	1,236,935	1,151,264	1,091,420
Riverside	B	662,084	696,634	646,253	581,379
Riverside as percentage	C = (B ÷ A)	53.8%	56.3%	56.1%	53.3%
Tips on credit card sales	D = (A × 17.66%)	217,130	218,443	203,313	192,745
From Riverside	E = (B × 17.66%)	116,924	123,026	114,128	102,672
Riverside cash receipts ¹¹⁰	F	111,923	101,094	84,935	75,874
Cash deficiency to pay tips for Riverside	G = (F - E)	(5,001)	(21,932)	(29,193)	(26,798)
Total cash receipts ¹¹¹	H = ((F*100)/55)	203,496	183,807	154,427	137,953
Cash deficiency to pay tips	I = (H - D)	(13,634)	(34,636)	(48,886)	(54,792)
<i>Total</i>					(151,947)

As time went on, more sales were by credit card than by cash. Credit card sales were deposited into the Bank Accounts and, from those figures, it is possible to estimate the amount of cash sales that The Red Door received.

¹⁰⁹ See Table 7.

¹¹⁰ Freebairn-Smith Summary (for 2016, 2017, and 2018); Jennings Riverside Report (for 2019).

¹¹¹ The average of Row C is 55%. Row H assumes Riverside accounted for 55% of total cash and check receipts (Riverside + 45%).

1 **Table 8. Cash sales for Riverside (2015-2019)**

	Smith ¹¹²				Jennings ¹¹³
	2015	2016	2017	2018	2019
Riverside					
Credit card receipts	427,218	662,084	696,634	646,252	581,379
Cash receipts	78,572	112,598	101,094	83,935	75,874
Riverside Total Receipts	505,790	774,682	797,728	730,187	657,253
Cash sales as a percent of credit card sales	18.4%	17.0%	14.5%	13.0%	13.1%
The Red Door					
Credit card receipts	574,356	567,417	540,300	505,011	510,042
Est. cash receipts ¹¹⁴	105,682	96,461	78,344	65,651	66,816
The Red Door Total Receipts	680,038	663,878	618,644	570,662	576,858
<i>Total cash and checks received¹¹⁵</i>	184,254	209,059	179,438	167,162	142,690
<i>Total credit card sales</i>	1,001,574	1,229,501	1,236,934	1,151,263	1,091,421

2

3 **Table 9. Cash remaining after paying tips (2015-2019)**

	Smith				Jennings	Subtotal
	2015	2016	2017	2018	2019	
Total cash receipts excl. checks ¹¹⁶	184,254	208,404	179,438	158,162	142,690	872,946
Est. tips from credit card sales ¹¹⁷	176,277	217,130	218,443	203,313	192,745	1,007,908
<i>Difference</i>	7,977	(8,726)	(39,005)	(45,151)	(50,055)	(134,962)

4

5 Calculating the cash deficiency for the period from 2011 through 2014 is much more
6 speculative. While The Red Door apparently took credit cards throughout this time, the POS
7 system only existed in Riverside, which TMLLC began to partially operate at the end of 2013
8 and completely operate in the middle of 2014.¹¹⁸ For the period from 2011 through 2014, the

¹¹² Exhibit 69.

¹¹³ Exhibits FF and GG.

¹¹⁴ Derived using Riverside’s figures regarding cash sales as a percent of credit card sales.

¹¹⁵ Checks are included in the Freebairn-Smith Summary, so these are included here. But they are such a small percent of sales that they do not skew the results. The Jennings Riverside Report does not have a figure for cash sales by The Red Door for 2019, so an estimate from the Freebairn-Smith Summary for the entire year of 2019 is used. This is clearly incorrect as the 2019 credit card receipt figure in the Jennings Riverside Report exceeds the figure in the Freebairn-Smith Summary by \$75,874.

¹¹⁶ Excluding checks. Exhibits 69, FF, GG.

¹¹⁷ Estimated at 17.66%. See Table 4. Figures for 2016 through 2019 are from row D of Table 7.

¹¹⁸ Exhibit 2 (Purchase Agreement for Riverside, dated June 20, 2013). Di Bacco states under penalty of perjury that “the middle/inside section was open in late 2013 early 2014. We called it the back of the Red Door. When the patio was completed in August of 2014 the whole front was opened as Riverside.” *Di Bacco Clarifications* [dkt. 219] 13. It is not clear exactly what money was used for the renovation, but it seems to have come largely or completely from investor loans and not from operating money.

1 Court must rely on the figures in the Freebairn-Smith Summary. The total credit card sales for
 2 this period were \$1,834,980, requiring tips to be paid in the total amount of \$342,057.

3 Table 8 demonstrates the steady growth of the use of credit cards. The Court estimates
 4 that the percent of cash sales during the period from 2011 through 2014 was about 20 percent
 5 each year.

6 **Table 10. Calculation of cash after paying tips (from Freebairn-Smith Summary)**

	Year				Total
	May-Dec 2011	2012	2013	2014	
Credit card sales					
The Red Door	29,165	431,300	537,421	579,775	1,577,661
Riverside	—	—	7,506	249,813	257,319
<i>Total</i>	29,165	431,300	544,927	829,588	1,834,980
Cash sales ¹¹⁹					
<i>Total</i>	5,833	86,260	108,985	165,918	366,996
Est. tips from credit card sales	5,150	76,168	96,234	146,505	324,057
Cash remaining after paying tips	683	10,092	12,751	19,413	42,939

7
 8 **Table 11. Summary of cash vs. tips from Tables 9 and 10**

Year	Cash	Tips	Difference
2011	5,833	5,150	683
2012	86,260	76,168	10,092
2013	108,985	96,234	12,751
2014	165,918	146,505	19,413
2015	184,254	176,277	7,977
2016	208,404	217,130	(8,726)
2017	179,438	218,443	(39,005)
2018	158,162	203,313	(45,151)
2019	142,690	192,745	(50,055)
<i>Total</i>	1,239,944	1,331,965	(91,021)

9
 10 Although the Court has fairly reliable information for 2020 forward until all operations
 11 ceased in July 2022, this is not relevant to the matters before the Court. Beginning March 16,

¹¹⁹ The Court estimates that the percent of cash sales during the period from 2011 through 2014 was about 20 percent each year.

1 2020, the Restaurants were closed due to COVID-19 pandemic restrictions.¹²⁰ It is unclear
2 whether any operations took place until the outdoor patio reopened on September 2, 2020. The
3 indoor portions opened at a later date. Both the outdoor patio and the inner portions had limited
4 seating due to Covid restrictions. On October 29, 2020, Di Bacco filed a voluntary chapter 7
5 petition.¹²¹ As discussed in the Conclusions of Law, everything after that date is post-petition and
6 not subject to the bankruptcy discharge.

7 It is clear that generally there was no ongoing cash overage at the end of the business day
8 and therefore there was no need or ability to make daily or perhaps weekly deposits into the
9 Bank Accounts. The Court also finds that the cash deficiency both to pay tips and to replenish the
10 register was a regular feature of the Restaurants. Kline always had an ATM/debit card. But he did
11 not actively participate in running The Red Door and Riverside, though he did open the Premises
12 on most days and close when Di Bacco was not available. But it was Di Bacco who generally
13 withdrew the needed cash from the ATM or the Bank Accounts themselves.¹²²

14 The above is not meant to be an accurate accounting; that is not possible. The information
15 is too scanty and incomplete. But it does paint a reasonably reliable picture of the situation
16 concerning the payment of tips, the reason for only periodic cash deposits into the Bank
17 Accounts, and the foundation of statements made by Di Bacco as to obtaining cash from the
18 ATM or the Bank Accounts to pay tips and replenish the register.

¹²⁰ *LA County Public Health Issues Order to Prohibit Group Events and Gatherings, Require Social Distancing Measures and the Closure of Certain Businesses*, Los Angeles County Department of Public Health (Mar. 16, 2020), <http://www.publichealth.lacounty.gov/phcommon/public/media/mediapubhpdetail.cfm?prid=2269>.

¹²¹ *Voluntary Petition* [dkt. 1], *In re Michael A. Di Bacco*, 1:20-bk-11952 (“Bankruptcy Case”).

¹²² Obviously, ATM withdrawals are from the Bank Accounts, but for clarification, the Court uses the term “the bank” to indicate a withdrawal slip rather than an ATM receipt.

1 2. Calculating Cash Used to Pay Employees

2 The information as to the payment of employees in the Freebairn-Smith Labor Report is
3 based solely on the checks to kitchen employees.¹²³ But there is no dispute that cash payments
4 were made to some or all employees at various times (paid “off-the-books” or “under-the-
5 table”).¹²⁴ Kline admitted that when he was not on the Bank Accounts, Di Bacco would get the
6 money and give it to Kline to pay the kitchen workers. This included the cooks, the pizza cooks,
7 and the dishwashers. Di Bacco would make cash payments to other employees, i.e., servers,
8 busboys, and bartenders. Kline testified that when he was a signatory on the Bank Accounts, he
9 paid employees in cash and then went to the bank, apparently putting a notation on the
10 withdrawal slip. Kline also testified that Felix Garcia (aka Antonio Hernandez, Rosa Aguilera,
11 and Marisol Aguilera) and Roberto Nunez, who were the main line cooks, were paid off-the-
12 books until 2018 when Di Bacco put them on payroll.¹²⁵

13 Two charts attempt to show the Restaurants’ employee costs: the Payroll Summary and
14 the Freebairn-Smith Labor Report. It appears that Freebairn-Smith did not have the Payroll
15 Summary when preparing the Freebairn-Smith Labor Report, which is limited to kitchen
16 employees only. Apparently, Kline gave her the names and she matched those to the checks that
17 she found on the Bank Account statements.

18 Only some of the people on the Payroll Summary are also on the Freebairn-Smith Labor
19 Report because it did not include servers, busboys or bartenders. For example, in 2017, when
20 TMLLC was already using a payroll system, only five of the eight people listed on the Freebairn-

¹²³ See Exhibit 85 (per the Freebairn-Smith Payroll Summary’s title).

¹²⁴ The testimony uses the term “off-the-books” and “under-the-table” to describe salaries paid in cash. These are used interchangeably in this memorandum.

¹²⁵ Di Bacco says that employees were on payroll at the end of 2018, but even then, they were paid with checks and cash. *Di Bacco Clarifications* [dkt. 219], ¶ 14. Exhibit FFF shows them on the payroll report starting in 2018.

1 Smith Labor Report are also on the Payroll Summary. Robert Nunez, who was paid \$34,294 in
2 checks, is not on the Payroll Summary. That same year, the Payroll Summary lists twenty
3 employees who received a salary (fifteen of which also received cash tips), but the Freebairn-
4 Smith Labor Report lists only eight employees.¹²⁶

5 No indication exists that the Freebairn-Smith Labor Report included the Kline-notated
6 withdrawal slips as part of the salaries paid to the cooks and pizza cooks, as it includes only
7 checks made payable to the employee. So, the remaining amounts due to the kitchen employees
8 were paid in cash through withdrawals either by Di Bacco or, if by Kline, not accounted for in
9 this analysis. Comparing the Freebairn-Smith Labor Report with the Payroll Summary helps to
10 show the actual cost of kitchen salaries. *See* Table 12.

¹²⁶ Exs. 85, FFF.

1 **Table 12. Comparing the Freebairn-Smith Labor Report (F-SLR) with the Payroll Summary (PS)**

Name	Function	2013		2014		2015		2016		2017		2018	
		F-SLR	PS	F-SLR	PS	F-SLR	PS	F-SLR	PS	F-SLR	PS	F-SLR	PS
Juan Gonzalez	dishwasher							1,566	351	16,038	15,410	19,824	19,258
Sam Lampson	dishwasher					13,209		11,115		890			
Felix Garcia ¹²⁷	line cook	1,085		18,761		20,644		8,996				3,844	3,844
Kurt Godwin	cook/bar		3,794	7,532	3,795								
Robert Nunez	line cook	1,520		8,267		43,934		50,246		34,294		4,095	4,095
Alexis Salinas	pizza cook											336	
Barney Armandsen	pizza cook							1,500	1,500	3,384	3,385		
Christian Salinas	pizza cook									5,962	4,934	20,568	21,608
Cole Vercammen	pizza cook					6,416							
Edwin Bellestrono	pizza cook							506		1,677			
Ellis Grant	pizza cook					426							
Ethan Cardenas	pizza cook					238							
Gevork Adanalyan	pizza cook							11,688	4,076				
Kevin Owens	pizza cook					3,442	3,143	8,381	8,163				
Mason Townley	pizza cook					1,053							
Mia Del Cid	pizza cook							508	436	145	146		
Nick Spera	pizza cook					1,939							

2

¹²⁷ Felix Garcia includes payments to akas: Antonia Hernandez, Rosa Aguilera, and Marisol Aguilera.

1 Both Kline and Di Bacco agree that some employees were paid entirely or partially in
2 cash.¹²⁸ According to Di Bacco, most employees were on payroll after 2016, except that “some
3 random people [who] would come in and work occasionally” were paid in cash.¹²⁹

4 While it is not possible to meaningfully estimate the cash paid under-the-table to
5 Restaurant employees, the Court can estimate the amount of money that was paid in cash to
6 kitchen staff.

7 With a few exceptions, The Red Door and Riverside were open seven days a week, fifty-
8 two weeks a year. According to Kline, two pizza cooks worked at any given time, each working
9 56 hours per week for a total of 112 hours per week. Kline does not remember what hourly wage
10 was paid to the pizza cooks and stated that Di Bacco was the one who paid the pizza cooks
11 throughout. According to Di Bacco, TMLLC paid the pizza cooks \$10 per hour, in cash, and that
12 Di Bacco gave the cash to Kline to give to the pizza cooks. Maria Abreu and Heidi Lohemiller
13 agreed that generally two pizza cooks worked at any given time, but more were hired if a big
14 party was dining.

15 Di Bacco testified that a dishwasher was present from when the Restaurants opened until
16 1:00 a.m. That person was paid \$10 per hour.

17 Garcia testified that, in 2012, he took a six-month break from working for Romanowski
18 and then came back in 2013. When TMLLC bought Riverside in 2013, Garcia began working for
19 them for two days a week. During this time, he worked about five hours a day because two other
20 men worked in the kitchen and he traded off with the dishwasher in 2014 and 2015. Di Bacco
21 testified that Garcia worked 60 hours during those two-week periods and received \$13 per hour.

¹²⁸ *Hr'g*, Sept. 24, 2024.

¹²⁹ *Di Bacco Clarifications* [dkt. 219], ¶ 14.

1 In general, two employees staffed the general (main) line, two staffed the pizza line (starting in
2 2015), and one staffed the dishwasher.

3 In an attempt to make sense of all of this, the Court finds that the kitchen staff were paid
4 the following amounts:

5 (a) Dishwasher (1), 5:00 p.m. to 1:00 a.m.; 8 hours per day at \$10 per hour.

6 (b) Pizza Cooks (2), 4:00 p.m. to 12:00 midnight; 8 hours per day at \$10 per hour.

7 However, more pizza cooks were working when there was a party, but the lack of
8 evidence prevents the Court from estimating this added labor cost.

9 In 2019, Hernandez and Nunez, the two line cooks, were paid \$15 and \$13.25 per hour
10 respectively.¹³⁰ The line cooks worked from 4:00 p.m. to 12:00 midnight—8 hours per day at a,
11 approximate \$14 average hourly rate.

12 When reviewing the individuals on the Freebairn-Smith Labor Report against the Payroll
13 Summary, many discrepancies stand out. The cash payments for ongoing or casual labor never
14 showed up on the Freebairn-Smith Labor Report. For example, the total for line cooks was
15 \$59,241 in 2016, but only \$7,938 in 2018. This is because Robert Nunez, who was paid \$50,246
16 in 2016, only worked 400 hours in 2018 for a total of \$4,095. But the Freebairn-Smith Labor
17 Report does not replace him with another person as a line cook, though there must have been a
18 second line cook during that year.

19 The Freebairn-Smith Summary does not contain a separate line for salaries, including
20 those in the kitchen and in the Restaurants. Apparently, it includes these in the category of “other
21 expenses.”

¹³⁰ Exhibit TTT.

1 Because of the person-by-person listing and the work category, the Court can estimate the
 2 total amount of cash that was used to pay the kitchen employees from the number of required
 3 personnel and the number of hours and hourly wages as calculated above.

4 **Table 13. Kitchen labor paid by check per Freebairn-Smith Labor Report**

	Dishwashers	Cooks ¹³¹	Pizza cooks	Subtotal
2011 (May-Dec)	—	—	—	—
2012	—	—	—	—
2013	—	2,605	—	2,605
2014	—	34,561	600	35,161
2015	13,210	64,578	13,512	91,300
2016	12,681	59,242	22,656	94,579
2017	16,928	34,294	15,780	67,002
2018	19,824	7,939	32,240	60,003
2019				
9 months	10,670	34,893	30,870	76,433
Whole year ¹³²	14,226	46,524	41,160	101,910
<i>Total</i>				
9 months	73,313	238,112	115,658	427,083
Whole year	76,869	249,743	125,948	452,560

5
 6 In order to estimate the yearly average cost for the various categories of kitchen
 7 employees, it is reasonable that the total was about the same from year to year:

- 8 (a) Dishwashers would total about \$15,000 per year;
- 9 (b) Cooks would total about \$58,000 per year; and
- 10 (c) Pizza Cooks would total about \$30,000 per year.

11 Table 14 leaves a blank for any year when there were no employees in a category (e.g.,
 12 pizza cooks before 2014), or where the total checks met or exceeded the expected salary for that
 13 category for that year (e.g., cooks in 2015 and 2016). Once 2019 was adjusted to include that
 14 entire year, about \$293,000 was not reflected on the Freebairn-Smith Labor Report. It is probable

¹³¹ The figures for the cooks in 2017 and 2018 are clearly wrong when compared to prior years. 2017 lists only one cook, although Garcia certainly worked during that year, and 2018 shows a minimal amount for Garcia and for Nunez. This indicates substantial cash payments that are not reflected on the Freebairn-Smith Labor Report.

¹³² As noted above, the Court has estimated the additional three months of 2019 which are not included in the Freebairn-Smith Labor Report.

1 that between May 11, 2015, and May 7, 2018, Kline took some money from the Bank Accounts
 2 to pay the cooks, but such withdrawals were sporadic and are not included in the Freebairn-
 3 Smith Labor Report.

4 **Table 14. Estimate of amounts paid in cash to kitchen employees**

	Dishwashers	Cooks	Pizza cooks	Subtotal
2011 (May-Dec)	7,500	—	—	7,500
2012	15,000	—	—	15,000
2013	15,000	55,395	—	70,395
2014	15,000	23,439	29,400	67,839
2015	1,791	—	16,488	18,279
2016	2,319	—	7,344	9,663
2017	—	23,706	14,220	37,926
2018	—	50,061	—	50,061
2019				
9 months	734	11,476	—	12,210
Whole year	1,032	15,301	—	16,333
<i>Total</i>				
9 months	57,344	164,077	67,452	288,873
Whole year	57,642	167,902	67,452	292,996

5
 6 While it is not certain, it is likely that some or most of the employees who were paid “off-
 7 the-books” were given cash at the end of a week or of a two-week period. But some of them may
 8 have been paid nightly from the cash in the register. This, along with the tips, would have
 9 required regular trips to the bank to replenish the cash on hand. Again, the Court has no specific
 10 information on this and makes no findings except that no excess cash remained available on a
 11 regular basis to pay the employees once the tips were distributed at the end of each day.

12 Although the Court believes this number to be quite low and clearly not an exact figure,
 13 for purposes of this accounting, the Court will find that Di Bacco took at least \$293,000 from the
 14 Bank Accounts to pay kitchen employees off-the-books in cash from 2011 through 2019.

1 However, the Court cannot possibly calculate the cash payments to servers, busboys, and
2 bartenders.

3 3. Other Payments

4 Kline does not raise the issue of the use of the money obtained from third parties as loans.
5 This is not a profit that he could share in, so he excludes it from his bookkeeping presentation.
6 The Freebairn-Smith Summary excludes these loan deposits because it only reports credit card
7 sales for 2011 and the restaurant did not open until September 23 of that year. But because Di
8 Bacco reimbursed (1) himself for some construction and start-up costs, and (2) Kline for outlays
9 for food after The Red Door began operations, it is likely that much of the \$23,741.84 “Di Bacco
10 Draw” in the Freebairn-Smith Summary for October through December 2011 was for these
11 items.¹³³

12 So, although the Court has some evidence as to loans, the Court will not attempt to
13 analyze it in any detail because the only relevance to this adversary proceeding is the use of the
14 money generated by the Restaurants. The loans that came prior to the COVID-19 pandemic were
15 used to pay for construction and start-up costs. In the very beginning, the loans also had to cover
16 The Red Door’s operating expenses. But no evidence establishes for how long. The Freebairn-
17 Smith Summary shows no cash income for The Red Door throughout, but this is largely
18 explained by the use of cash to pay tips and salaries. And while credit card sales grew annually,
19 only the money from the loans and from the line of credit covered costs initially. As time went
20 on, apparently sufficient income existed to pay salaries, purchase food and drinks, etc.

21 Di Bacco testified that all payments to Percel were made in cash because Percel would
22 not accept checks. But Di Bacco later testified that \$7,500 of the \$19,000—referring to exhibit

¹³³ Exhibit EEEE [dkt. 223], at 4.

1 TT—was paid by check. No evidence contradicts this. The parties agree that Di Bacco paid
 2 Percel the sum of \$19,000 to take his name off the liquor license. Of that amount, \$8,500 was
 3 deducted from the \$250,000 purchase price owed to Romanowski for obtaining Robano’s.¹³⁴
 4 Accordingly, the Court will credit Di Bacco with \$11,500 of cash against the Freebairn-Smith
 5 Summary (and Neumeister Report) amount of excess draws.

6 Di Bacco also testified that he paid rent and utility charges to Romanowski in cash.¹³⁵

7 **Table 15. Other cash payments from operations for rents and purchase**

Date	Paid to	Purpose	Amount
10/25/11-12/5/11	Romanowski	Rent and utilities for The Red Door	4,200 ¹³⁶
1/17/12-12/15/12	Romanowski	Rent and utilities for The Red Door	56,717
1/4/13-12/15/13	Romanowski	Rent and utilities for The Red Door	20,800
1/22/14	Romanowski	Rent and utilities for The Red Door	500
<i>Subtotal excluding money from construction loans</i>			78,017
9/9/13-12/30/13	Benefit of Romanowski	Purchase of Riverside	35,000 ¹³⁷
1/14/14-12/31-14	Benefit of Romanowski	Purchase of Riverside	57,000
1/7/15-6/17/15	Benefit of Romanowski	Purchase of Riverside	24,000
<i>Subtotal</i>			107,000¹³⁸
4/14-11/14	Bob Percel	Purchase of liquor license	11,500
<i>Total cash payments from operations for rents and purchase</i>			196,517

8
 9 Another major use of the money—besides rent, utilities, etc.—was for supplies,
 10 groceries, and liquor. Calculating these amounts is just slightly more than guesswork. Di Bacco
 11 said that these items usually were paid for by check or credit card, but that cash was used when
 12 they were at their credit card limit and that Kline used cash quite often.¹³⁹ Kline agrees that there
 13 were times when he used cash because there was no money on the ATM/debit card or the credit

¹³⁴ Exhibit TT.

¹³⁵ See Exhibit UU. Di Bacco read the top half of exhibit UU into the record because the copies are illegible.

¹³⁶ Deemed to have come from construction loans.

¹³⁷ Exhibit Q1; remaining purchase price paid to Ronnie Jr. in the form of checks.

¹³⁸ Reduced by \$9,000 that Di Bacco admits was paid by check.

¹³⁹ *Di Bacco Clarifications* [dkt. 219], ¶ 7.

1 card was at its limit. Once again, the Court is forced to rely on somewhat inaccurate numbers and
2 must try to calculate something meaningful from them.

3 If Kline had given the Court thorough information, the Court could merely say that Kline
4 has met his burden of proof and then let Di Bacco chip away at it. But Kline’s contentions are
5 based on the Freebairn-Smith Summary, which is solely from the checks and credit cards.
6 Further, Kline participated in the confusion by using cash to pay employees, taking cash as a
7 “supplemental draw,” etc. Although Kline claims to have created notations for everything, he
8 clearly did not inform Freebairn-Smith of such documentation, and there were gaps in his record.
9 Cash was used for other things and the Freebairn-Smith Summary does not provide any insight
10 into this.

11 Conversely, Di Bacco sets forth theories without documentation to back them up. He has
12 introduced only a few sample receipts into evidence, which are not enough to create a reliable
13 picture. And Di Bacco gives no workup of these receipts. Even if all the receipts for the ten years
14 of the existence of TMLLC were in evidence, the Court is not a bookkeeper and cannot be
15 expected to catalog and make sense of them.

16 Beyond tips, under-the-table payments, and “supplemental draws,” the biggest piece
17 missing is the cash that was used to purchase food or alcohol. The Freebairn-Smith Summary
18 notes cost of goods sold as \$3,263,580. Both partners bought groceries and Di Bacco purchased
19 the necessary liquor and other items. But the Court cannot possibly determine how much Di
20 Bacco spent on these items and how much was paid by cash, check, or credit card. Di Bacco’s
21 lack of adequate bookkeeping has impeded a reliable accounting.

22 Comparing the figures for the cost of goods sold in the Freebairn-Smith Summary with
23 those in the tax returns, it appears that Freebairn-Smith accounted for all supplies, whereas the

1 tax returns seriously underreported the amount spent every year. The August 2016 Otto Letter
2 confirms this.¹⁴⁰

3 **Table 16. Cost of goods sold**

Year	Tax Returns ¹⁴¹	Freebairn-Smith	Difference
2011	8,973	11,342	2,369
2012	115,097	122,253	7,156
2013	225,651	144,423	(81,228)
2014	246,128	326,308	80,180
2015	374,377	483,034	108,657
2016	512,517	565,003	52,486
2017	597,449	579,046	(18,403)
2018	774,026 ¹⁴²	591,881	(182,145)
2019	710,806 ¹⁴³	587,054 ¹⁴⁴	123,754
<i>Total</i>	3,565,024	3,410,343	92,825

4
5 Table 16 does not give reliable figures because Freebairn-Smith did not have accurate
6 numbers for items paid in cash and therefore her amounts are less than what was actually paid.
7 But Table 16 again confirms that the tax returns are as unreliable as is the rest of the information.

8 While it is likely that additional food and alcohol were paid for in cash, the Court cannot
9 determine that without having any verifiable receipts or accounting. Di Bacco must be
10 responsible for his bad bookkeeping and lack of records.

11 Using the “draw details” on the Freebairn-Smith Summary (which are the basis of the
12 Neumeister Report) and considering that 2019 is only a partial year but some calculations are for
13 the full year, the Court can account for the following:

¹⁴⁰ See Exhibit 20.

¹⁴¹ 2011, 2012, 2013, and 2014 are incomplete tax returns and the “cost of goods sold” includes the cost of labor. Exhibits 45, 97, 98, and 47. But for comparison with Freebairn-Smith, this table uses the figure on page one of all tax returns, which includes the cost of labor.

¹⁴² This figure is identical to that of the 2018 Gallego P&L.

¹⁴³ This figure is identical to that of the 2019 Gallego P&L.

¹⁴⁴ Adjusted for full year.

Table 17. Alleged excess draws excluding personal expenses from Oct. 2011 through Sept. 2019

Draw detail	Amount	Accounted for?	Balance remaining
“Change for Register”	65,698	Yes. See below.	0
“Reimbursement”	19,898	No.	19,898
ATM Withdrawal	123,700	No.	123,700
Cash Sales Not Deposited	6,966	Yes. See below.	0
Check to Himself	193,518	No.	193,518
Checks Not Deposited	100	Ignored as <i>de minimis</i> .	0
Counter Withdrawal	990,517	No.	990,517
Unknown AMEX Card	1,000	No.	1,000
Unknown Credit Line (7968)	28,308	Yes.	0
<i>Total</i>	1,429,705		1,328,633

The Freebairn-Smith Summary should not have included the category of “Change for Register” when calculating the Di Bacco draw. At the time, Freebairn-Smith could not have known about the use of cash to pay tips and employees or the increased amount of credit card sales such that the register would need periodic refreshing. Because the Freebairn-Smith Summary does not accurately contemplate cash sales for The Red Door, there is no reason to deal with cash for the tips to cover this amount.

Rather than attempt to divide up the amounts for payment of tips, under-the-table wages, and other items, the Court will simply add up the alleged excess draws from Table 17 and deducted the accounted-for uses of cash from that remaining balance. *See* Table 18.

Table 18. Unaccounted-for use of cash

Remaining Balance of alleged excess draws (Table 17)	1,328,633
Deductions	
Cash deficiency to pay tips (Table 11) ¹⁴⁵	91,021
Amounts paid in cash to kitchen employees (Table 14)	292,996
Payments for rent and purchase (Table 15)	196,517
Reimbursement for construction costs (estimate from Ex. EEEE)	23,742
<i>Total</i>	724,357

¹⁴⁵ This may be a double deduction of \$65,698 for Change for Register. However, given the uncertainty of all these figures and the apparent failure to credit payments on the Credit Line (the validity of which is questioned in the Freebairn-Smith Summary), it is not improper to use the above figures.

1 Table 18 excludes any amount for cash payments for supplies, food, or liquor because it
2 is impossible to calculate or even estimate that amount.

3 4. Personal Expenses

4 The Freebairn-Smith Summary sets forth a list of “personal expenses,” which the
5 Neumeister Report incorporates into its analysis. The Court finds that those for dining (given the
6 small amounts and likelihood that these were for quick meals while shopping) and medical are
7 appropriate business expenses. Sprint Wireless is a business expense that was used in the
8 Restaurants. The Court will not disallow the “Other” category of personal expenses because it is
9 not itemized. However, there is no business use for the gym fees or for the travel expenses.

10 **Table 19. Personal expenses**

Personal expenses	Total amount	Amount allowed	Amount disallowed
Dining	1,299	1,299	
Gym	2,054		2,054
Medical	571	571	
Sprint Wireless	18,727	18,727	
Travel expense	5,518		5,518
Other	20,239	20,239	
<i>Total</i>	48,408	40,836	7,572

11
12 **Table 20. Total cash unaccounted for or disallowed¹⁴⁶**

Unaccounted for use of cash (Table 18)	724,357
Disallowed personal expenses (Table 19)	7,572
<i>Total</i>	731,929

13
14 **D. Net Profit**

15 The third amended complaint that was filed in the superior court contains four theories
16 for recovery: (1) breach of contract; (2) breach of fiduciary duty; (3) breach of implied covenant
17 of good faith and fair dealing; and (4) fraud and intentional misrepresentation and concealment.
18 It also seeks the remedy of injunctive relief and compensatory damages in the amount of \$1.5

¹⁴⁶ As noted, this does not include any amount for cash purchases of supplies, food, or liquor.

1 million plus punitive damages.¹⁴⁷ This adversary complaint in the bankruptcy court also argues
2 that TMLLC was profitable, but that Di Bacco misrepresented to Kline that it was not profitable
3 and thus it could not pay a higher draw. Meanwhile, Di Bacco was withdrawing money from the
4 business for his own personal use. The crux of this is in paragraphs 12 and 13 of the adversary
5 complaint:

6 12. Since the inception of TWO MICHAELS, Kline and DiBacco have received
7 minimal, weekly "owner's draws" as income in an agreed upon amount from TWO
8 MICHAELS' bank accounts. At all times, DiBacco has represented and told Kline
9 that their company has not been profitable, and that there have never been
10 additional profits available at the end of each year to be distributed to Kline and
11 DiBacco, beyond their minimal owner's draws.

12 13. Based upon information and belief, Kline alleges that DiBacco misrepresented
13 the true facts regarding TWO MICHAELS' financial situation, the amount of
14 revenues generated each year, and the actual profitability of the company, above
15 and beyond the amount they received in owner's draws. Kline alleges that DiBacco
16 has regularly and routinely withdrawn money from the business bank accounts for
17 his own use and benefit, without Kline's knowledge or consent, while continuously
18 misinforming Kline, and concealing from Kline the fact that their businesses were
19 in fact profitable.

20 The many pages of facts in the adversary complaint deal with the lack of information that
21 Di Bacco provided to Kline, the failure to run TMLLC in a business-like fashion, the
22 disagreements between them as to opening for lunch, construction decisions, breach of terms of
23 the Operating Agreement, taking of COVID Loans, failure to properly wind-up the business, and
24 a variety of other disputes. But the crux is that Di Bacco misappropriated money and thus denied
25 Kline payment of his fifty percent of the actual profits of TMLLC, which he estimates to be an
26 amount in excess of \$1.5 million.

27 Three indisputable facts refute this claim for unpaid profits:

¹⁴⁷ Exhibit 101.

1 1. Restaurant survival rate is not high. In March 2012 there were 46,512 restaurants
2 that had opened in the prior year. By March 2020 only 43.2% were still in business.¹⁴⁸ Another
3 way to look at it, the median lifespan of restaurants in the Western United States in 2014 was
4 about 4.5 years.¹⁴⁹ Most of these restaurants did not close because they were showing a profit.
5 Rather, they were making too little money to go forward. There is no reason to believe that
6 TMLLC would have bucked the trend had it paid all employees on-the-books, repaid their
7 lenders in a timely fashion (all of whom were family or friends and willing to wait), and not
8 literally “raided the till” to take supplemental draws from the cash income of the restaurants.

9 2. Supplemental Draws depleted cash but gave income to the partners. There is no
10 record of how much money was taken and so it cannot be added to the profit (if any) that Kline
11 and Di Bacco shared.

12 3. Money owed to investors has priority over profit to the owners. Because this
13 adversary is part of the bankruptcy case of Di Bacco rather than of TMLLC, there are no claims
14 made by creditors of TMLLC. These creditors would include credit card companies, suppliers,
15 employees, the landlord, and the investors. All of these are entitled to repayment in full before
16 the owners would get one cent. There is no evidence of the amount owed except the Tony Action
17 which claims in excess of \$100,000.

18 To determine net profits would be sheer guesswork, so the Court does not find any
19 amount owed to Kline under this category.

¹⁴⁸ *Business Employment Dynamics*, Bureau of Labor Statistics
https://www.bls.gov/bdm/us_age_naics_72_table7.txt (Accommodation and food services: Table 7. Survival of private sector establishments by opening year).

¹⁴⁹ Tian Luo & Philip B. Stark, *Only the Bad Die Young: Restaurant Mortality in the Western US* (2014),
<https://arxiv.org/pdf/1410.8603>.

1 **E. Dissolving the Partnership and Taking Partnership Assets**

2 Beyond trying to trace money that was allegedly improperly removed from the business
3 and used for the personal benefit of Di Bacco, there are three relevant issues concerning the
4 claim of breach of fiduciary duty.

5 1. Addendum to the Lease

6 Although TMLLC owned the restaurants, it leased the building from a third party. The
7 lease is not in evidence, but on February 28, 2019, Di Bacco obtained an addendum to the lease
8 from the landlord, which allowed it to be assigned to him on the happening of certain events.

9 This brief one paragraph document states:

10 In the event that Two Michaels, LLC decides to change or dissolve its entity’s name
11 for any reason, Lessor Burbank Boys II, LLC agrees by this addendum to continue
12 the existing lease in its entirety by changing Lessees name to Michael A. DiBacco
13 (Two Michaels, LLC member) or any other name of Michael A. DiBacco’s
14 choosing as the Lessee.¹⁵⁰

15 At best, this was a conditional agreement and the condition was satisfied only when Kline
16 filed the certificate of dissolution in May 2020. Prior to that time, Di Bacco took no action to
17 dissolve TMLLC or change its name. Once Kline moved to dissolve and terminate TMLLC, on
18 June 8, 2020, Di Bacco incorporated VLIET518, Inc. and started operating under that entity.¹⁵¹ It
19 was a breach of fiduciary duty to fail to reveal this agreement to Kline, though no damages arose
20 before June 2020. But from that time forward, Di Bacco would be liable for damages due to his
21 continued operation of the restaurants under the lease.

22 2. Operating after the Kline Certificate of Dissolution

23 Even before Covid hit in March 2020, by March 2018 things were going really badly
24 between the partners. The “cash crunch” emails demonstrate a financially diminishing business

¹⁵⁰ Exhibit N.

¹⁵¹ Exhibit 92.

1 and the inability of Kline and Di Bacco to work together to resolve the issues. During this period:
2 Di Bacco took Kline off the bank account for about seven months; Kline filed suit against Di
3 Bacco accusing him of various types of wrongdoing; Kline and Alison Freebairn-Smith went to
4 the premises to prepare an accounting; unknown to Kline, Di Bacco got the lease addendum from
5 the landlord; Tony Di Bacco filed suit against the partnership and got a writ of attachment; and
6 Di Bacco and Kline had screaming matches in the kitchen.¹⁵² And all of this was before Covid
7 closed the restaurants and then limited operations.

8 With the coming of Covid, restaurants in Los Angeles County were barred from serving
9 indoors from March 15, 2020, until March 14, 2021.¹⁵³ The relationship of Kline and Di Bacco
10 continued to deteriorate. Over Kline’s objection, Di Bacco sought the COVID Loans. While the
11 restaurants were closed, Kline filed the certificate of dissolution. Di Bacco ignored this and
12 continued to operate in a limited capacity. Once Kline’s lawyer sent Di Bacco a letter to stop
13 conducting business, Di Bacco locked Kline out of the restaurant (though it is likely that Kline
14 had already stopped coming in). On October 29, 2020, Di Bacco filed personal bankruptcy, but
15 he continued to operate Riverside under the name of “Michael’s on Riverside.” Meanwhile Kline
16 went forward in the State Court Action to try to stop Di Bacco from operating. While the timing
17 is not completely clear, it appears that by July 2022 the restaurants closed.

18 The timing here is interesting. Covid interrupted the business, as it did for many or even
19 most restaurants, and there were no operations for some months. It was during this period that
20 Kline filed his Certificate of Dissolution (on May 11, 2020) and Kline’s lawyer notified Di
21 Bacco to stop operating and begin to wind-up TMLLC (May 27, 2020). It is possible that by this
22 time Riverside had started to operate at the much-reduced level that was limited to the patio. Di

¹⁵² A video of one screaming match is Exhibit AAA.

¹⁵³ Los Angeles Times, by Bill Addison, 3/18/21.

1 Bacco refused to cease operations. He relied on the terms of the Partnership Agreement and
2 ignored Kline's attorney's notification of the change in the law.¹⁵⁴ During the following months
3 Riverside slowly increased its operations through indoor dining and at some point The Red Door
4 also opened again. By that time Di Bacco was using the name and bank account of VLIET518,
5 which was incorporated on June 8, 2020. Di Bacco was running Michael's on Riverside on
6 February 14, 2021, but this was after the bankruptcy petition had been filed.¹⁵⁵

7 As far as the bankruptcy goes, the adversary proceeding does not include any debt
8 incurred after October 29, 2020, the date that the bankruptcy petition was filed. These post-
9 petition debts are not subject to the discharge. As to the part of 2020 prior to the filing date, the
10 records are very sketchy. When Di Bacco started operating again, he was initially limited to the
11 outdoor patio with tables scatter at least six feet apart. When he could reopen the indoor area(s),
12 the distance restriction remained.

13 The portion of 2020 that is subject to the breach of fiduciary duty is the five months from
14 June 8 through October 28. The only financial evidence that exists is the 2020 Gallego P&L. It is
15 for VLIET 518, Inc. and shows total income of \$148,343.63. Di Bacco wrote on this exhibit that
16 the restaurant opened on September 2, 2020, and that seems reasonable given that in a normal
17 pre-Covid year the annual income was over \$1.2 million (see Table 3 for 2018). There is no need
18 to attempt to pro-rate the 2020 Gallego P&L for the two months before bankruptcy was filed
19 because the operations showed no profit, but there was a loss of almost \$8,000. Thus, there are
20 no prepetition financial damages to Kline from the breach of fiduciary duty through the
21 addendum to the lease and the continued operation of the restaurants.

¹⁵⁴ Exhibit NNH (article 8); Exhibit JJJJ.

¹⁵⁵ Exhibit 25.

1 3. Sale of the Partnership Assets

2 In July 2022, when The Red Door and Riverside ceased operations due to the upcoming
3 sale of the building by the landlord, Di Bacco inventoried the Restaurants’ assets. This was about
4 a year and half after Di Bacco filed bankruptcy. Many of the assets were sold, possibly by the
5 bankruptcy trustee. By August 2022, Di Bacco produced a list of the Restaurants’ assets to Kline
6 in the State Court Action. Exhibit 88 [dkt. 185, at 441-448]. As to Kline’s claim to some of the
7 Restaurants’ assets as his personal property, that is post-petition and needs to be handled in the
8 State Court Action.

9 **F. Credibility of the Parties and the Witnesses**

10 Kline and Di Bacco have very different personalities. This shows in many ways. Kline is
11 a detail person. His memory of the details of this business is amazing and seems to be accurate in
12 most respects. He also has focused on what happened with a laser-like sharpness and is not ready
13 to move forward with his life until he feels justified and, perhaps, until he has punished Di Bacco
14 for a perceived wrong and the dissolution of their friendship. Other than the fact that he has not
15 taken any responsibility for the bookkeeping lapses, he is a credible witness to events.

16 Di Bacco is trying to go forward and is justifiably irritated that Kline is standing in his
17 way with a civil lawsuit and a criminal action. He is not a detail person and his testimony shows
18 that lack of specificity and sharp memory. At times he fudges the facts, though the Court does
19 not find that he is an outright liar. Some is from memory lapse, some from a desire to paint a
20 picture that is more beneficial to himself, and some is to avoid liability. So, his testimony is
21 credible as to the larger events, but less so as to the smaller details. He takes responsibility for
22 the bookkeeping mess of the first years but gives no reason for his continued failure to get things
23 in order once the accountant told him to do so.

1 The other percipient witnesses also are credible. The Court questions Garcia because of
2 his history of using various names to avoid paying taxes on his income. But there is nothing in
3 his testimony that is glaringly false or is not corroborated by others.

4 The bookkeepers are professionals who did a professional job with the information that
5 they were given. Neumeister is unimpeachable except that he and Ms. Freebairn-Smith look at
6 this as if they were tax auditors rather than analysts seeking to figure out what really happened to
7 the money in this business. Had Di Bacco hired Ms. Gallego or someone in her capacity in 2015
8 or earlier, we probably would not be here today.

9 While Ms. Jennings did not testify, a comparison of her figures to those of Ms. Freebairn-
10 Smith demonstrates that they are valid.

11 On a side note, Ms. Freebairn-Smith questions why Di Bacco did not make regular
12 deposits into the U.S. Bank account. The Court finds that to the extent that much of the cash
13 receipts was being used to pay out tips, pay employees “under-the-table,” or being split between
14 Kline and Di Bacco, it is logical that Di Bacco would not make daily or even weekly deposits
15 into the bank account. What would be the point if he would have had to make frequent
16 withdrawals to refresh the register and the pouches in the restaurants?

17 It appears that Di Bacco was less than cooperative as to providing information in
18 preparation for this trial. The Court gave him a huge amount of leeway in bringing in new
19 evidence after the pretrial and during the trial itself. Had I not done so, I have no idea how I
20 could have come to a decision because the accounting provided by Kline was clearly deficient.
21 The Court might not have been able to reach a figure and surely could not have declared any
22 amount to be non-dischargeable. The additional evidence clarified the actual movement of
23 money and aided in determining whether any portion is not dischargeable.

1 **G. Kline’s Responsibility**

2 One of the elements of this case is what responsibility Kline had and also whether he
3 reasonably relied on the actions of Di Bacco. The evidence shows that by 2016 Kline was aware
4 that Di Bacco, on behalf of TMLLC, was not keeping adequate books and records. Minimally
5 they needed a bookkeeper. From the beginning he also knew that many of the kitchen staff (who
6 were under his direct control) were being paid in cash “under-the-table.” Some of this was
7 money that he received from Di Bacco and handed to the kitchen employees. Some he took from
8 the bank himself.

9 There is a dispute as to whether Di Bacco refused to show the financial records (such as
10 they were) to Kline or whether Kline showed no interest in reviewing them. By Mid-March 2018
11 Kline was demanding to see organized books and not piecemeal records.¹⁵⁶ It is sometime later
12 that year that Di Bacco finally hired a bookkeeper. Should Kline have done more? His statement
13 to Tony of March 2018 shows that he was not willing to take any part of the control of the
14 financial situation. The original deal was that Di Bacco would handle this and Kline was
15 determined to make him do so – but Kline took no action to force it.¹⁵⁷

16 Kline cannot claim that he was without knowledge or power to put TMLLC on a
17 business-like footing. He just chose to sit back and complain rather than take action. Taking
18 action would have meant that it was Kline who would have hired a bookkeeper and would have
19 stopped paying his kitchen staff under-the-table. That it was Kline who would have required
20 meetings between him and Di Bacco and the accountant. In short, Kline really did not want to
21 run the business - just to run the kitchen. And that was not enough.

¹⁵⁶ Exhibit 42.

¹⁵⁷ Exhibit 42.

1 And when Di Bacco – on the advice of the accountant – implemented a wide-spread
2 payroll system, Kline refused to be on it so that he could take his draw without any deductions
3 and without a record for tax purposes.¹⁵⁸

4 There is no evidence as to Kline’s prior business experience. He was a veterinarian, but
5 no longer practiced in that area. It is unknown whether he had an ownership interest in that
6 practice or was an employee or independent contractor. Nonetheless, he had to have known that
7 an employer is required to withhold taxes and social security money from an employee’s pay,
8 that this must be turned over by the employer to the proper authority along with the employer’s
9 share, and that the employee must be given a correct W-2 form each year. And he clearly knew
10 that this was not the practice of TMLLC. He allowed this to happen, and he participated in it.
11 Under the circumstances, he could not have expected Di Bacco to keep accurate records and
12 report “under-the-table” payments to employees and give them W-2s. Both Kline and Di Bacco
13 participated in an illegal act.

14 That the books and records would not be accurate was a foreseeable result. That the tax
15 returns would be unreliable was completely expected.

16 By distancing himself from the financial side of the business, Kline allowed this to
17 happen and cannot claim to be unaware of or bear no responsibility for the problems that arose.

18 **III. CONCLUSIONS OF LAW**

19 **A. The Complaint for Nondischargeability as to Diverted Net Profits**

20 The theory of this adversary complaint is that TMLLC was profitable, but Di Bacco
21 misrepresented to Kline that it was not profitable and could not pay a higher draw. Meanwhile,
22 Di Bacco was withdrawing money from the business for his own personal use. One of the

¹⁵⁸ Exhibit 79.

1 elements is that the plaintiff suffered damages due to the actions of the defendant. The burden of
2 proof is on the plaintiff, though under certain circumstances it can shift to the defendant.

3 In this adversary proceeding, Kline has relied on the Freebairn-Smith Summary and the
4 Neumeister Report. Both are sufficiently incomplete that they largely do not support any type of
5 determination of monetary damages. The Court has taken a substantial amount of time analyzing
6 the evidence, which is set forth in the various tables above. When it comes to profits, the lack of
7 detailed information makes this extremely difficult. But what is particularly devastating to
8 Kline’s adversary complaint is that Kline apparently failed to advise his witnesses that, through
9 the years, he and Di Bacco had taken cash receipts for their own benefit and that they were
10 paying employees under-the-table. Although he had left a note of the amount of cash taken as
11 “supplemental draws,” he knew that those were not given to Freebairn-Smith and were not part
12 of the Freebairn-Smith Summary. This was critical for her review, but Kline hid it from her.
13 Similarly, the cash used to pay employees and the system to pay tips from cash were withheld
14 from her. Without this information, the actual profits and how much of them went to each partner
15 could not possibly be calculated. Thus, no damages can be determined for §§ 523(a)(2) and
16 (a)(6).

17 Looking at Table 3 for example, the Court cannot draw any specific conclusion as to the
18 income and expenses for 2018. This would also apply to the other years on the Freebairn-Smith
19 Summary. The figures available to the Court are so uncertain that any final determination is mere
20 guesswork. Table 3 also shows that the Neumeister Report’s conclusions that Di Bacco took,
21 stole, embezzled, or diverted money for his own benefit is without a sound foundation. Everyone
22 admits that Di Bacco kept inadequate books and records and that might be actionable in a civil

1 proceeding, but it is not necessarily sufficient to find any amount to be non-dischargeable in this
2 bankruptcy case.

3 Further, assuming that there is a way to accurately (or at least somewhat accurately)
4 arrive at a figure for damages, there must be a finding of fraud. The concept of “fraud” occurs in
5 11 U.S.C. §§ 523(a)(2), (a)(4), but is not a requirement in § 523(a)(6). The Supreme Court has
6 set forth the definition as to each of these sections:

7 This Court has historically construed the terms in §523(a)(2)(A) to contain the
8 “elements that the common law has defined them to include.” *Field v. Mans*, 516
9 U.S. 59, 69, 116 S. Ct. 437, 133 L. Ed. 2d 351 (1995). “Actual fraud” has two parts:
10 actual and fraud. The word “actual” has a simple meaning in the context of
11 common-law fraud: It denotes any fraud that “involv[es] moral turpitude or
12 intentional wrong.” *Neal v. Clark*, 95 U.S. 704, 709, 24 L. Ed. 586 (1878). “Actual”
13 fraud stands in contrast to “implied” fraud or fraud “in law,” which describe acts of
14 deception that “may exist without the imputation of bad faith or immorality.” *Ibid.*
15 Thus, anything that counts as “fraud” and is done with wrongful intent is “actual
16 fraud.”

17 *Husky Int’l Elecs., Inc. v. Ritz*, 578 U.S. 355, 360 (2016).

18 And, of course, our interpretation of “actual fraud” in §523(a)(2)(A) also preserves
19 meaningful distinctions between that provision and §§523(a)(4), (a)(6). Section
20 523(a)(4), for instance, covers only debts for fraud while acting as a fiduciary,
21 whereas §523(a)(2)(A) has no similar limitation. Nothing in our interpretation
22 alters that distinction. And §523(a)(6) covers debts “for willful and malicious
23 injury,” whether or not that injury is the result of fraud, see *Kawaauhau v. Geiger*,
24 523 U.S. 57, 61, 118 S. Ct. 974, 140 L. Ed. 2d 90 (1998) (discussing injuries
25 resulting from “‘intentional torts’”), whereas §523(a)(2)(A) covers only fraudulent
26 acts. Nothing in our interpretation alters that distinction either. Thus, given the clear
27 differences between these provisions, we see no reason to craft an artificial
28 definition of “actual fraud” merely to avoid narrow redundancies in §523 that
29 appear unavoidable.

30 *Id.* at 363.

31 Before looking at the application of § 523 as to the allegation of the diversion of funds
32 that should have been distributed as net profits, the Court needs to determine whether there were
33 net profits or any profit at all. “Net profit” is defined as “total sales revenue less the cost of the
34 goods sold and all additional expenses.” *Black’s Law Dictionary*, (9th ed. 2009). There are other

1 definitions for types of “profit,” but the concept in this case is that TMLLC had excess funds and
2 that Kline should have been given half of those monies at least each year.

3 As noted, the “supplemental draws” make it impossible to calculate actual profits. Even
4 as to money that has not been unaccounted for, the evidence does not support that Kline had any
5 right to it as a 50 percent partner in TMLLC. It is undisputed that TMLLC owed its lenders,
6 although the exact terms of repayment are not revealed except as to Tony, who had a 2011
7 \$32,000 note at 6% interest, payable on demand, and a 2013 \$100,000 note at 6% interest, also
8 payable on demand.¹⁵⁹ Money was also owed to Clickner (\$45,000), Romanowski, Kline’s
9 father, etc.¹⁶⁰ There simply was no profit to be distributed to the owners after all expenses and
10 obligations would have been timely paid or paid at all.

11 **B. Issues of Dischargeability of the Debt to Kline Under 11 U.S.C. § 362**

12 1. Factual Issues as to Denial of Discharge Under § 523(a)(2)

13 A bankruptcy discharge does not discharge an individual debtor from any debt—

14 (2) for money, property, services, or an extension, renewal, or refinancing of credit,
15 to the extent obtained by—

16 (A) false pretenses, a false representation, or actual fraud, other than a
17 statement respecting the debtor’s or an insider’s financial condition;

18 (B) use of a statement in writing—

19 (i) that is materially false;

20 (ii) respecting the debtor’s or an insider’s financial condition;

21 (iii) on which the creditor to whom the debtor is liable for such money,
22 property, services, or credit reasonably relied; and

23 (iv) that the debtor caused to be made or published with intent to deceive .
24 . . .

¹⁵⁹ Exhibit 78.

¹⁶⁰ Exhibit 77.

1 11 U.S.C. § 523(a).

2 A false representation is an express misrepresentation, while a false pretense refers to an
3 implied misrepresentation or conduct intended to create and foster a false impression. *In re*
4 *Reingold*, 2013 WL 1136546, *3 n.4 (B.A.P. 9th Cir. Mar. 19, 2013); *Shannon v. Russell (In re*
5 *Russell)*, 203 B.R. 303, 312 (Bankr. S.D. Cal. 1996). To prevail on a § 523(a)(2)(A) claim
6 concerning false pretenses or false representation, plaintiffs must prove by a preponderance of
7 the evidence the following five elements:

- 8 (1) misrepresentation, fraudulent omission or deceptive conduct by the debtor;
- 9 (2) knowledge of the falsity or deceptiveness of his statement or conduct;
- 10 (3) an intent to deceive;
- 11 (4) justifiable reliance by the creditor on the debtor's statement or conduct; and
- 12 (5) damage to the creditor proximately caused by its reliance on the debtor's statement or
13 conduct.

14 *In re Weinberg*, 410 B.R. 19, 35 (B.A.P. 9th Cir. 2009) (citing *In re Slyman*, 234 F.3d
15 1081, 1085 (9th Cir. 2000)).

16 As to the fourth requirement, “a creditor's reliance on a debtor's misrepresentation need
17 be only justifiable, not reasonable, to except a debt from discharge under § 523(a)(2)(A)” *In*
18 *re Eashai*, 87 F.3d 1082, 1090 (9th Cir. 1996) (citing *Field v. Mans*, 516 U.S. 59, 75 (1995)).
19 Justifiable reliance takes into account the “qualities and characteristics of the particular plaintiff,
20 and the circumstances of the particular case, rather than of the application of a community
21 standard of conduct to all cases.” *Field v. Mans*, 516 U.S. at 71. Thus, a plaintiff does not have a
22 duty to investigate. *Id.* at 70, 73-75 n.12. However, “justifiable reliance does not exist where a
23 creditor ignores red flags” that show up before extending credit. *In re Miller*, 310 B.R. 185, 198-
24 99 (Bankr. C.D. Cal. 2004) (citing *In re Anastas*, 94 F.3d 1280, 1286 (9th Cir. 1996)); *see also In*
25 *re Apte*, 180 B.R. 223, 229 (B.A.P. 9th Cir. 1995), *aff'd*, 96 F.3d 1319, 1324 (9th Cir. 1996).

1 In determining whether a plaintiff's reliance was justifiable, bankruptcy courts "must
2 look to all of the circumstances surrounding the particular transaction, and must particularly
3 consider the subjective effect of those circumstances upon the creditor." *In re Kirsh*, 973 F.2d
4 1454, 1460 (9th Cir. 1992). *In re Kirsh* largely dealt with the issue of a knowledgeable attorney
5 who relied on the representation of his client even when he knew that the client was having
6 financial difficulties. *Id.* at 1455-56. In deciding that the reliance was not justifiable, the Ninth
7 Circuit Court of Appeals stated, "[w]e recognize that [the plaintiff] and [the defendant] were very
8 close friends, but that does not excuse [the plaintiff's] throwing of all caution to the winds and
9 relying on the [defendant's] word alone." *Id.* at 1461.

10 Here, the Court must determine whether Di Bacco raided TMLLC's assets for his own
11 use, as this factual finding is necessary to all claims for relief in this adversary proceeding. But
12 as to damages sought by Kline, the calendar stops no later than the first part of 2017. By the end
13 of 2016, Kline was aware that Di Bacco had taken a substantial amount of money and did not
14 provide accurate and detailed accountings to show its use. Section 523(a)(2) requires that Kline
15 have justifiably relied on Di Bacco's statements or conduct. Kline must show that his reliance (if
16 it even existed) was justifiable under the circumstances starting in 2017.

17 Not only did Kline have reason to wonder about Di Bacco's financial dealings as to the
18 restaurant, but he had specific numbers and analyses and a warning from TMLLC's accountant.
19 He truly "thr[ew] all caution to the winds" when he allowed Di Bacco to continue to handle the
20 business side of TMLLC, at least beginning in January 2017. However, prior to that time, Kline
21 did not have any reliable warning of possible misdoings. So, his reliance on Di Bacco's
22 representations up to January 2017 meets the "reliance" test, but not thereafter.

1 The Court must next decide whether Di Bacco skimmed off money from 2011 through
2 2016 so as to reduce the profits that were owed to Kline. Table 21 shows the maximum amount
3 of unaccounted for “draw” by Di Bacco from 2011 through 2016.

1

Table 21. Maximum damages before 50/50 analysis

Year	2011	2012	2013	2014	2015	2016	Subtotal
Agreed to Draws or Pay							
Di Bacco	6,500	31,000	32,250	39,000	39,000	46,000	193,750
Kline	6,500	31,000	32,250	39,000	39,000	46,000	193,750
Additional checks for Kline (Ex. S to ex.14), Unaccounted for Draw for Di Bacco (ex. 69)	23,742	154,504	264,051	210,237	178,757	258,938	1,090,229
Unaccounted for Draw for Di Bacco (ex. 69) less agreed to Draw	17,242	123,504	231,801	171,237	139,757	212,938	896,479
Kline draws (Ex. 69) less agreed to Draw			10,000	3,000	23,911	49,850	86,761
<i>Difference</i>	17,242	123,504	221,801	168,237	115,846	163,088	809,718
Cash accounted for							
To pay tips (Table 11)						(8,726)	(8,726)
To pay kitchen employees (Table 14)	(7,500)	(15,000)	(70,395)	(67,839)	(18,278)	(9,663)	(188,675)
To Romanowski for The Red Door lease (Table 15)	(4,200)	(56,717)	(20,800)	(500)			(82,217)
For benefit of Romanowski for Riverside (Table 15)			(35,000)	(57,000)	(24,000)		(107,000)
To Bob Percel (Table 15)				(11,500)			(11,500)
Allowed Personal Expenses (Ex. 69, Table 19)	(379)	(2,307)	(1,037)	(1,902)	(1,957)	(2,776)	(10,358)
Credit Line (7968)			(1,008)	(9,528)	(3,011)	(8,036)	(21,583)
Construction costs (Table 19) ¹⁶¹		(23,742)					(23,742)
<i>Subtotal</i>	(12,079)	(97,766)	(128,240)	(148,269)	(47,246)	(29,201)	(239,801)
<i>Maximum Damages</i>	5,163	25,738	93,561	19,968	68,600	113,887	569,917

2

3

¹⁶¹ Estimated reimbursement on 2012.

1 As to § 523(a)(2)(B), Di Bacco never made written statements to Kline; Di Bacco's only
2 written statements were those he gave to the accountant(s) to prepare the tax returns. While such
3 written statements were certainly inaccurate and might even be called "false," their materiality
4 cannot be determined because they did not reflect all salaries paid and all TMLLC's income.
5 Notwithstanding, Kline never saw any of those written statements, so § 523(a)(2)(B) does not
6 apply to this case.

7 Accordingly, the Court will next analyze whether Kline has met the requisite elements
8 under § 523(a)(2)(A).

9 Misrepresentation, fraudulent omission or deceptive conduct by the debtor: Di Bacco
10 kept such unreliable accounting records that anything that he provided to the accountants for
11 purposes of preparing tax returns or any oral representations that he made to Kline were certainly
12 a misrepresentation of the actual facts, but there is no evidence that they were intentionally
13 fraudulent. Rather, they were the result of a combination of an initial lack of knowledge and
14 experience, but later of stubbornness and intentional ignorance on the part of Di Bacco as to how
15 to run a restaurant in a business-like fashion.

16 Knowledge of the falsity or deceptiveness of his statement or conduct: Di Bacco had
17 knowledge that he was doing improper (and illegal) acts by paying employees under-the-table
18 and not providing them with the required W-2 information. This also meant that the accountants
19 did not have accurate figures on the tax returns. But Kline was also aware of this. He may have
20 claimed ignorance of the specifics, but he participated by making those payments. The benefit to
21 the employee was that s/he did not have to pay taxes on the income and the benefit to TMLLC
22 (and thus to Kline) was that it did not have to pay the employer's share of social security, etc. So,
23 while Di Bacco had knowledge of and participation in this conduct, so did Kline.

1 An intent to deceive: The issue concerning the unaccounted-for money is whether Di
2 Bacco intended to deceive Kline. The Court does not find this to be the case. Kline had no desire
3 to review the books and records (such as they were), the tax returns, or anything else concerning
4 the business side of the Restaurants. Kline’s range of vision was limited to the kitchen—the
5 kitchen employees, the supplies needed, the recipes, etc. There is no evidence that Kline ever
6 asked to see any books or records of the business prior to 2017. There is no evidence that Di
7 Bacco ever provided Kline with any information as to the use of the income, the payment of
8 expenses, etc. Thus, no deception took place.

9 Justifiable reliance by Kline on the Di Bacco’s statement or conduct: As discussed above,
10 prior to 2017, Kline never asked for information. Beginning in 2017, Kline knew that there were
11 problems with the state of the books and records, yet he did not meet with Di Bacco, require that
12 a professional review them, or get personally involved in a review. He asked that Di Bacco turn
13 over all information but was not willing to take raw data and deal with it. Kline communicated
14 more by email than in-person. He never hired a bookkeeper, instead leaving this in Di Bacco’s
15 hands and permitting delay. Kline knew that something was wrong because Tony had included
16 Kline in his emails about TMLLC not repaying its loans. Kline also was aware that the only way
17 that TMLLC could make enough money to pay its debts and show a profit was by expanding its
18 hours to include lunch and solicit lunch business from the nearby studios. But he refused to do
19 this.

20 Damage to Kline proximately caused by his reliance on Di Bacco’s statement or conduct:
21 Per Table 21, the amount unaccounted for is approximately \$570,000. Kline is a 50/50 partner
22 and entitled to only half of that. Thus, if Kline had taken an active role in the business side of the
23 restaurants, \$285,000 is about the maximum damage that he could recover upon proof of Di

1 Bacco’s fraudulent conduct. But as noted many times in this opinion, all the numbers are
2 approximations at best and guesses at worst.

3 In the long run, the wrongful acts of Di Bacco were that he kept inadequate records and
4 did not follow the law as to the employees of TMLLC. This is not a fraud on Kline, who was
5 well aware of the under-the-table payments that he also participated in making.

6 Accordingly, the Court grants judgment to Di Bacco as to § 523(a)(2)(A).

7 2. Factual Issues as to Denial of Discharge Under § 523(a)(4)

8 A bankruptcy discharge does not discharge an individual debtor from any debt “for fraud
9 or defalcation while acting in a fiduciary capacity, embezzlement, or larceny” 11 U.S.C. §
10 523(a)(4).

11 Federal law determines the issue of whether a fiduciary relationship exists for purposes of
12 § 523(a)(4). However, state law is to be consulted as to whether the trust relationship existed
13 before the wrong occurred and without reference to the wrongful act. Under California law, all
14 partners are trustees over the assets of the partnership and are fiduciaries to each other. Citing to
15 *Leff v. Gunther*, 33 Cal. 3d 508, 514 (1983), the Ninth Circuit Court of Appeals held that
16 “California partners are fiduciaries within the meaning of § 523(a)(4)” and so the debt from one
17 partner to the other is non-dischargeable under §523(a)(4) if the other criteria are met. *Ragsdale*
18 *v. Haller*, 780 F.2d 794, 796-97 (1986).

19 While Di Bacco was a fiduciary as to both the partnership and to Kline, the complained
20 of actions had to occur as part of his capacity as a partner. There is no doubt that this is true—
21 although they were friends (at least at the beginning), the only relevant relationship that existed
22 between Kline and Di Bacco was as business partners in TMLLC. All of Di Bacco’s activities

1 relevant to this adversary proceeding were due to his functioning as a partner and, specifically, as
2 the partner who was in charge of the business aspects of the partnership.

3 Thus, we come once again to the requirement that fraud occurred. As noted above, the
4 elements of fraud are the same under §§ 523(a)(2) and (a)(4). Because of Kline’s participation in
5 the improper use of money to pay employees under-the-table and his knowledge of the lack of
6 proper books and records, the Court cannot find that Di Bacco committed actual fraud.

7 But even if fraud is not found as to each act, the lesser standard of defalcation can apply.
8 Courts had struggled with trying to define “defalcation” until the Supreme Court stepped in:

9 [W]here the conduct at issue does not involve bad faith, moral turpitude, or other
10 immoral conduct, the term requires an intentional wrong. We include as intentional
11 not only conduct that the fiduciary knows is improper but also reckless conduct of
12 the kind that the criminal law often treats as the equivalent. Thus, we include
13 reckless conduct of the kind set forth in the Model Penal Code. Where actual
14 knowledge of wrongdoing is lacking, we consider conduct as equivalent if the
15 fiduciary “consciously disregards” (or is willfully blind to) “a substantial and
16 unjustifiable risk” that his conduct will turn out to violate a fiduciary duty. ALI,
17 Model Penal Code § 2.02(2)(c), p. 226 (1985). *See id.*, § 2.02 Comment 9, at 248
18 (explaining that the Model Penal Code’s definition of “knowledge” was designed
19 to include “ ‘wilful blindness’ ”). That risk “must be of such a nature and degree
20 that, considering the nature and purpose of the actor’s conduct and the
21 circumstances known to him, its disregard involves a gross deviation from the
22 standard of conduct that a law-abiding person would observe in the actor’s
23 situation.” *Id.*, § 2.02(2)(c), at 226 (emphasis added). *Cf. Ernst & Ernst v.*
24 *Hochfelder*, 425 U.S. 185, 194, n.12, 96 S.Ct. 1375, 47 L.Ed.2d 668 (1976)
25 (defining scienter for securities law purposes as “a mental state embracing intent to
26 deceive, manipulate, or defraud”).

27 *Bullock v. BankChampaign, N.A.*, 569 U.S. 267, 273-74 (2013).

28 Embezzlement and larceny are separate grounds for a § 523(a)(4) action that do not
29 require a fiduciary relationship. The major difference between the two is that embezzlement
30 applies when the person has lawfully come by the money; larceny applies when the money was
31 taken without the consent of the owner. Only embezzlement could apply in this case.

32 Federal law and not state law controls the definition of embezzlement for purposes
33 of section 523(a)(4). *Fraternal Order of Eagles, Aerie v. Mercer (In re Mercer)*, 169

1 B.R. 694, 697 (Bankr.W.D.Wash.1994); *Brown v. Felsen*, 442 U.S. 127, 99 S.Ct.
2 2205, 60 L.Ed.2d 767 (1979); *In re Schultz*, 46 B.R. 880, 890 (Bankr.D.Nev.1985).
3 Embezzlement is defined as “the fraudulent appropriation of property by a person
4 to whom such property has been [e]ntrusted or into whose hands it has lawfully
5 come.” *Moore v. United States*, 160 U.S. 268, 269, 16 S.Ct. 294, 295, 40 L.Ed. 422
6 (1895).

7 In the context of non-dischargeability, embezzlement requires three elements: (1)
8 property rightfully in the possession of a nonowner, (2) nonowner's appropriation
9 of the property to a use other than which it was entrusted, and (3) circumstances
10 indicating fraud. *Transamerica Commercial Finance Corp. v. Littleton (In re*
11 *Littleton)*, 942 F.2d 551, 555 (9th Cir.1991) (quoting *In re Hoffman*, 70 B.R. 155,
12 162 (Bankr.W.D.Ark.1986)); *In re Schultz*, 46 B.R. at 889.

13 *In re Wada*, 210 B.R. 572, 576 (BAP 9th Cir. 1997).

14 Of all the claims for relief in this adversary complaint, the facts justify relief only under §
15 523(a)(4) only. This could be embezzlement, but there needs to be actual fraud to support such a
16 finding. And as discussed above, Kline cannot receive damages because of his lack of reliance on
17 the actions of Di Bacco.

18 That only leaves the concept of defalcation. Di Bacco was a fiduciary to Kline and to
19 TMLLC. This status requires a high degree of care in the conduct of the business and the
20 relationship. Even if Di Bacco did not have actual knowledge that he committed wrongdoing in
21 the failure to keep accurate records and account for all monies, he was consciously and willfully
22 blind to the unjustifiable risk that he took. These actions violated his fiduciary duty and fall
23 under the definition of defalcation.

24 The problem here is to come up with a figure that is nondischargeable. The sticking point
25 is the “supplemental draws” that Kline took and split with Di Bacco. Were they \$100 or maybe
26 \$10,000? Maybe between those figures or even more? As in so much else, the Court is left to
27 estimate with very little concrete evidence. Had there been no “supplemental draws,” the Court
28 would find for Kline in the amount of \$285,000 (50% of the total maximum damages as set forth
29 in Table 21).

1 Nevertheless, the disallowed personal expenses (gym and travel) set forth in Table 19 do
2 fall under the definition of defalcation. Di Bacco knew that these were not for business purposes,
3 that it was wrong to use TMLLC money for them, and that doing so anyway violated his
4 fiduciary duty to Kline and TMLLC. Di Bacco may have actually repaid them, but there is no
5 evidence of that. The total amount of disallowed personal expenses in Table 19 is \$7,572. If
6 TMLLC were the plaintiff, that entire amount would be nondischargeable. But only Kline is the
7 plaintiff, and he is only entitled to 50% of TMLLC's interest in the disallowed personal
8 expenses, which is \$3,786.

9 Accordingly, the Court grants judgment to Kline as to § 523(a)(4) in the amount of
10 \$3,786.

11 3. Factual Issues as to Denial of Discharge Under § 523(a)(6)

12 A discharge under § 727 does not discharge an individual debtor from any debt “for
13 willful and malicious injury by the debtor to another entity or to the property of another entity.”
14 11 U.S.C. § 523(a)(6). In brief summary, the act must have been both willful and maliciously
15 caused the injury. Willful injury and malicious injury are two separate things, each with its own
16 standard.

17 A deliberate and intentional act that leads to injury is not sufficient. There must be a
18 certainty or almost certainty that harm will result from the intentional act. *See Kawaauhau v.*
19 *Geiger*, 523 U.S. 57 (1998), and later cases interpreting it.

20 “The willful injury requirement of § 523(a)(6) is met when it is shown either that the
21 debtor had a subjective motive to inflict the injury or that the debtor believed that injury was
22 substantially certain to occur as a result of his conduct.” *In re Jercich*, 238 F.3d 1202, 1208 (9th
23 Cir. 2001).

1 A "malicious" injury involves "(1) a wrongful act, (2) done intentionally, (3) which
2 necessarily causes injury, and (4) is done without just cause or excuse." *In re Bammer*, 131 F.3d
3 788, 791 (9th Cir. 1997).

4 As to the evidence in this case, there is nothing to support a subjective motive to hurt
5 Kline or TMLLC or a belief by Di Bacco that an injury was substantially certain to occur. Both
6 partners were sloppy with the money and with business practices – although Di Bacco’s actions
7 covered a much broader area than did Kline’s. But Kline paid the kitchen staff in cash and kept
8 no records. Di Bacco accused Kline of taking cash to pay the “pizza boys” at the rate of \$10 an
9 hour, but that he only paid them \$7 an hour. There is no evidence of this except for Di Bacco’s
10 statement, but Kline has not produced any receipts or records showing how much cash he
11 actually gave them.

12 Because the Court really does not believe that Di Bacco embezzled the large sums of
13 money that are unaccounted for, the Court cannot find that he expected that the business would
14 be hurt. Certainly not by the vacation charges or the gym ones. In fact, he and Kline conspired to
15 pay employees off-the-books in order to keep more money for the business in that they may have
16 been able to pay a lower hourly rate and did not have to pay the employer’s share of social
17 security taxes.

18 As to the malicious prong, there was a wrongful act in taking money for vacations and for
19 the gym and there was a wrongful act in failing to keep sufficient books and records (if for no
20 other reason than to properly report the TMLLC taxes). And Kline participated in the wrongful
21 act of paying employees under-the-table and not deducting required items from their wages and
22 in not paying the employer contributions. These were done intentionally, but many small

1 businesses do similar acts and get away with it. While this does not excuse these actions, they
2 did not necessarily cause harm; in fact, they gave TMLLC more money to cover its operations.

3 Because the evidence in this case is legally insufficient, the Court grants judgment to Di
4 Bacco as to § 523(a)(6).

5 **C. Denial of Discharge Under 11 U.S.C. § 727**

6 The denial of discharge under § 523 concerns a particular debt to a particular creditor and
7 the relationship between the two parties. The denial of discharge under § 727 is a totally different
8 animal and deals with the relationship of the debtor to the bankruptcy system and can result in
9 the inability to receive a discharge as to all debts owed at the time that the petition was filed. The
10 plaintiff has the burden of proof on the elements necessary to deny a discharge under § 727(a).
11 Fed. R. Bankr. P. 4005.

12 As described above, there is some evidence that about \$724,000 is unaccountable from
13 the Restaurants while they were under Di Bacco's control between 2011 and 2019. *See* Table 18.
14 Because there is no other major source of income for Di Bacco during this period, the question
15 under § 727(a) is whether, at the time of filing bankruptcy, Di Bacco had any of this in the form
16 of cash or other assets that he was required to reveal to the chapter 7 trustee.

17 It should be noted that for all of the §727(a) claims, the assets and accounts of TMLCC
18 are the exclusive evidence provided. There is no attempt to show the amounts in Di Bacco's
19 personal bank accounts or his personal assets (except the assertion that he had some jewelry and
20 owned a new car each year, which is discussed below). Thus the Court will limit its analysis to
21 the TMLCC information.

22 1. Factual Issues as to Denial of Discharge Under § 727(a)(2)

23 The court shall grant the debtor a discharge, unless—
24 . . .

1 (2) the debtor, with intent to hinder, delay, or defraud a creditor or an officer of
2 the estate charged with custody of property under this title, has transferred,
3 removed, destroyed, mutilated, or concealed, or has permitted to be
4 transferred, removed, destroyed, mutilated, or concealed

5 (A) property of the debtor, within one year before the date of the filing of the
6 petition; or

7 (B) property of the estate, after the date of the filing of the petition

8 11 U.S.C. § 727(a).

9 As to § 727(a)(2), the crux of the adversary complaint is that Di Bacco had at least two
10 sets of books for TMLLC (one accurate and one fabricated) and that he generated undisclosed
11 income so that creditors could not determine his financial condition. *Complaint* [dkt. 1], ¶¶ 155-
12 161 (Fifth Cause of Action). Further, Di Bacco concealed and destroyed documents, no
13 justification exists for his failure to maintain valid books and records for TMLLC, and he does
14 not have any personal books and records. *Id.* Kline demanded to see the accountings, but Di
15 Bacco refused. Finally, Di Bacco comingled the TMLLC assets with his own. *Id.*

16 Given the facts of this case, Kline cannot meet the requirement of the one-year deadline
17 before the date of filing the bankruptcy petition. His evidence is detailed until September 2019
18 through the Freebairn-Smith Summary and the Neumeister Report, but Di Bacco filed
19 bankruptcy on October 29, 2020. The 2019 Gallego P&L and 2020 Gallego P&L are quite
20 detailed and Gallego testified that she saw back-up materials. As to the wind-down of the
21 restaurants in 2021 and 2022, this was post-petition and there are inventories of the assets which
22 were given to the trustee.

23 A party seeking denial of discharge under § 727(a)(2) must prove two things: "(1)
24 a disposition of property, such as transfer or concealment, and (2) a subjective intent
25 on the debtor's part to hinder, delay or defraud a creditor through the act [of]
26 disposing of the property." *Hughes v. Lawson (In re Lawson)*, 122 F.3d 1237, 1240
27 (9th Cir. 1997).

28 A debtor's intent need not be fraudulent to meet the requirements of § 727(a)(2).
29 Because the language of the statute is in the disjunctive it is sufficient if the debtor's
30 intent is to hinder or delay a creditor. *In re Bernard*, 96 F.3d at 1281. Furthermore,

1 "lack of injury to creditors is irrelevant for purposes of denying a discharge in
2 bankruptcy." *Id.* at 1281-82 (quoting *In re Adeb*, 787 F.2d at 1343).

3 *In re Retz*, 606 F.3d 1189, 1200 (9th Cir. 2010).

4 Even if the one-year deadline had been met, there is no evidence that Di Bacco
5 transferred, removed, destroyed, or concealed his property or property of TMLLC during the
6 required timeframe.

7 Accordingly, the Court grants judgment to Di Bacco as to § 727(a)(2).

8 2. Factual Issues as to Denial of Discharge Under § 727(a)(3)

9 11 U.S.C. § 727(a)(3) provides, in relevant part:

10 The court shall grant the debtor a discharge unless . . . the debtor has concealed,
11 destroyed, mutilated, falsified, or failed to keep or preserve any recorded
12 information, including books, documents, records, and papers, from which the
13 debtor's financial condition or business transactions might be ascertained, unless
14 such act or failure to act was justified under all of the circumstances of the case.

15 As described in more detail below, the amended schedules show that Di Bacco had no
16 real property and very little personal property at the time of the bankruptcy. *Amended Schedule*
17 *A/B* [Bankruptcy Case, dkt. 14]. Much of it was claimed as exempt. *Amended Schedule C*
18 [Bankruptcy Case, dkt. 15]. Di Bacco listed a few business debts, personal credit card debts,
19 unpaid federal taxes, some minor amounts for attorneys, etc. *Amended Schedule E/F*
20 [Bankruptcy Case, dkt. 16]. But the major portion of the \$1,487,373 was a claim by Kline for
21 \$1,400,000. *Id.*

22 Other than unsupported assertions that Di Bacco had a new car each year¹⁶² or that he had
23 undisclosed bank accounts, there is no evidence that Di Bacco had undisclosed assets at the time
24 that he filed bankruptcy.

¹⁶² The motion for relief from stay instead shows a three-year car lease. *Motion for Relief from Stay* [Bankruptcy Case, dkt. 8].

1 As noted, the issues under § 727(a) are whether there are assets for the trustee to recover
2 for the estate. Here, the issue of books and records is really one between Kline and Di Bacco.
3 There are certainly cases that deny discharge because the business and/or personal records are
4 sketchy, inadequate, or not compiled. But in this adversary proceeding, there is no evidence to
5 support the contention that Di Bacco embezzled and then hid money from TMLLC and that he
6 failed to report these assets in the Bankruptcy Case. This is really a fight between two former
7 partners.

8 It is undisputed that Di Bacco kept less than adequate records in a business-like fashion
9 of the transactions of TMLLC. However, there is evidence that the records themselves exist, just
10 in forms that have not been accessed or summarized. There is the Payroll Summary (annual
11 payroll reports from 2013 through 2019)¹⁶³ and the payroll summary reports for each pay period
12 from December 2016 through December 2018.¹⁶⁴ There are detailed bank statements and credit
13 card statements.¹⁶⁵ There was testimony as to the POS records that show tips being paid on credit
14 card sales for Riverside. These have all been reviewed by both Freebairn-Smith and Jennings.
15 What exists, but has not been reviewed, are receipts for purchases, etc. some of which were done
16 in cash. There is no contrary evidence to Freebairn-Smith's statement that she saw a few boxes of
17 these but did not record them. There is no dispute to Di Bacco's testimony that many more boxes
18 exist and were stored in the second-floor office/apartment. And as discussed above, for 2018 and
19 2019 there was a chart of accounts and profit and loss statements that are based on actual receipts
20 as well as bank and credit card records.¹⁶⁶

¹⁶³ Exhibit FFF.

¹⁶⁴ Exhibit HHHHH.

¹⁶⁵ Exhibit 2 to Exhibit 14.

¹⁶⁶ Exhibits CCCCC, DDDDD.

1 While this may not be the best method of accumulating books and records, given Di
2 Bacco's lack of training, they meet the test of minimal appropriate behavior as to § 727(a)(3).

3 § 727(a)(3) has no requirement of intent, merely of action. Some courts hold that the lack
4 of accountings and summaries of income and expenses, etc. is sufficient to deny discharge under
5 this section. The trustee (here creditor) is not required to "sift through the documents and attempt
6 to reconstruct the flow of debtor's assets." *Hernandez v. Shove (In re Shove)*, 638 B.R. 1, 19
7 (BAP 1st Cir. 2022) (citing *Krohn v. Frommann (In re Frommann)*, 153 B.R. 113, 118 (Bankr.
8 E.D.N.Y. 1993)).

9 The mere lack of a bookkeeping compilation of the documents is not enough to deny
10 discharge. The back-up materials must be voluminous and unorganized. The *Morando* court uses
11 a more colorful description:

12 However informal the record keeping, the financial history of a debtor must be
13 preserved in enough of a paper trail so that those concerned . . . need not be
14 experienced explorers of a rat's nest of scraps of uncoordinated bits and pieces like
15 parts of some impressionistic puzzle that needs to be solved in order to decipher the
16 financial machinations of the debtor.

17 *In re Morando*, 116 B.R. 14, 16 (Bankr. D. Mass. 1990).

18 Once the plaintiff shows that the records are inadequate, the burden shifts to the debtor:

19 The initial burden of proof under § 727(a)(3) is on the plaintiff. Fed. R. Bank. P.
20 4005. "In order to state a prima facie case under section 727(a)(3), a creditor
21 objecting to discharge must show (1) that the debtor failed to maintain and preserve
22 adequate records, and (2) that such failure makes it impossible to ascertain the
23 debtor's financial condition and material business transactions." *Meridian Bank v.*
24 *Alten*, 958 F.2d 1226, 1232 (3d Cir. 1992). Once the objecting party shows that the
25 debtor's records are absent or are inadequate, the burden of proof then shifts to the
26 debtor to justify the inadequacy or nonexistence of the records. *Id.* at 1233; *Cox*,
27 904 F.2d at 1404 n.5; *Matter of Horton*, 621 F.2d 968, 972 (9th Cir. 1980); *In re*
28 *Lawler*, 141 Bankr. 425, 428-29 (Bankr. 9th Cir. 1992) (stating that a debtor must
29 "provide a credible explanation" for failure to keep records).

30 *Lansdowne v. Cox (In re Cox)*, 41 F.3d 1294, 1296 (9th Cir. 1994).

1 Although it concerns a claim under §727(a)(5) rather than §727(a)(3), *In re Retz* provides
2 an example of an egregious attempt by the debtor to prevent a meaningful accounting by the
3 trustee even though the debtor turned over 28,000-plus pages of records to the trustee.¹⁶⁷ 606
4 F.3d at 1205-06. In affirming denial of the plaintiff's discharge under § 727(a)(5), the Ninth
5 Circuit Court of Appeals stated:

6 Retz fails to explain how the Trustee should have found the relevant information,
7 if Retz himself was unable to discover it in the 28,000-plus pages of records he
8 provided to the Trustee. "A petitioner cannot omit items from his schedules, force
9 the trustee and the creditors, at their peril, to guess that he has done so--and hold
10 them to a mythical requirement that they search through a paperwork jungle in the
11 hope of finding an overlooked needle in a documentary haystack." *In re Tully*, 818
12 F.2d at 111. As the BAP so succinctly noted, "In the end, there simply is no basis in
13 the voluminous but nevertheless woefully incomplete record before the bankruptcy
14 court from which anyone could explain satisfactorily Retz's deficiency of assets to
15 meet his liabilities. Retz certainly has not done so."

16 *Id.*

17 On the other hand, in affirming the bankruptcy court's denial of the plaintiffs § 727(a)(3)
18 claim in *MacIntyre*, the Ninth Circuit Court of Appeals stated:

19 Debtors provided extensive records of their transactions during the time periods
20 complained of by DeMassa. They submitted receipts, bank statements, and cash
21 expenditure breakdowns in the MacIntyre and Pikus Cash Flow Analysis, October
22 27, 1991 to March 9, 1992. The bankruptcy court, obliged to determine Debtors'
23 financial status, found Debtors' testimony to be credible, and that Plaintiffs failed
24 to establish grounds for the denial of discharge. The bankruptcy court's findings,
25 supported by the Debtors' extensive records and their offered explanations for any
26 lack of record-keeping, are not clearly erroneous.

27 *DeMassa v. MacIntyre (In re MacIntyre)*, 79 F.3d 1153 (9th Cir. 1996).

28 The lack of good business practices for TMLLC has been established. Hundreds of
29 thousands of dollars are not in the current accounting. Kline has shown that a compiled but
30 limited accounting demonstrates a lot of missing money. That shifts the burden to Di Bacco to

¹⁶⁷ The facts of *In re Retz* are discussed in more detail below.

1 demonstrate that his lack of analytic record-keeping was justified under the circumstances of the
2 case. This has been discussed in detail above.

3 The bank records were easily available. Although unlawful, the payment of salaries
4 under-the-table provides a credible explanation for many of the missing records. The major
5 missing pieces to the creation of a reliable accounting are the receipts for cash payments. Di
6 Bacco testified to their existence and showed the Court at least one set of bundled documents. It
7 is unknown whether those receipts were kept in some sort of order such as chronologically or by
8 subject. It is possible that they were just tossed into a mixed mess in the boxes, but that does not
9 seem to be the case given the bundle presented to the Court.¹⁶⁸These receipts could have been
10 entered into a spreadsheet in the same way that the banking information was compiled. The
11 Court does not know whether this is a sufficient “rat’s nest of scraps” to deny Di Bacco a
12 discharge. But the real question here is not TMLLC (although the estate owns 50% of this
13 defunct company), but whether Di Bacco has that missing money or the assets that it purchased.
14 There is no evidence at all of this.

15 While an accounting of the receipts would have saved the Court many hours and led to a
16 much more accurate understanding of the business, the absence of that accounting is somewhat
17 justified given Di Bacco’s non-existent business experience, the expected cost of creating an
18 accounting, and the lack of resources of Di Bacco to do so. But the ultimate issue is not whether
19 Di Bacco used TMLLC assets to live “the good life.” It is whether Di Bacco acquired or had
20 assets that have not been revealed. There is no evidence of this. Thus, it would be improper to
21 deny discharge under § 727(a)(3).

22 Accordingly, the Court will grant judgment for Di Bacco as to § 727(a)(3).

¹⁶⁸ EXHIBT VV OR RRRR?

1 3. Factual Issues as to Denial of Discharge Under § 727(a)(4)

2 The court shall grant the debtor a discharge unless . . . the debtor knowingly and
3 fraudulently, in or in connection with the case—

4 (A) made a false oath or account;

5 (B) presented or used a false claim;

6 (C) gave, offered, received, or attempted to obtain money, property, or advantage,
7 or a promise of money, property, or advantage, for acting or forbearing to act;
8 or

9 (D) withheld from an officer of the estate entitled to possession under this title, any
10 recorded information, including books, documents, records, and papers,
11 relating to the debtor’s property or financial affairs.

12 11 U.S.C.I. § 727(a)(4).

13 In the Sixth Cause of Action, the complaint lists some 26 items that Kline contends Di
14 Bacco lied about or failed to disclose as part of the bankruptcy process. *Complaint* [dkt. 1], ¶¶
15 162-64. At the trial itself, Kline’s main argument was that Di Bacco did not disclose everything
16 in his initial schedules and statement of affairs and was forced to file amended ones with more
17 information. This is not an unusual circumstance.

18 At trial, Kline did not try to put in evidence specifically as to this cause of action. But
19 looking at the complaint, here is what he contended:

- 20 d. Took money instead of paying taxes causing severe monetary penalties over the
21 years, and a lien on the liquor license owned by MRRS, which is owned by Two
22 Michaels, LLC... and being used by Defendant for their restaurant since
23 reopening on Sept. 2, 2020 under a new name;
- 24 e. Over \$1,000,000 cash + other funds from TWO MICHAELS’s bank accounts
25 for his own use - Defendant lied about it in writing over and over again;
- 26 f. Created fraudulent tax returns that under reported the company’s income in
27 order to conceal the funds he embezzled for his own use – putting Kline in legal
28 and financial jeopardy with state and federal agencies;
- 29 g. Embezzled funds not disclosed;
- 30 h. Falsely claiming TWO MICHAELS was “over” in March, yet Defendant
31 received \$10,000 in April and \$25,000 in July 2020 in the name of TWO
32 MICHAELS;
- 33 i. Failing to disclose cash income in 2019 based on the point of service of One
34 restaurant in Riverside;
- 35 j. Created fraudulent tax returns that under reported the company’s income by
36 over \$1 million in order to conceal the funds he embezzled for his own use;

- 1 k. Defendant is generating income that he has not disclosed, in his Schedules and
2 Statement of Financial Affairs;
- 3 l. The Truck was a TWO MICHAELS business vehicle according to tax records
4 (listed \$1,000). Yet Plaintiff never drove it, but Defendant wrote it off and used
5 company funds;
- 6 m. Di Bacco has a lot of jewelry. His favorite ring is gold with diamonds initialed
7 with "MAD 13." He has a modest collection of watches as well as silver and
8 gold chains. None of this is disclosed;
- 9 n. Defendant said he has no cash, yet he stole over \$1,000,000 in cash from the
10 company accounts, and that finding by Jeff Neumeister did not include all of
11 the cash from Riverside through 2019, and from the point of service system
12 which tracks cash of approximately \$53,006.41;
- 13 o. Deposits of Money; Defendant names two accounts - checking and savings at
14 AFTRA SAG Credit Union. Plaintiff is informed and believes, and thereon
15 alleges that Defendant may have other accounts, including a Wealth
16 Management Account at US Bank;
- 17 p. Defendant's new corporation, VLIET 518, which was meant for TWO
18 MICHAELS, was used, wholly or in part, to run Defendant's new restaurant,
19 possibly being deposited into a VLIET 518 account. Defendant listed the value
20 at \$100. The business is very busy and thus has a much higher value. Plaintiff
21 maintains the \$35,000 SBA loan, meant for other business, went into the VLIET
22 518 business;
- 23 q. Defendant did not disclose the \$15,000 payment to BOE, and answered NO at
24 the 341(a) when asked whether he paid anyone over \$600 shortly before or after
25 filing;
- 26 r. Defendant listed the value of MRRS at \$100. MRRS is owned by TWO
27 MICHAELS (both LLC's 50% ownership – Plaintiff and Defendant) and owns
28 the liquor license Defendant has been using illegally since 9/2/20;
- 29 s. Plaintiff maintains Defendant has undisclosed financial accounts; Defendant
30 stole more than \$1,000,000 and Plaintiff believes part of that went to an
31 undisclosed retirement or financial account;
- 32 t. Loans for which Defendant is liable, from his brother Anthony Di Bacco to
33 Defendant in 2011 and 2013;
- 34 u. Defendant listed the value of the Liquor license at \$50,000. The liquor license
35 is owned by MRRS, which is owned by Two Michaels, LLC, which Defendant
36 claimed in the Schedules as worth only \$100;
- 37 v. Business related equipment has not been disclosed, including office equipment
38 including desks, chairs, rugs, electronic devices, restaurant furniture, TV's, and
39 point of service machines;
- 40 w. Plaintiff believes Defendant has an undisclosed gun that he proudly showed
41 years ago;
- 42 x. Defendant failed to disclose his interests in Partnerships. He answered "no",
43 however Defendant has a 50/50 interest with Plaintiff in Two Michaels and
44 MRRS;
- 45 y. Defendant opened a new restaurant on or around September 2, 2020;

- z. Plaintiff is informed and believes, and thereon alleges, that at the 341(a), the Debtor committed perjury numerous times when responding to questions from the Chapter 7 Trustee about all of the above, his income, assets, debts and expenses;
- aa. Plaintiff maintains Defendant signed a personal guaranty or guarantees for business leases that are not disclosed;
- bb. Restaurant Lease for the premises where the restaurant is located;
- cc. Income from the new restaurant Defendant opened using the assets of TWO MICHAELS.

Complaint [dkt. 1], ¶ 164.

The crux of this cause of action is that Di Bacco made a series of false oaths. The other possible issue would be withholding recorded information as to his property or financial affairs. That is also included and dealt with under § 727(a)(3).

The false oath must relate to a material fact which bears on the relationship to the debtor's business transactions or concerns the discovery of assets, etc. *Retz*, 606 F.3d at 1198. If it detrimentally affects the administration of the bankruptcy estate, it is material. *Id.* (quoting *In re Wills*, 243 B.R. 58, 63 (9th Cir. B.A.P. 1999)). And the statement had to be made with fraudulent intent. *Id.* at 1197.

The *Retz* case is an example of the proper use of § 727(a)(4) to deny discharge. Retz formed a construction company (TCI) to perform development and construction work in Montana. *Id.* at 1193. He had a degree in business management and kept the TCI books on a business accounting program. *Id.* Abbey was an experienced real estate investor and these two men entered into an oral agreement to form Timberland Construction, LLC. *Id.* at 1193-94. Retz put in all of the assets of TCI and Abbey contributed \$300,000. *Id.* at 1194.

After Abbey ran into Retz in the "high roller" portion of a Las Vegas hotel, he became suspicious and discovered that Timberland Construction had entered into partnerships and loan agreements without his knowledge or consent and in violation of the Timberland operating agreement. *Id.* Abbey had an accountant review the Timberland books and found that there were

1 irregularities, suspicious transfers to Retz, and other loans and repayments that were not clearly
2 identified. Retz filed bankruptcy. *Id.*

3 At the adversary trial, Retz admitted that his schedules and statement of financial affairs
4 were incomplete, but that he intended to amend them when he had additional information. *Id.* at
5 1195. The bankruptcy judge found that Retz was not a credible witness and denied discharge
6 under § 727(a)(2) and § 727(a)(4). *Id.* This was affirmed by the BAP and then by the Ninth
7 Circuit Court of Appeals. *Id.*

8 Noting that the burden of proof is by a preponderance of the evidence and is on the
9 objector, the Court stated that the purpose of § 727(a)(4) is to ensure that the “trustee and
10 creditors have accurate information without having to conduct costly investigations.” *Id.* at 1196
11 (quoting *In re Willis*, 243 B.R. 58, 63 (BAP 9th Cir. 1999)). “To prevail on this claim, a plaintiff
12 must show, by a preponderance of the evidence, that (1) the debtor made a false oath in
13 connection with the case; (2) the oath related to a material fact; (3) the oath was made
14 knowingly; and (4) the oath was made fraudulently.” *Id.* at 1197 (internal citations and quotations
15 omitted).

16 Retz knew that the schedules and statement of affairs were incomplete when he signed
17 them. *Id.* Among other things, he left off valuable watches, a bank account, two cars, and the sale
18 of a helicopter and hanger. *Id.* He left off income for a few years and he never completely
19 amended to correct these omissions. *Id.*

20 In the case before this court, the false oath must have related to a material matter and
21 have been knowingly and fraudulently given as part of the bankruptcy process, not merely a lie
22 to Kline or a lack of adequate bookkeeping by Di Bacco. Di Bacco had to have knowledge of the

1 false oath or account and he is given the chance to correct it. In fact, it is not unusual for debtors
2 to file amended schedules and statement of affairs, particularly early in the case.

3 The original schedules and SOFA were filed by Di Bacco's attorney. *Voluntary Petition*
4 [Bankruptcy Case, dkt. 1]. They list \$26,600 of personal property. *Id.* These included a 2018
5 Mercedes Benz of unknown value, a 1967 chevy pickup truck, several electronics, and no
6 jewelry. *Id.* It discloses an interest in VLIET518 Inc., \$800 in miscellaneous stocks, and two
7 AFTRA-SAG credit union accounts (\$20,500). *Id.*

8 On December 16, 2020, Di Bacco filed amended schedule A/B to add a 50% interest in
9 MRRS (\$100) and the ABC liquor license (\$50,000) and miscellaneous alcohol (\$500). *Amended*
10 *Schedule A/B* [Bankruptcy Case, dkt. 13]. This totaled \$76,900 in personal property as opposed
11 to the original list of \$26,600 in total personal property—the main asset being the liquor license.
12 *Id.* All the personal property, except for the liquor license, was claimed as exempt under Cal. Civ.
13 P. Code § 703.140(b)(5). *Id.*

14 One of the things that Kline argued at trial to show that Di Bacco had been stealing
15 money from the business was that he bought a new car every year. The facts presented in the
16 relief from stay motion undercut Kline's argument. At the time that Di Bacco filed bankruptcy,
17 he represented that he owned a 2018 Mercedes-Benz C300W. *Voluntary Petition* [Bankruptcy
18 Case, dkt. 1]. This was actually a lease to which Daimler Trust filed a motion for relief from stay
19 on November 17, 2020. *Motion for Relief from Stay* [Bankruptcy Case, dkt. 8]. Attached to that
20 motion is the lease that was entered into on November 2, 2017, which terminated on November
21 2, 2020. *Id.* Monthly payments were \$489.14 and \$1,100 was paid on the signing of the lease. *Id.*
22 There had been no missed payments, but the lease had terminated and that was the basis of the
23 motion for relief from stay, which was granted. *Id.*; *Order Granting Motion for Relief from Stay*

1 [Bankruptcy Case, dkt. 20]. Each partner took a draw of \$500 per week at the beginning and later
2 increased it to \$1,000 per week, so the monthly payment was not out-of-line for Di Bacco's
3 income.

4 This adversary proceeding is really about the relationship of the two partners and
5 accounting for the expenses and profits of the restaurants. Although Kline seeks to deny
6 discharge of all debts under § 727(a), that does not really fit the facts and evidence presented to
7 the court. There are cases where sloppy record-keeping has been used to deny discharge, but it
8 must be egregious and indicate a desire of the debtor to hide assets from the trustee. In most or
9 all of those cases, the trustee is also a party to the adversary complaint. That is not the situation
10 here.

11 The docket shows that the first § 341(a) meeting of creditors was held on December 7,
12 2020, and that the last day to file a § 523 or § 727 complaint was February 5, 2021. The amended
13 schedules were filed on December 16, 2020, about a week after the first meeting of creditors.
14 This adversary proceeding was filed on February 4, 2021, and continued meetings of creditors
15 were held on March 5, 2021, April 19, 2021, and May 7, 2021. There is no notice that it has been
16 adjourned. However, the trustee had months of notice in which she could have joined the Kline
17 adversary proceeding or bring her own. She has not done so. While this does not mean that she is
18 satisfied that discharge should be granted, it does show that she does not believe that there is a
19 sufficient reason to use estate resources to block it.

20 As to § 727(a)(4), the evidence is lacking. During the trial, Kline did not question Di
21 Bacco or present evidence as to assets that Di Bacco owned and failed to reveal. The fact that Di
22 Bacco may have kept sketchy business records or failed to pay taxes when due or wrote off the
23 truck as a business asset, etc. are not relevant to this cause of action. The pre-petition accounting

1 issues do not demonstrate that Di Bacco made a false oath in this case. There is no evidence of
2 knowing and fraudulent behavior as to this bankruptcy case. Kline has not borne his burden of
3 proof.

4 Accordingly, the Court grants judgment for Di Bacco as to § 727(a)(4).

5 **IV. CLOSING COMMENTS**

6 The story of the existence of TMLLC should not be considered to be unusual. It is
7 notoriously difficult to successfully run a restaurant. Restaurants come and go with great
8 frequency. Fewer than half survive for seven years and the median lifespan is less than five
9 years. In this adversary proceeding, we have two amateurs who went forward with little or no
10 professional advice or assistance. While Kline seems to have been adequate in the kitchen, it was
11 negligent of him not to be involved in the daily financial life of the Restaurants. He had a reason
12 to remain off the Bank Accounts (and later when he was a signatory there was a levy, *see supra*,
13 n. 84), but this meant that he did not have direct access to seek to review the bank statements. He
14 showed no desire to review the credit card statements or other records. And even when he was a
15 signatory on the Bank Accounts, he never pursued any kind of a review. Di Bacco raised the
16 question of whether Kline was efficient in his ordering of food and supplies, but that is irrelevant
17 to this adversary proceeding. Although Kline and Di Bacco probably contributed to its demise,
18 the business did not fail because of lack of money or poor purchasing practices, as described
19 below.

20 Di Bacco apparently knew how to run a bar and to advertise and staff a restaurant and
21 pizzeria, but he had no idea about accounting systems and keeping track of income and expenses
22 in a business-like fashion. Had either or both Di Bacco or Kline done a better job, this adversary
23 proceeding would never have occurred.

1 Beyond doing the accounting, it must be remembered that this adversary proceeding is
2 more than an analysis of the amount, if any, that might be owed by Di Bacco to TMLLC and
3 thereby to Kline. The Court had to determine whether the errors were intentional, whether Di
4 Bacco intended to and actually did defraud Kline, whether there was a breach of fiduciary duty
5 or a defalcation between them, whether Di Bacco took and kept money that was owed to
6 TMLLC and, if so, whether that was done with actual intent to harm TMLLC and/or Kline and
7 whether the harm actually occurred.

8 Finally, the post-petition running of the Restaurants and liquidation of the assets of
9 TMLLC are not relevant to this adversary proceeding. But even if they were, the parties agree
10 that neither of them would receive these or their value because they would go to the creditors of
11 TMLLC and to the taxes owed by that entity.¹⁶⁹

12 There were a series of errors that the parties made. Had these not occurred, perhaps this
13 very drawn-out and hostile ongoing litigation could have been avoided. Minimally these include
14 the following:

15 ERROR #1: The parties each assumed a task for which he lacked the personality and
16 skills. While Di Bacco knew how to run a bar, he had no interest, ability, or training in keeping
17 books and records for any business and certainly not for one that is as complicated as a
18 restaurant/bar. Such a business has an ever-changing need of supplies, employees who work
19 various days and shifts, and employees who draw a salary but also are compensated through
20 direct amounts added to customers' bills as tips. This is extremely complicated and needs a
21 skilled business manager. And it is better if that business manager is a perfectionist and very

¹⁶⁹ Facts agreed to on May 22, 2024, starting at about 2:05 pm. Kline claims that Di Bacco did not return some personal items of his, but this was also post-petition.

1 good with numbers and details. Di Bacco has not shown this skillset and that was a major
2 detriment to TMLLC.

3 However, Kline possesses exactly this group of skills. He reviews everything in detail,
4 notes and corrects each inconsistency, is aware of numerous facts, and seems to truly enjoy the
5 detail work. Had he been willing to actively run, supervise, or at least be involved with the
6 business side of TMLLC, we would not be in this situation and these two men might have
7 continued to have a successful ongoing partnership—at least until the building was torn down.

8 It is tragic that they were each blinded by a dream rather than acknowledging the reality
9 of their skills and situation. Kline refused to handle or participate in the business side. Di Bacco
10 refused to hire the professional help that he needed to compliment his efforts.

11 And so, the business failed . . . two friends became enemies . . . many thousands of
12 dollars and years have been wasted in hatred and litigation. And here we are, trying to straighten
13 out the facts of a failed business that should not have failed.

14 **ERROR #2:** Although Di Bacco had some background in the restaurant/bar business, it
15 was as a bartender and not an owner. To start The Red Door with no professional assistance was
16 foolish and a direct cause of this adversary proceeding. Such entities as the Small Business
17 Administration’s SCORE program will provide retired business professionals at no charge to
18 help direct new business owners in their initial organization. In this case, TMLLC needed a
19 competent bookkeeping method. This would include a proper computer program; a chart of
20 accounts; and a part-time person to enter the data from checks, bank statements, receipts,
21 withdrawals, etc. Di Bacco had neither the time nor the training to do this himself. Someone who
22 could work a few hours a week would have prevented much of the confusion and would also
23 have created the back-up information for the accountant to prepare the annual tax returns. At the

1 suggestion of Foster, who had taken over the function of preparing the tax returns, Di Bacco
2 finally hired a bookkeeper starting in 2018.

3 ERROR #3: Paying people “off-the-books” and in general using cash without proper
4 records. Trying to run the business on a shoestring may have seemed like a good idea because
5 you can pay the staff less in that you are not withholding money for taxes, etc. You also are not
6 responsible for the employer’s share of social security. But in the long run that often leads to
7 disputes as to how many hours people worked. Beyond this it is not legal. It is not a good way to
8 sustain your business operations. Both partners played “fast and loose” with the cash and may
9 have depleted the assets through their “supplemental draws.”

10 ERROR #4: Kline not taking an active part in the business analysis. While there was no
11 need for him to be involved in the day-to-day financial operations and oversight, he should at
12 least have had a monthly meeting with Di Bacco (and the bookkeeper if they had one) to review
13 the status of the financial operations and make decisions about purchases, employees, hours of
14 operation, etc.. And he should have attended an annual meeting with Di Bacco and the
15 accountant to review the books and records and to obtain direction as to how to proceed into the
16 coming year. Both men should have used the accountant as an advisor for these purposes.

17 ERROR #5: Di Bacco’s failure to properly document each cash deposit and each cash or
18 check withdrawal from the bank so that they could be added to the books and records of the
19 business.

20 ERROR #6: From the beginning the partners did not work out a business plan. And they
21 failed to do one even after it was clear that the business was not making a sufficient profit to
22 repay its lenders/creditors, or maybe no profit at all.

1 They never analyzed whether they could make a consistent profit given the limited hours
2 that they were open. They never considered that someone other than Kline could handle the
3 lunchtime food preparation, though under Kline’s general supervision. They never considered
4 the effect of taking their “supplemental draw” on the operations and profitability of the
5 restaurants and their obligation to repay the creditors and lenders.

6 **ERROR #7:** As the business broke up, the partners needed to sit down with a mediator or
7 guide or arbitrator and work out a plan as to how to proceed. It is difficult to tell who was
8 dragging his feet. Di Bacco was angry and frustrated because Kline began dissolution
9 proceedings; Kline was angry and frustrated that his best friend would simply move forward
10 without any consideration for what he wanted. Kline also resented that Di Bacco was running the
11 business without him. Being a chef was Kline’s passion and Di Bacco had removed the
12 opportunity to exercise it when Di Bacco locked him out. Had they hired someone whom they
13 both agreed to and trusted, that person could have worked with them to create a plan that would
14 have saved lots of money and anger. The ultimate demise of the restaurant(s) could not be
15 avoided due to both Covid and the future sale of the building. But the year or two between the
16 filing of the dissolution notice and Covid could have been productive rather than destructive if
17 handled correctly. Again, asking the Small Business Administration’s SCORE program for help
18 might have been a benefit.

19 But this is all based on hindsight, which is infallible. None of it happened and here we are
20 today. While the Court has decided the ultimate issues before it in this adversary proceeding, the
21 Court urges Di Bacco to acknowledge the errors that he made and apologize to Kline for any
22 harm that he did and any pain that he caused and accept his role in destroying their friendship.
23 The Court urges Kline to acknowledge the errors that he made in not actively participating in the

1 business side of TMLLC and for any harm that he caused by unilaterally filing for dissolution
2 and any pain that he inflicted through the multiple lawsuits that he has pursued and that he also
3 accepts his role in destroying their friendship. Life is simply too short for this ongoing animosity
4 to continue.

5 One further comment: the State Court Action is still pending, though the state court
6 stayed it while this trial took place. It is certainly up to the judge in that case to determine what
7 remains and how to proceed. But this Court makes the following observation: almost all of the
8 complained-of behavior was prepetition and has been determined in this adversary proceeding.
9 Once a debt or alleged-debt has been found to be discharged, no further action to collect is
10 allowed. It appears to this Court that only two issues remain:

11 (1) were there any pieces of Kline's personal property at the restaurants when the
12 business closed and, if so, who has the proceeds or the property?

13 (2) what damages did Kline suffer because of Di Bacco's breach of fiduciary duty as to
14 the continued running of the restaurants under the lease addendum and/or in violation of the
15 certificate of dissolution? The evidence of this is contained in exhibit FFFFFF, the Gallego P&Ls
16 for 2021 and 2022. For some reason her 2021 statement is only through September 2021. It
17 shows a net income of \$38,141. Even if this were adjusted to add the fourth quarter (as the Court
18 did with Freebairn-Smith for 2019), it would only total \$50,853. For 2022, Ms. Gallego shows a
19 net income of \$21,502. Kline may be entitled of 50% of this, which is \$36,178. But it is also
20 possible that Di Bacco took a draw throughout and it is possible that Kline is also entitled to an
21 equal sum. The Gallego P&Ls do not breakout a figure for owner draw, and it might be included
22 in the general category of salaries and wages. These issues are left to be determined in the State
23 Court Action.

1 While the state court may disagree with this Court's analysis, if it does agree, the
2 maximum that Kline can obtain is a judgment for \$36,178, the same apparent amount of draw as
3 Di Bacco took in 2021 and 2022, plus the return of Kline's personal property or its value. And
4 because some of this may be seen as profit, other creditors may have a right to it. Anyway, I urge
5 the parties to settle. Kline is vindicated in that Di Bacco violated some of his rights, but the
6 amount of damages can probably be paid by Di Bacco. That will be the end and both men can go
7 forward with their lives.

8 #####

Date: January 13, 2025



Geraldine Mund
United States Bankruptcy Judge