NOT FOR PUBLICATION

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

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In re:

EERIE WORLD ENTERTAINMENT, L.L.C., Case No. 00-13708 (ALG)

Debtor.

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MEMORANDUM OF OPINION

A P P E AR A N C E S:

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ALLAN L. GROPPER
UNITED STATES BANKRUPTCY JUDGE

Before the Court is a motion by Ronald Bergrin for permission to bring a State action seeking damages of $24 million against defendants Todtman, Nachamie, Spizz & Johns, P.C. ("TNS&J"), and two of its partners, Barton J. Nachamie and Scott S. Markowitz, and Gazes &

Associates, LLP, Gazes, LLC, Eric Wainer and Ian J. Gazes ("Gazes"). Gazes is the Chapter 7 trustee for the Debtor (the "Trustee"), Gazes & Associates, LLP and Gazes LLC were his law firms at the relevant times, and Gazes and Wainer are or were partners of the firms. TNS&J served as counsel to Eerie Entertainment, Inc. (the "Debtor") from August 2000 through October 9, 2003, when TNS&J was disqualified from representing the Debtor in its bankruptcy proceedings. On December 3, 2003, the case was converted to a proceeding under Chapter 7 and the Trustee was appointed.

Bergrin has moved this Court for permission to file a State action against the Defendants for malicious prosecution and violation of New York Judiciary Law § 487. For the reasons stated below, permission to sue the Defendants in State court is hereby denied, with leave to file one of the claims as an adversary proceeding in this Court.

Background

The Debtor was a Delaware limited liability company engaged in the theme restaurant business. As the District Court found in its Opinion and Order further discussed below, in November 1997, Bergrin received stock in the Debtor in exchange for services rendered in connection with the Debtor's formation. Two years later, during the summer of 1999, it appears that the Debtor's board determined to recapitalize the Debtor, and its chairman, James Burke, sought to purchase additional shares from the Debtor at $50 per share. By the terms of agreements executed by the Debtor's 35 shareholders, Burke, an officer, needed the unanimous consent of all 35 shareholders in order to purchase shares from the Debtor for less than $100 per share, and Bergrin was the only shareholder who refused to consent. Thereafter, in August 1999, Burke and Bergrin apparently reached an agreement whereby the Debtor would redeem Burke's shares for $100 per share. To that end, on or about October 7, 1999, Burke deposited $1,750,000

(the "Funds") into a bank account of a holding company he controlled, which downstreamed the money to the Debtor. A few days later, on October 13, 1999, the Debtor and Bergrin entered into a Retirement and Release Agreement, under which Bergrin surrendered his shares to the Debtor for $1,750,000 (the "Transfer"). Bergrin has asserted that the Funds were specifically earmarked for payment to him for his shares and not available to the Debtor for any other purpose.[1]

The Bankruptcy

The Debtor filed a voluntary petition under Chapter 11 of the Bankruptcy Code on August 11, 2000, approximately ten months after the Transfer. On September 22, 2000, the Debtor, by its counsel, TNS&J, commenced a fraudulent conveyance action under § 548 of the Bankruptcy Code against Bergrin (the "Adversary Proceeding"), claiming that the Debtor was insolvent at the time of the Transfer or was rendered insolvent by the Transfer, thereby making the Transfer a constructive fraudulent conveyance under the Bankruptcy Code. The lawsuit was apparently supported by the Creditors Committee.

On July 2, 2002, Bergrin (by then proceeding *pro se*) requested a jury trial and transfer of the Adversary Proceeding to the District Court, and on July 11, 2002, the Adversary Proceeding was transferred to the District Court and assigned to the Honorable Shira A. Scheindlin. Thereafter, Bergrin filed a motion for summary judgment (the "Summary Judgment Motion"), arguing that there was no fraudulent conveyance because (i) the Debtor had not been insolvent or rendered insolvent by the Transfer and (ii) the Funds had been earmarked by Burke for transmittal to Bergrin, and the Debtor's financial position had not been impacted by what was in

[1] It is assumed for the purposes of this opinion that the $1,750,000 paid by the Debtor was paid with the Funds that Burke had deposited a few days before for the purpose of making the payment to Bergrin. Bergrin and Burke apparently used the Debtor as a temporary custodian to effect the sale of Bergrin's stock in order to avoid the necessity of obtaining unanimous shareholder consent for a direct sale of shares from Bergrin to Burke.

effect Burke's personal purchase of Bergrin's shares.[2] Bergrin included various financial statements as part of his defense, specifically relying on the Debtor's consolidated financial statements for 2000, reviewed by Arthur Andersen, to demonstrate that the Debtor had been solvent at the time of the Transfer.

TNS&J filed the Debtor's opposition to the Summary Judgment Motion, including the affidavit of Stuart Fleischer of Stuart Fleischer Associates, which had been retained as accountants for the Creditors Committee (Gazes Aff., Ex. A, the "Fleischer Affidavit"). The Fleischer Affidavit concluded that the Debtor had been rendered insolvent by the Transfer. While Bergrin's motion for Summary Judgment Motion was pending in the District Court, the Debtor's Chapter 11 case was converted to a case under Chapter 7 on December 3, 2003, and Gazes was appointed as Chapter 7 trustee.

After his appointment, the Trustee retained his own accountant, Alan R. Barbee of Barbee & Associates, who reviewed the documents submitted by Bergrin in connection with his Summary Judgment Motion. As set forth in Barbee's affidavit, submitted in the District Court litigation (Gazes Aff., Ex. C, the "Barbee Affidavit"), Barbee concluded that the Debtor's 2000 financial statements did not demonstrate the Debtor's solvency at the time of the Transfer and were not reliable with respect to the Debtor's net worth at that time. In light of these conclusions and the entire record, the Trustee asserts that he ultimately determined to pursue the Adversary Proceeding on behalf of the Debtor's estate and filed his own opposition papers to the Summary Judgment Motion, which included the Barbee Affidavit. (Gazes Aff., ¶ 5). Barbee took the

[2] Bergrin also filed a motion with the Bankruptcy Court to disqualify TNS&J from representing the Debtor in its bankruptcy proceedings on the basis of a conflict of interest. The Bankruptcy Judge then hearing this case denied Bergrin's motion, and Bergrin appealed the decision to the District Court. In October 2003, the District Court reversed and disqualified TNS&J. *Bergrin v. Eerie World Entm't, LLC*, 2003 U.S. Dist. LEXIS 18259 (S.D.N.Y. Oct. 14, 2003).

position that the record did not establish that the Debtor was solvent at the relevant times, but he did not opine that the Debtor was insolvent. (Barbee Aff., ¶ 15).

On November 23, 2004, the District Court entered an order granting Bergrin summary judgment and dismissing the Adversary Proceeding on the ground that the Trustee had failed to submit evidence that the Debtor was insolvent at the time of the Transfer or was rendered insolvent by the Transfer. *Eerie World Entm't,* 2004 U.S. Dist. LEXIS 23882, at *12-13 (S.D.N.Y. Nov. 29, 2004).

On September 2, 2005, Bergrin filed his motion for permission to bring a State action against the Defendants for malicious prosecution and violation of New York Judiciary Law § 487 in bringing and maintaining the Adversary Proceeding. He attached a proposed Verified Complaint (Jury Trial Requested). The proposed Complaint claims, as further discussed below, that the Defendants brought the lawsuit against Bergrin without a substantial basis and for improper motives. It is also replete with charges of alleged harassment and intimidation. According to Bergrin, TNS&J and Markowitz tapped his phone in violation of civil rights, told him they hired private investigators to track his "every move" and "harassed Bergrin by making statements with full knowledge about confidential discussions that Bergrin had …." (Proposed Complaint, ¶¶ 38-39). It is also worth noting that although the U.S. Trustee is not named a defendant in the Complaint, Bergrin charges that her office was a participant in the wrongdoing. Bergrin alleges that the "Office of the U.S. Trustee in both New York and Washington were quite concerned about being sued by Bergrin because he had threatened to sue both the Office of the U.S. Trustee and certain of its individuals for not complying with the Office of the U.S. Trustee's own mandate, which would have led them to terminate the frivolous lawsuit against Bergrin three years earlier, to reprimand Mr. Markowitz and TNS&J, and to recover assets on

behalf of the Estate." (Proposed Complaint, ¶ 45). According to the Complaint, because of concern that Bergrin would sue, the U.S. Trustee instructed the new Chapter 7 Trustee to maintain the case and "decided that it was in their interest to continue the frivolous lawsuit against Bergrin, as opposed to admitting their mistakes and terminating the lawsuit." (Proposed Complaint, ¶¶ 46, 50).

Discussion

In *Barton v. Barbour*, 104 U.S. 126, 127 (1881), the Supreme Court held that before suit could be brought against a receiver appointed by a Federal court, "leave of the court by which he was appointed must be obtained." In *Vass v. Conton Bros. Co.*, 59 F.2d 969 (2d Cir. 1932), the Second Circuit (per L. Hand) applied the rule in a suit brought against a trustee in bankruptcy, stating that "an action against a trustee in bankruptcy for transactions of his own, must be brought in bankruptcy court, unless it gives leave to liquidate elsewhere; it concerns the distribution of the assets as much as a claim against the bankrupt, and is justiciable only as that is." 59 F.2d at 971. The rule applied to suits against trustees appointed under Chapter X of the Bankruptcy Act, *Rothberg v. Kirschenbaum (In re Beck Indus., Inc.)*, 725 F.2d 880 (2d Cir. 1984), and it applies to suits against trustees under the Bankruptcy Code. *Lebovits v. Schefel (In re Lehal Realty Assoc.)*, 101 F.3d 272 (2d Cir. 1996). The rule is a matter of federal common law. *In re Linton*, 136 F.2d 544, 545 (7th Cir. 1998); see also *Muratore v. Darr*, 375 F.3d 140, 147 (1st Cir. 2004); *Carter v. Rodgers*, 220 F.3d 1249, 1252 (11th Cir. 2000); *Allard v. Weitzman (In re DeLorean Motor Co.)*, 991 F.2d 1236, 1240 (6th Cir. 1993). The Ninth Circuit recently stated in *Beck v. Fort James Corp. (In re Crown Vantage, Inc.)*, 421 F.3d 963, 970 (9th Cir. 2005), "We join our sister circuits in holding that a party must first obtain leave of the bankruptcy court before it initiates an action in another forum against a bankruptcy trustee or

other officer appointed by the bankruptcy court for acts done in the officer's official capacity." As indicated in that quote, the rule has been extended to attorneys representing trustees as well as attorneys representing debtors in possession. See *DeLorean Motor Co.*, 1991 F.2d at 1241; *In re Balboa Improvements, Ltd.*, 99 B.R. 966, 970 (9th Cir. B.A.P. 1989).[3]

Many of the decisions enforcing the *Barton* rule emphasize that the Bankruptcy Court must exercise its sound discretion in determining whether to grant a party permission to sue in another court. *Beck Indus.*, 725 F.2d at 889; *Linton*, 136 F.3d at 546. However, the factors a court should consider in exercising its discretion have been subject to less extensive analysis. In *Anderson v. United States*, 520 F.2d 1027 (5th Cir. 1975), the Court said, "Before such permission is granted, the prospective plaintiffs must make out a prima facie case against the trustee." 520 F.2d at 1029. In *In re Kashani*, 190 B.R. 875 (9th Cir. B.A.P.1995), the Bankruptcy Appellate Panel held that even if a plaintiff successfully states a *prima facie* case, the Court may nevertheless exercise its discretion and refuse to grant the movant permission to sue in another forum if the Court finds that it is in a better position to adjudicate the claim based on a "balancing of the interests of all parties involved." *Kashani*, 190 B.R. at 886, citing *In re Adolf Gobel, Inc.*, 89 F.2d 171, 172 (2d Cir. 1937); see also *In re Kids Creek Partners, L.P.*, 2000 U.S. Dist. LEXIS 17718, at *17-18 (N.D. Ill. Nov. 29, 2000). In *In re Crown Vantage*, the Ninth Circuit cited *Kashini* with approval as having identified a series of factors for a court "to consider in exercising its discretion," including (i) whether the acts or transactions at issue "relate to the carrying on of the business connected with the property of the bankruptcy estate";

[3] A limited exception to this rule is provided in 28 U.S.C. § 959(a), which states that "[t]rustees, receivers or managers of any property, including debtors in possession, may be sued, without leave of the court appointing them, with respect to any of their acts or transactions in carrying on business connected with such property." Bergrin does not argue that this exception applies here and has in fact moved for permission to sue in accordance with the *Barton* doctrine.

(ii) whether the claims pertain to actions of the trustee while administering the estate"; (iii) whether "the claims involve the individual acting within the scope of his or her authority under the statute or orders of the bankruptcy court, so that the trusteee is entitled to quasi-judicial or derived judicial immunity"; (iv) whether movants are "seeking to surcharge the trustee, that is, seeking a judgment against the trustee personally"; and (v) whether "the claims involve the trustee's breaching her fiduciary duty either through negligent or willful misconduct." 421 F.3d at 976, citing *Kashani*, 190 B.R. at 886-87. The Circuit Court concluded that the existence of "one or more of these factors may be a basis for the bankruptcy court to retain jurisdiction over the claims." *Id*., quoting *Kashani*, 190 B.R. at 887.

Based on the foregoing authority, two questions must be answered in connection with Bergrin's motion. First, does Bergrin's proposed Complaint state a *prima facie* case against the Defendants, or would it be subject to dismissal for failure to state a claim? Second, if the Complaint does state a *prima facie* case, should the litigation proceed in the Federal courts rather than in the State court system?

I. Does the Complaint State a Claim for Malicious Prosecution?

The elements of a cause of action for malicious prosecution under New York law are (i) initiation or continuation of an action by the defendant that terminated in favor of the plaintiff; (ii) lack of probable cause for the prior action; and (iii) actual malice. *Colon v. City of New Yo*rk, 60 N.Y.2d 78, 455 N.E.2d 1248, 468 N.Y.S.2d 453 (1983); *Campion Funeral Home v. State of New York*, 166 A.D.2d 32, 569 N.Y.S.2d 518 (3d Dep't 1991), *lv. denied* 78 N.Y.2d 859, 580 N.E.2d 1058, 575 N.Y.S.2d 455 (1991).[4] If the prior action was a civil action, the plaintiff must also prove special damages resulting from such action. *Honzawa v. Honzawa*, 268 A.D.2d 327, 701 N.Y.S.2d 411 (1st Dep't 2000); *Ellman v. McCarty*, 70 A.D.2d 150, 420 N.Y.S.2d 237 (2d

[4] There is no dispute that New York law is applicable.

Dep't 1979); *Molinoff v. Sassower*, 99 A.D.2d 528, 471 N.Y.S.2d 312 (2d Dep't 1984); *Clark v. MacKay*, 97 A.D.2d 394, 467 N.Y.S.2d 217 (2d Dep't 1938). There is no question that Bergrin was sued in a civil action resolved in his favor. We consider the three remaining elements hereafter.

A. Probable Cause

"[P]robable cause is the knowledge of facts, actual or apparent, strong enough to justify a reasonable man in the belief that he has lawful grounds for prosecuting [an action] in the manner complained of." *New York State Props., Inc. v. Clark*, 183 A.D.2d 1003, 1006, 583 N.Y.S.2d 317, 320 (3d Dep't 1992), quoting *Burt v. Smith*, 181 N.Y. 1, 5, 73 N.E. 495, 496 (1905). For purposes of the rule in *Barton v. Barbour*, a claim that an estate representative brought an action without probable cause must be pled with particularity. See *Kids Creek Partners*, 2000 U.S. Dist. LEXIS 17718, at *7 ("prima facie" requires more than mere notice pleading on a motion for permission to sue); *In re Smith*, 2002 Bankr. LEXIS 1893, at *18 (Bankr. S.D. Ind. April 24, 2002) (to establish a *prima facie* case on motion for permission to sue, plaintiff is "required to plead facts with a reasonable degree of particularity which support, either directly or inferentially, the elements of the claims asserted").

Bergrin asserts that the Defendants did not have probable cause to bring or to prosecute the Adversary Proceeding because (i) the Debtor was solvent at the time of the Transfer and (ii) the Defendants had actual knowledge that the Funds paid to Bergrin were provided by Burke rather than the Debtor. On the issue of solvency, Bergrin's proposed Complaint relies on and attaches evidence demonstrating solvency, including the following: Arthur Andersen's "Client Profile" for the Debtor, dated February 10, 2000, that allegedly rated the Debtor's "Financial Health" as "Good" and its "Industry/Operations Risk" and "Accounting and Financial Reporting

Risk" as "Minimal"; the Debtor's consolidated financial statements for 2000, apparently reviewed by Arthur Andersen, that assertedly showed $33,974,714 in assets and $7,065,781 in liabilities; a presentation made by the Debtor to its board of advisors in January of 2000 that allegedly showed the Debtor to be in good financial health; and testimony of Burke and Eerie's former CFO, Warren Fite, at their respective depositions that they believed the Debtor to be solvent at the time of the Transfer. (Proposed Complaint, Ex. F, G, L). This includes evidence that Bergrin submitted to the District Court in connection with his successful motion for summary judgment. *Eerie World Entm't*, 2004 U.S. Dist. LEXIS 23882, at *7-8.

In its opposition to the motion, TNS&J asserts that it received financial information from the Debtor's CFO that showed the Debtor to be losing substantial sums of money and to be insolvent or on the verge of insolvency at the time of the Transfer. (Markowitz Aff., Ex. F). In addition, TNS&J attaches the affidavit of Stuart Fleischer, the accountant for the Creditors Committee, who provided his expert opinion that the Debtor was rendered insolvent by the Transfer.

Bergrin questions the credibility of the Fleischer Affidavit because the Trustee chose not to submit the affidavit when he filed his opposition to Bergrin's Summary Judgment Motion before the District Court. Although the record indicates that the Trustee reviewed the Fleischer Affidavit in making his determination to maintain the Adversary Proceeding (Gazes Aff., ¶¶ 5, 8), the Trustee only submitted the affidavit of his own accountant, Alan R. Barbee. Unlike the Fleischer Affidavit, the Barbee submission does not opine on insolvency but simply states that the financial statements submitted by Bergrin did not definitively establish solvency. Barbee based his conclusion on the fact that the financials submitted by Bergrin (i) were prepared on a consolidated basis and did not place a value on the Debtor's assets, which primarily consisted of

its membership interests in its affiliated entities, (ii) used historical values for the assets, which were not valid for the purposes of determining solvency, and (iii) did not take into account contingent liabilities. (Barbee Aff., ¶¶ 7, 8, 10).

The District Court found that the Barbee Affidavit was not sufficient to defeat the Summary Judgment Motion because it did not conclude that the Debtor was insolvent. *Eerie World Entm't,* 2004 U.S. Dist. LEXIS 23882, at *10. In granting Bergrin's Summary Judgment Motion, the District Court held that the Trustee, on pain of losing the motion, was obligated to put forward his case and produce evidence that the Debtor was insolvent, rather than simply proposing to produce such evidence in the context of a full valuation at trial. *Id.* at *10-12.

The record does not reflect the Trustee's reasons for not relying on the Fleischer Affidavit in his opposition to the Summary Judgment Motion, but an obvious justification is provided by a review of its contents. Fleischer states that he was asked to determine both whether the Debtor was insolvent at the time it made the payment to Bergrin and whether the Debtor was rendered insolvent by the payment to Bergrin. (Fleischer Aff., ¶ 5). His conclusion was that "the debtor was rendered insolvent by the Payment to Bergrin." (Fleischer Aff., ¶ 12). But he does not explain how the payment of $1,750,000 to Bergrin could have been the straw that caused the Debtor to become insolvent when that same sum had been, only a few days before, infused into the Debtor by its chairman.[5] In any event, TNS&J's reliance on the Fleischer Affidavit requires further explanation, and Bergrin's Complaint states a *prima facie* case against TNS&J on the issue of probable cause to sue.

The issues relating to probable cause are different with respect to the Trustee. He inherited a multifaced situation that, as discussed below under the issue of "actual malice," gave

[5] There is nothing in the record to indicate that Burke took the position that his payment was debt rather than equity; the record contains affidavits from Burke and Fite which indicate that the infusion was equity.

him virtually no choice other than to go forward with a lawsuit that was already pending. Under the circumstances, since Bergrin's failure to plead facts demonstrating actual malice is so clear, there is no need to reach the issue whether the Complaint states a *prima facie* case that the Trustee lacked probable cause to maintain the Adversary Proceeding against Bergrin.[6]

The issues are different with respect to Bergrin's claim that the Defendants lacked probable cause to file or maintain the Adversary Proceeding against him because the Funds paid to him were deposited by Burke a few days before the Transfer and were "earmarked" for buying back his interest in the Debtor. Bergrin charged in his motion for summary judgment before the District Court that the "earmarking" doctrine provided him with an absolute defense to a fraudulent transfer claim, and he again takes this position in his proposed Complaint.[7] The issues are not as clear as Bergrin insists. As the Defendants point out, the "earmarking" defense is a technical doctrine developed by the courts in preference cases where the allegedly preferential payment was made from funds of a third party that were clearly "earmarked" for transmittal to a transferee *and* where the funds never became subject to the control of the debtor. The key to the earmarking defense is the question of control. See *Coral Petroleum, Inc. v. Banque Paribas-London*, 797 F.2d 1351, 1356 (5th Cir. 1986); *Adams v. Anderson (In re Superior Stamp & Coin Co.)*, 223 F.3d 1004, 1009 (9th Cir. 2000); *In re Maxwell Newspapers*, 151 B.R. 63, 70 (Bankr. S.D.N.Y. 1993).

Bergrin has failed to provide adequate support for the proposition that the Debtor did not have control over the Funds when it made the payment to him. He recognizes the issue and has submitted an affidavit from Burke dated June 2, 2004 in which Burke avers that he had "strict

[6] In addition to the Chapter 7 Trustee and his law firms, Bergrin also proposes to sue Defendants Nachamie, a partner of TNS&J, and Wainer, a partner of Gazes & Associates, LLP and Gazes LLC. The Complaint fails to identify actionable acts on their part. This is not adequate pleading as to these defendants individually, and Bergrin has not stated a *prima facie* case against either of these defendants.

[7] In granting Bergrin summary judgment, the District Court did not reach this issue.

control over the funds at all times." (Proposed Complaint, Ex. D, Burke Aff., ¶ 3). This conclusory assertion, however, does not negate the fact that the Funds were channeled through the Debtor, that Burke was its chairman, and that the Defendants could have reasonably concluded that there was a fair justiciable issue as to control, assuming *arguendo* that the earmarking doctrine can be imported from preference law into fraudulent conveyance cases in general.[8] On this issue, it is clear on the face of the pleadings that the Defendants had probable cause to pursue a claim against Bergrin, notwithstanding the possibility that he might be able to prevail on an "earmarking" defense.

B. Actual Malice

Under New York law, a plaintiff in a malicious prosecution action must also prove that the defendant initiated or continued a prior action with actual malice, *i.e.*, that the defendant brought the prior action "due to a wrong or improper motive, something other than a desire to see the ends of justice served." *Scanlon v. Flynn*, 465 F.Supp. 32, 39 (S.D.N.Y. 1978), quoting *Nardelli v. Stamberg*, 44 N.Y.2d 500, 502, 406 N.Y.S.2d 443, 445, 377 N.E. 2d 975, 976 (1978). Bergrin asserts that TNS&J had three improper motives for commencing the Adversary Proceeding. First, TNS&J allegedly developed a close relationship with the Debtor's principals, who held a personal grudge against Bergrin. Second, TNS&J realized that the Adversary Proceeding was hurting Bergrin's business and therefore had some settlement value. Third, TNS&J allegedly used Bergrin as a scapegoat, pursuing the Adversary Proceeding as a way to show the Court and the Debtor's creditors that it was fulfilling its fiduciary duties where it had previously neglected such duties by allowing assets of the Debtor to be sold for below market

[8] Defendants also contend that there is no authority that has applied the "earmarking" doctrine in a fraudulent conveyance case, and Bergrin has cited none. It is obvious that Bergrin agreed to a form of transaction where Burke, the purchaser, funneled the funds through a corporation in order to satisfy certain contractual obligations. Bergrin received the benefit of the transaction but obviously took the risk that his payment would be considered property of the Debtor, with whatever consequences would flow from that fact.

value and had failed to pursue claims against the principals. (Pls. Mem. of Law, p. 4; Proposed Complaint, ¶¶ 41-43). As to the Trustee's alleged malice, Bergrin contends that the Trustee maintained TNS&J's "malicious prosecution" at the behest of the U.S. Trustee, who allegedly feared that a voluntary dismissal of the Adversary Proceeding would have exposed the U.S. Trustee to embarrassment and a probable lawsuit by Bergrin. (Proposed Complaint, ¶ 46). Bergrin asserts in his Complaint that his efforts to convince the Chapter 7 Trustee to drop the Adversary Proceeding were met with the following response from Gazes: "I don't care. The Office of the U.S. Trustee wants me to pursue the lawsuit against you, and that is what I am going to do." (Pls. Mem. of Law, p. 4; Proposed Complaint, ¶ 50).

The Complaint is clearly inadequate with respect to its allegations that the Trustee acted with malice. It is assumed for purpose of this motion that the Trustee made the statement attributed to him and that he was pursuing the Adversary Proceeding merely because the U.S. Trustee wanted him to do so. This is not adequate pleading of malice. The U.S. Trustee is appointed by the Attorney General as an administrator of the bankruptcy system and is charged with the general supervision of chapter 7 trustees. 28 U.S.C. § 586(a)(3). The Chapter 7 Trustee was new to the case and had an obligation to consider the position of the U.S. Trustee, who had been monitoring the Chapter 11 proceedings before the order of conversion. The U.S. Trustee's office was fulfilling a statutory duty if it advised Gazes to maintain the Adversary Proceeding, and the Trustee's compliance with that advice is not, in itself, any indication of malice. Bergrin does not adequately allege actual malice against the U.S. Trustee, assuming that the U.S. Trustee did recommend that the Chapter 7 trustee maintain the litigation.

Moreover, as the Second Circuit has stated, "all of the equities of the situation [have] to be taken into account." *Lehal Realty Assoc.*, 101 F.3d at 277. Bergrin admits that he "threatened

on numerous occasions to bring suit against the Office of the U.S. Trustee and several of its employees for not taking action to reprimand Mr. Markowitz and for refusing to put an end to the erroneous lawsuit that was brought against Bergrin." (Proposed Complaint, ¶ 48). In light of these threats by a *pro se* defendant, there can be no question that there was no malice in the Chapter 7 Trustee's determination to let the Court decide Bergrin's pending motion. The Trustee has put in evidence of a telephonic message that Bergrin left at his office as follows: "I am very upset that you are pursuing such a frivolous suit. You are conspiring with the Office of the United States Trustee. There is no question that you will regret this for the rest of your life as Mr. Markowitz is. You don't know who you are messing with." Under the circumstances, "[h]ad the Trustee not persevered in his defense, he would have risked breaking his duties to other creditors." *Kids Creek Partners*, 2000 U.S. Dist. LEXIS 17718, at *16.

The record is not as clear as to TNS&J on the issue of malice. As detailed in the Complaint, the District Court, on Bergrin's motion, disqualified TNS&J (defined in the District Court Opinion and Order as the Todtman, Nachamie firm and its partner, Scott Markowitz) from representing the Debtor as a result of the cumulative impact of three transactions that made "the impression of impropriety … unavoidable": (i) the firm's acceptance of a $130,000 payment from Burke to the exclusion of the Debtor's other creditors; (ii) the acceptance of a fee from a subsidiary; and (iii) the firm's failure to bring an adversary proceeding to seek recovery of a contractually prohibited severance payment. *Bergrin v. Eerie World Entm't, LLC*, 2003 U.S. Dist. LEXIS 18259, at *21. Obviously, the disqualification took place long after the firm had brought the Adversary Proceeding against Bergrin, and Bergrin does not claim that the firm acted with malice *because* he had engineered its disqualification. But he does allege malice in connection with certain of the same activities that caused the District Court to disqualify the

firm: a questionable relationship with Burke and a failure to carry out the firm's responsibilities in connection with an avoidance proceeding. Moreover, in analyzing the firm's role, the District Court clearly found that the firm had certain responsibilities of its own and that it could not rely on the instructions of its client, the Debtor, as a defense. Based on the record as a whole, and recognizing that the only issue at this time is the sufficiency of allegations, the proposed Complaint adequately pleads facts that, if established, would demonstrate an improper motive on the part of Defendants TNS&J and Markowitz.

C. Special Damages

The third element that must be pleaded in an action for malicious prosection in New York is special damages. New York courts have defined special damages as injury or interference with the plaintiff's person, property or business that entails "some concrete harm that is considerably more cumbersome than the physical, psychological, or financial demands of defending a lawsuit." *Engel v. CBS, Inc.*, 93 N.Y.2d 195, 205, 711 N.E.2d 626, 631, 689 N.Y.S.2d 411, 417 (1999). Special damages must exceed "the damages normally attendant upon being sued." *Honzawa*, 268 A.D.2d at 329; see also *Campion Funeral Home*, 569 N.Y.S.2d at 521. Cases in New York hold that where the prior action is civil rather than criminal, the complaint must allege special damages in the form of "[s]ome interference with plaintiff's person or property, for example, by way of some remedy such as attachment, arrest or injunction." *Molinoff*, 99 A.D.2d at 529.

Bergrin claims damages and special damages resulting from the loss of his ability to operate his "once successful Investment Banking business" and the consequent loss of income during the entire period the Adversary Proceeding was pending. (Proposed Complaint, ¶ 55). He asserts there were "numerous situations where he had to disclose to his clients and to his

financing sources that he was being accused of receiving a fraudulent transfer of funds. In every single case, either his financing sources or his clients, stated that they were not interested in doing business with him until it was proven that Bergrin was found to be not guilty of receiving a fraudulent transfer." (Proposed Complaint, ¶ 58). The Complaint specifies one business opportunity, in 2001, that Bergrin claims he lost because of the pendency of the lawsuit against him. (Proposed Complaint, ¶¶ 56-57). New York law recognizes loss of business as a special injury in a case for malicious prosecution. *Dudick v. Gulyas*, 277 A.D.2d 686, 688, 716 N.Y.S.2d 407, 410 (3rd Dep't 2000) (chiropractor's loss of business was special injury resulting from disciplinary action brought by defendant); see also *Engel*, 182 F.3d at 132 ("we can forsee specific, verifiable loss of business providing the necessary grievance").

A motion to dismiss cannot test the credibility of Bergrin's claims.[9] As a matter of pleading against TNS&J and Markowitz, Bergrin has made out a *prima facie* case that his loss of business, and specifically his loss of business from Structured Capital Corporation, was a special injury that was the direct result of the initiation and prosecution of the Adversary Proceeding.[10] However, the loss of one business opportunity in 2001 cannot constitute adequate pleading of special damages against the Trustee, who was not appointed until 2003. Bergrin attempts to cure this default in a reply affidavit, in which he asserts the loss of a specific business opportunity at just the time of the Trustee's appointment. Nevertheless, reference in a reply affidavit does not

[9] Bergrin was a defendant in an action seeking recovery of a constructive fraudulent conveyance, a cause of action which is based on a transfer for less than fair consideration at a time when the transferor was insolvent or was rendered insolvent by the transfer. Although this type of suit is characterized as an action for "fraudulent" conveyance, the defendant is not being accused of fraud and the term fraudulent is "inapposite" at best. *In re Young*, 82 F.3d 1407, 1414 (8th Cir. 1996). Cases recognize that the plaintiff does not even have to plead with particularity because "fraudulent" conduct is not at issue. See *In re White Metal Rolling and Stamping Corp.*, 222 B.R. 417, 428-29 (Bankr. S.D.N.Y. 1998); see also *SIPC v. Stratton Oakmont, Inc.*, 234 B.R. 293, 319 (Bankr. S.D.N.Y. 1998); *China Resource Prods. (USA), Ltd. v. Fayda Int'l, Inc.*, 788 F. Supp. 815, 819 (D. Del. 1992).

[10] Bergrin also alleges damages in the form of attorney's fees, legal expenses, harm to reputation and emotional damage and mental stress. These cannot be considered special damages under New York law. See *Engel*, 689 N.Y.S.2d at 417-18; *Campion Funeral*, 569 N.Y.S.2d at 521.

constitute adequate pleading in a complaint. See *Wright v. Ernst & Young LLP*, 152 F.3d 169, 178 (2d Cir. 1998).

II. Does the Complaint State a Claim Under New York Judiciary Law § 487?

Bergrin alleges a second claim for relief against certain of the Defendants[11] under New York Judiciary Law § 487, which provides in pertinent part:

> An attorney or counselor who:
>
> 1. Is guilty of any deceit or collusion, or consents to any deceit or collusion, with intent to deceive the court or any party; or,
>
> 2. Wilfully delays his client's suit with a view to his own gain; or, wilfully receives any money or allowance for or on account of any money which he has not laid out, or becomes answerable for,
>
> Is guilty of a misdemeanor, and in addition to the punishment prescribed therefor by the penal law, he forfeits to the party injured treble damages, to be recovered in a civil action.

N.Y. Jud. Law § 487.

Bergrin argues that the Defendants violated Judiciary Law § 487 by colluding and deceiving Bergrin, this Court, the District Court, the Debtor and other interested parties with regard to the merits and motivation of the Adversary Proceeding. In an effort to establish the Defendants' alleged misconduct under Judiciary Law § 487, Bergrin relies on the same allegations raised in connection with his claim for malicious prosecution. To these charges, Bergrin adds the claim that the Defendants concealed their true motivations for bringing and prosecuting the Adversary Proceeding and misrepresented the merits of the case when they "knew" that the Transfer did not constitute a fraudulent conveyance.

Nevertheless, the Complaint is devoid of any allegation that Bergrin, this Court, the District Court or any other party relied on or was actually deceived by the Defendants' alleged

[11] This claim is brought against all of the Defendants except Wainer.

misrepresentations. Pleading that someone actually relied on and was deceived by the alleged misrepresentations made by the Defendants is required to establish liability under Judiciary Law § 487. See *New York City Transit Auth. v. Morris J. Eisen, P.C.*, 276 A.D.2d 78, 86, 715 N.Y.S.2d 232, 238 (1st Dep't 2000); see also *Werner v. Katal Country Club*, 234 A.D.2d 659, 663, 650 N.Y.S.2d 866, 869 (3d Dep't 1996). Indeed, as the Trustee notes, the District Court would have denied the Summary Judgment Motion if it had in fact been deceived. (Gazes Mem. of Law, p. 11). Bergrin has not made out a *prima facie* case for his claim under Judiciary Law § 487, and his motion to bring a State action against the Defendants on this ground must be denied.

III. Leave to File in State Court

As discussed above, a bankruptcy court may, in its discretion, deny a motion to pursue an action in another forum, despite a *prima facie* showing of the underlying claims, if the court determines that it is in a better position based on a "balancing of the interests of all parties involved." *Kashani*, 190 B.R. at 886, cited with approval in *Crown Vantage, Inc.*, 421 F.3d at 976; see also *Kids Creek Partners*, 2000 U.S. Dist. LEXIS 17718, at *17-18. In determining whether to retain jurisdiction, courts consider the following factors, any of which may serve as a basis for denial of a motion for leave to sue in another court:

1. whether the acts or transactions relate to the carrying on of the business connected with the property of the bankruptcy estate;

2. whether the claims pertain to actions of the trustee while administering the estate;

3. whether the claims involve the individual acting within the scope of his or her authority under the statute or orders of the bankruptcy court, so that the trusteee is entitled to quasi-judicial or derived judicial immunity;

4. whether the movants or proposed plaintiffs are seeking to surcharge the trustee, that is, seeking a judgment against the trustee personally; and

5. whether the claims involve the trustee's breaching her fiduciary duty either through negligent or willful misconduct.

Kashani, 190 B.R. at 886-87; see also *Crown Vantage*, 421 F.3d at 976.

Several of these factors militate in favor of retaining the case in the Bankruptcy Court. The claims pertain to actions of the trustee (or, in this case, attorneys representing the debtor in possession) while administering the estate (factor 2). To the extent these defendants claim only against the estate, the claims will directly impact the administration of the bankruptcy proceedings.[12] The claims indirectly involve charges that there was a breach of fiduciary duty and conflict of interest that impact the issues raised in the charge of malicious prosecution (factor 5).

In *In re Lehal Realty Assoc.*, the Second Circuit affirmed an order of the District Court that had reversed a Bankruptcy Court's decision and had enjoined a State action against a Chapter 11 trustee. The Court emphasized that in a case like the present one, "institutional concerns … are weighty." 101 F.3d at 277. In *Lehal*, the core of the State action was negligence, a traditional State concern, but the Circuit Court found that, based on "all of the equities of the situation," the case should be enjoined. *Id*. See also *Beck Indus.*, 725 F.2d at 889-90, where the court on equitable grounds refused to require a trustee to be subject to punitive damage claims in a California court. Taking all of the equities of this case into account, the Court retains jurisdiction over Bergrin's claim against TNS&J and Markowitz for malicious prosecution and leave to bring this claim in State court is denied.

[12] It cannot be ignored that TNS&J and Markowitz were lawyers, and they may argue that they were bound to follow the reasonable instructions of their client, the Debtor. Their responsibility vis-à-vis the responsibility of their client is not dealt with at this point in the proceedings.

Conclusion

For the reasons set forth above, Bergrin's motion to bring a State action is denied. Bergrin has pleaded a *prima facie* case of malicious prosecution only against TNS&J and Scott S. Markowitz and is granted leave to pursue this claim against such defendants by bringing an appropriate adversary proceeding in this Court. The Trustee is directed to settle an appropriate order on five days' notice.[13]

Dated: New York, New York
April 28, 2006

/s/ Allan L. Gropper
UNITED STATES BANKRUPTCY JUDGE

[13] This case was referred to the undersigned judge after the retirement of Judge Blackshear and before the appointment of his successor, Judge Peck. After entry of the order referred to above, further proceedings in this Chapter 7 case will be heard by Judge Peck.