UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF NEW YORK

IN RE:

DANIEL P. FERRARO
CELESTE H. FERRARO

CASE NO. 00-63241

Chapter 7

Debtors

LEE E. WOODARD, TRUSTEE

Plaintiff

vs.

ADV. PRO. NO. 03-80476

ALAN BALCOURT

Defendant

APPEARANCES:

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Hon. Stephen D. Gerling, Chief U.S. Bankruptcy Judge

**PROPOSED FINDINGS OF FACT,
CONCLUSIONS OF LAW AND RECOMMENDATION**

Under consideration by the Court is a motion filed by Alan Balcourt ("Balcourt") on February 25, 2005, seeking an order dismissing the complaint of Lee E. Woodard, the Chapter 7 Trustee ("Trustee") for the Debtors' joint bankruptcy estate on the grounds that (1) the claims

asserted in the complaint are time barred, or alternatively (2) the Trustee is attempting to assert claims held by non-debtor parties. Balcourt filed this motion pursuant to Rule 7056 of the Federal Rules of Bankruptcy Procedure ("Fed.R.Bankr.P."), which incorporates Federal Rule of Civil Procedure 56 ("Fed.R.Civ.P."). The Trustee filed a response on March 31, 2005, requesting that (1) the Court deny Balcourt's Motion or, alternatively (2) compel the joinder of Integrated Office Technologies, L.L.C. and Balfer Acquisition Company, L.L.C. (collectively referred to as the "LLCs") as defendants in the Adversary Proceeding, or permit the Trustee to recommence the proceeding as a shareholder derivative action on behalf of the LLCs.

The Court heard oral argument on the motion at its regular motion term in Syracuse, New York on April 5, 2005. The Court then adjourned the motion until May 31, 2005 for further consideration. The Court provided the parties an opportunity to file memoranda of law, and the matter was taken under consideration on June 20, 2005.

JURISDICTION

28 U.S.C. §§ 157 and 1334 define this Court's subject matter jurisdiction. *Plaza at Latham Assocs. v. Citicorp North America, Inc.*, 150 B.R. 507, 510 (N.D.N.Y. 1993). Section 1334(b) states that "district courts shall have original but not exclusive jurisdiction of all civil proceedings arising under title 11, or arising in or related to cases under title 11." As permitted by section 157(a), the United States District Court of the Northern District of New York vested the bankruptcy courts of this District with four categories of subject matter jurisdiction: (1) cases "under title 11"; (2) civil proceedings "arising under title 11"; (3) civil proceedings "arising in"

a case under title 11; and (4) civil proceedings "related to" a case under title 11. *Local Rule 76.1 for the U.S. District Court for the Northern District of New York.* A case "under title 11" is one that is commenced, either voluntarily or involuntarily, by filing a petition with the bankruptcy court under the appropriate chapter of title 11. *Plaza at Latham Assocs.*, 150 B.R. at 510 n.3 (citing Code §§ 301, 302, and 303). Proceedings "arising under title 11" involve a cause of action created or determined by a statutory provision of title 11. *Id*. at n.4. Proceedings "arising in" a case under title 11 involves "administrative" matters that arise only in bankruptcy cases. *In re Wood*, 825 F.2d 90, 92 (5th Cir. 1987). They are not based on any right expressly created by title 11, but, nevertheless, would have no existence outside of the bankruptcy. *Id*.

The Second Circuit defines "related to" jurisdiction broadly. A bankruptcy court's "related to" jurisdiction requires a showing of any "significant connection" to the debtor's bankruptcy. *Plaza at Latham Assocs.*, 150 B.R. at 511 n.6 (quoting *Turner v. Ermiger*, 724 F.2d 338, 341 (2d Cir. 1983)). The test for determining whether litigation has a significant connection with a pending bankruptcy proceeding is whether its outcome might have any "conceivable effect" on the bankruptcy estate. If that question is answered affirmatively, the litigation falls within the "related to" jurisdiction of the bankruptcy court. *Publicker Indus. v. United States* (*In re Cuyahoga Equip. Corp.*), 980 F.2d 110, 114 (2d Cir. 1992).

Section 157(b)(1) permits bankruptcy judges to hear, determine, and enter appropriate orders and judgments in all cases under title 11 and all core proceedings arising under title 11. While § 157(c)(1) permits bankruptcy judges to hear non-core proceedings that are otherwise related to a title 11 case, bankruptcy judges may not finally determine the issue in such proceedings; rather, they may only submit proposed findings of fact and conclusions of law to

the district court. *Resolution Trust Corp. v. Best Prods. Co.* (*In re Best Prods. Co.*), 68 F.3d 26, 30 (2d Cir. 1995). Section 157(b) authorizes bankruptcy judges to make a determination on whether a proceeding is a "core" proceeding or otherwise "related to" the bankruptcy case. Cases and proceedings which "arise under" or "arise in" title 11 are considered "core proceedings" pursuant to section 157(b)(1). *Plaza at Latham Assocs.*, 150 B.R. at 511.

Section 157(b)(2) provides a non-exclusive list of proceedings that Congress has deemed core, which includes section 157(b)(2)(F) (proceedings to determine, avoid, or recover preferences). The Trustee asserts that this proceeding is a core proceeding under section 157(b)(2)(F), but the Trustee's causes of action involve questions of fraud, conversion, defalcation, and embezzlement. The Trustee never alleges in his complaint that he is seeking to avoid a preference, as defined by Code § 547(b). Instead, the Trustee attempts to mask these tort claims by referencing Code §§ 541 and 542 in his complaint, but those sections are not the bases of the Trustee's complaint; they simply provide a remedy to the Trustee if he succeeds in his tort claims. The lawsuit before this Court does not invoke a substantive right created by the federal bankruptcy law and is one that could easily exist outside of bankruptcy. The outcome of the lawsuit, however, might have a "conceivable effect" on the bankruptcy estate. Under § 157(c)(1), the Court finds that it is an "otherwise related" or non-core proceeding. Therefore, the Court may only submit proposed findings of fact and conclusions of law to the District Court.

PROPOSED FINDINGS OF FACT

Balcourt and Daniel Ferraro (the "Debtor" and collectively, with Celeste Ferraro, the "Debtors") each have a 50% share in two limited liability companies identified as Integrated Office Technologies, L.L.C. and Balfer Acquisition Company, L.L.C. which Balcourt alleges were formed in 1995 and 1996, respectively. *Balcourt Affidavit sworn to Feb. 25. 2005* ("Balcourt Aff.") ¶ *2*; *Trustee's Opposition to Defendants' Mot. for Summary Judgment*. The Debtors filed a joint petition for Chapter 7 relief on June 26, 2000. Apparently, the LLCs have not been dissolved, though they are both inactive. *Balcourt Aff.* ¶ *3*. On November 13, 2003, the Trustee filed a complaint (the "Complaint") asserting four causes of action, as follows: (1) Balcourt embezzled or converted to his own use and benefit $400,000 from the LLCs; (2) Balcourt committed fraud when he intentionally, with deception and without the Debtors' knowledge, took $400,000 from the LLCs; (3) Balcourt committed defalcation when he failed to account for the $400,000, which he received in his fiduciary capacity; and (4) Balcourt committed conversion when he improperly withheld the $400,000, when the right to possess the money belonged to the LLCs.

Balcourt answered the complaint on May 5, 2004 and generally denied the Trustee's allegations. Additionally, Balcourt asserted four affirmative defenses: (1) the Court does not have jurisdiction over the subject matter contained in the Complaint; (2) the Complaint fails to state a claim upon which relief can be granted; (3) the action is barred by the applicable statute of limitations; and (4) the action is barred by the doctrine of laches.[1] Balcourt also demanded a trial

[1]Though Balcourt asserted lack of jurisdiction in his answer to the Trustee's complaint, he did not raise that ground in his motion papers. Nevertheless, this Court must independently determine the jurisdictional basis for the pending Adversary Proceeding.

by jury of all the issues and requested that the Court dismiss the Complaint and grant him judgment for costs and attorney's fees, as well as such other relief the Court deems proper. Balcourt then filed the instant motion on February 25, 2005.

ARGUMENTS

Balcourt asserts that the Complaint does not state a claim upon which relief can be granted to the Trustee because the Complaint's language is limited to asserting torts allegedly committed by Balcourt against the LLCs, not committed against the Debtor or the estate. Balcourt contends that under New York Limited Liability Company Law ("NYLLCL"), a member of a limited liability company has no interest in the specific property of the limited liability company. The Complaint admits that the $400,000 belonged to the LLCs, not to the Debtor or the estate. Because the $400,000 belonged to the LLCs, Balcourt argues, neither the Debtor nor the Trustee can claim the money. Balcourt concedes that the LLCs may have viable claims against him, but the Debtor and the Trustee do not.

Balcourt also contends that the Trustee's claims of conversion, embezzlement, and defalcation are barred under New York law (New York Civil Practice Law and Rules)("CPLR") because the Trustee filed the Complaint in November of 2003, which was more than three years from the date when the claims allegedly accrued. In the Trustee's response to Balcourt's interrogatories, the Trustee asserts that he believed that the Debtor was aware of the alleged fraud, embezzlement and conversion in September of 1999. According to Balcourt, the Court should also dismiss the Trustee's fraud claim because it was not pled with particularity, as

required by Fed.R.Civ.P. 9(b).

The Trustee argues that the Court must permit him to pursue the action against Balcourt on behalf of the bankruptcy estate because that is the only viable way for the Trustee to pursue his claims. The Trustee continues by alleging that the only way that either LLC can pursue the Trustee's claims against Balcourt is if both members of the LLCs agree to do that. Balcourt would prevent the LLCs from pursuing claims against himself because he owns 50% of each LLC. The Trustee further contends that a shareholder derivative action against Balcourt is not an appropriate mechanism to pursue those claims because NYLLCL does not provide such a right, and case law is conflicting over whether NYLLCL permits shareholder derivative suits.

The Trustee argues that the state law statute of limitations does not bar his claims. He pleads that the Court should not penalize him for any delay in filing the Complaint because the underlying facts are subject to an ongoing criminal investigation by the United States Attorney's Office, and they would not discuss any part of the pending investigation. He further argues that if the Court is persuaded that his cause of action is properly framed as a shareholder derivative action or an action to be pursued by the LLCs, it would be timely. According to the Trustee, CPLR § 213(7) provides that shareholder derivative actions are governed by a six year statute of limitations.

PROPOSED CONCLUSIONS OF LAW

A trial court will grant a motion for summary judgment if "there is no genuine issue as

to any material fact and .... the moving party is entitled to a judgment as a matter of law." Fed.R.Civ.P. 56(c). In assessing the record to determine whether genuine issues of material fact are present, the trial court must resolve all ambiguities and draw all inferences in favor of the party against whom summary judgment is sought. *LaFond v. General Physics Servs. Corp.*, 50 F.3d 165, 171 (2d Cir. 1995). When presented with a motion for summary judgment, the trial court's task is limited to carefully "discerning whether there are any genuine issues of material fact to be tried, not to deciding them. Its duty, in short, is confined at this point to issue finding; it does not extend to issue-resolution." *Gallo v. Prudential Residential Servs., Ltd. P'ship,* 22 F.3d 1219, 1224 (2d Cir. 1994). If there is any evidence in the record from any source from which to draw a reasonable inference in favor of the non-moving party, summary judgment is improper. *Chambers v. TRM Copy Ctrs. Corp.*, 43 F.3d 29, 37 (2d Cir. 1994).

Here, neither party disputes any material fact. The question for the Court is whether Balcourt is entitled to a judgment as a matter of law because the Trustee has no standing to pursue his claims against him on the estate's behalf. NYLLCL provides that a membership interest in a limited liability company is personal property. However, a member has no interest in the specific property of the limited liability company. NYLLCL § 601. The Trustee contends that Balcourt committed various torts against the LLCs when he allegedly took $400,000 from them. The $400,000, however, belonged to the LLCs, not to the Debtor. NYLLCL § 203(d) provides that a limited liability company is a separate legal entity. Therefore, only the LLCs can pursue the tort claims against Balcourt. The Trustee cannot pursue his claims against Balcourt on the bankruptcy estate's behalf because the $400,000 claim did not belong to the Debtor. The Debtor's injury was essentially a diminution in the value of his membership interest in the LLCs

because of a loss of the LLCs' assets. *See Weber v. King*, 110 F.Supp.2d 124, 132 (E.D.N.Y. 2000) (stating that if the primary injury is to the limited liability company, a direct cause of action belongs to the limited liability company, even though all members of the limited liability company may be injured by a diminution in value of their interests). *See also PacLink Communications Intern., Inc. v. Superior Court*, 109 Cal. Rptr. 2d 436, 440 (Cal. Ct. App. 2001) (plaintiffs claimed that the defendant fraudulently transferred the limited liability company's assets without any compensation being paid to the limited liability company, but court found that the real party in interest was the limited liability company, not the limited liability company's shareholders).

The Court will not consider whether the Trustee can file a derivative suit. That is not the issue before it. It is not a live controversy before the Court because the Trustee has not filed a shareholder derivative suit. This Court's jurisdiction does not extend to a controversy that is not ripe. *See Renne v. Geary*, 501 U.S. 312, 320 (1991); *Sosna v. Iowa*, 419 U.S. 393, 402 (1975); *Blanchette v. Connecticut General Ins. Corps.*, 419 U.S. 102, 138 (1974). The Court must, therefore, exercise judicial restraint and not rule on whether the Trustee may file a shareholder derivative suit. Additionally, the Court lacks the judicial power to force a limited liability company to become a plaintiff in a lawsuit. Finally, the Court will not make any determination on whether the Trustee's claims are time-barred because the Court concludes that the Trustee cannot assert claims on behalf of the Debtor when those claims do not belong to the bankruptcy estate.

Based on the foregoing, it is hereby

RECOMMENDED to the United States District Court for the Northern District of New

York that it grant Balcourt's Motion for Summary Judgment.

Dated at Utica, New York

this 23rd day of November 2005

/s/ Stephen D. Gerling
STEPHEN D. GERLING
Chief U.S. Bankruptcy Judge