Filed 6/12/17 Shawbeth, Inc. v. Diversified Funding CA2/7

NOT TO BE PUBLISHED IN THE OFFICIAL REPORTS

IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

SECOND APPELLATE DISTRICT

DIVISION SEVEN

SHAWBETH, INC., Plaintiff and Appellant, v. DIVERSIFIED FUNDING, INC. et al., Defendants and Respondents.	B264006 (Los Angeles County Super. Ct. No. BC490642)

APPEAL from a judgment of the Superior Court of Los Angeles County, Mitchell L. Beckloff, Judge. Affirmed.

Robertson & Associates and Robert Nation for Plaintiff and Appellant.

Mark B. Simpkins for Defendants and Respondents.

INTRODUCTION

Shawbeth, Inc. appeals from the judgment entered against it after a court trial on its cause of action for conversion and request for imposition of a constructive trust. Shawbeth sued Diversified Funding, Inc. and Oralabs, Inc. (collectively, Diversified) to recover $420,595 Shawbeth had put into an escrow account but never got back. Shawbeth alleged that, after it deposited the funds into escrow, the escrow agent, Karen Gardner at First National Escrow (FNE), transferred the funds first to a different escrow account and then to Diversified, all without Shawbeth's authorization or consent. The trial court found that, because Shawbeth did not meet its burden of proving that Diversified owned or possessed property of Shawbeth, Shawbeth's conversion and constructive trust causes of action failed. Because the evidence does not compel a finding in favor of Shawbeth as a matter of law, we affirm.

FACTUAL AND PROCEDURAL BACKGROUND

A. *Shawbeth and Diversified Transfer Money into a Commingled Trust Account*

Shawbeth transferred $1,518,203.79 into escrow for the purchase of five single-family homes. The money went into FNE's trust account at City National Bank. FNE used the same commingled trust account for all transactions for which FNE was the escrow company, and deposited and withdrew all funds into and out of the same commingled account. Whenever money was transferred in connection with a particular escrow, FNE followed the following procedure: "With the aid of a computer program, a[n] FNE escrow officer would note each deposit made into the

commingled Trust Account for a particular transaction and each payment made from the Trust Account for a particular transaction. This accounting process would create an accounting for each transaction, i.e. each Escrow Number, with each accounting representing to whom commingled funds in the Trust Account belonged."

FNE credited Shawbeth's money to escrow number 10808, which was the second half of what was supposed to be a double escrow transaction. The seller with whom Shawbeth contracted to buy the properties, Bianca Malekzadeh, did not yet own the properties she had contracted to sell to Shawbeth; she was planning to buy those properties, and the two transactions were scheduled to close concurrently. The FNE escrow number for the first half of the double escrow transaction was 10807. In that transaction, Malekzadeh was the buyer and Lifeway Capital Group was the seller.

But before Lifeway could sell the properties to Malekzadeh, it had to buy them from something called Selene RMOF REO Acquisitions II, LLC. That transaction (with Lifeway as the buyer) was assigned FNE escrow number 10778. Diversified agreed to loan Lifeway $400,000 in bridge financing to purchase those properties, and "Oralabs invested money with Diversified for this purpose." Diversified wired $400,000 to FNE's commingled trust account, and Gardner credited it to escrow number 10778.

B. *When the Transactions Do Not Close, Diversified Gets Its Money Back, but Shawbeth Does Not*

Diversified's closing instructions for escrow, which Gardner signed, provided that, if the Selene-Lifeway transaction (escrow

number 10778) and the Lifeway-Malekzadeh transaction (escrow number 10807) did not both close within three days, Gardner had to return the $400,000 to Diversified. The two transactions were supposed to close simultaneously, and Gardner was only supposed to disburse the $400,000 "when all pertinent closing documents are signed for the closing by all parties to [escrow number 10778], and when all documents are fully signed by all parties to [escrow number 10807]." If escrow number 10807 (the Lifeway-Malekzadeh transaction) closed as anticipated, Diversified would receive $410,297.50 and another company, Coastal Funding LLC, would receive a $10,297.50 referral fee.

But two weeks after Diversified wired its money to FNE, the transactions had not closed, and Diversified had not received its $400,000 back. Counsel for Diversified sent a demand letter detailing Gardner's malfeasance: Gardner did not comply with the escrow instructions (because she had not returned Diversified's money), was nonresponsive, represented that some of the money "had been used for another closing," and falsely stated she was going to wire Diversified the money. The demand letter from Diversified threatened to file a claim with FNE's insurance company and to "commence legal action" if FNE did not return the "funds, plus fees" by the following day.

And so the next day Gardner transferred $420,595 from FNE's trust account to Diversified. Gardner accounted for the $420,595 as having come from escrow number 10807. Her records reflected that the principals of escrow number 10807 had authorized the transfer "and [Lifeway's] demand for cash at the close of escrow [was] reduced accordingly." As a result of Gardner's dubious accounting, Lifeway effectively "repaid"

Diversified's loan, plus fees, before the Lifeway-Malekzadeh transaction (escrow number 10807) closed.

But so meanwhile Gardner credited $1,303,047 of Shawbeth's money to Malekzadeh (in escrow number 10807), despite the fact that the Shawbeth-Malekzadeh transaction (escrow number 10808) had not yet closed. The only money Gardner had credited to escrow number 10807 when she refunded Diversified's loan was Shawbeth's money. Therefore, if Gardner's records accurately reflected the transfer(s) of money, it appeared as if Gardner had transferred Shawbeth's money to Malekzadeh, who loaned that money to Lifeway to repay Diversified. Gardner continued to credit and debit money from the three escrow accounts, allowing the balances associated with escrow numbers 10807 and 10778 to fall below $0, in violation of applicable law.[1]

And so six months later Shawbeth sought to cancel escrow number 10808. By that point, Shawbeth had closed on two of the original five properties, and had received a refund for one of the properties Shawbeth and Malekzadeh had agreed to remove from the deal. A Housing and Urban Development (HUD) Form 1 Final Settlement Statement reflected that, after the transfer of the two properties and the refund for the third, Shawbeth was

---

[1] Although "[a] bank may charge against the account of a customer an item that is properly payable from that account even though the charge creates an overdraft" (Com. Code, § 4401, subd. (a)), "[a]n escrow agent shall not withdraw, pay out, or transfer monies from any particular escrow account in excess of the amount to the credit of such account at the time of such withdrawal, payment, or transfer" (Cal. Code Regs., tit. 10, § 1738.1).

entitled to receive $497,235.38 from escrow.[2] But by this point FNE was only two months away from bankruptcy. Shawbeth ultimately received only $10,978 back from escrow.

C. *Shawbeth Obtains a Default Judgment Against Gardner and a Partial Recovery from the Bankruptcy Estate of FNE*

Shawbeth sued FNE, its president, and Gardner for breach of fiduciary duty and conversion. One month later, FNE filed a Chapter 7 bankruptcy petition in the United States Bankruptcy Court. Shawbeth made a claim in the bankruptcy court for $526,203.77 and ultimately recovered $265,336.34. Shawbeth also obtained a default judgment against Gardner for $1,024,835.48.[3]

Diversified also filed a complaint against Gardner with the Department of Corporations, which prosecuted Gardner in an administrative proceeding. The Department ultimately barred Gardner for life from employment in the escrow field. According

---

[2] At trial, Shawbeth conceded that this HUD statement, which Gardner prepared, was not entirely accurate.

[3] Diversified argues Shawbeth's claim against Diversified is barred because Shawbeth "prosecuted a previous lawsuit to judgment against FNE and Gardner based upon the same primary rights." The primary rights doctrine, however, only applies to "a second suit between the same parties." (*Boeken v. Philip Morris USA, Inc.* (2010) 48 Cal.4th 788, 792.) A plaintiff may sue in separate actions parties who are jointly and severally liable, and a "'claim against *others* who are liable for the same harm is regarded as separate.'" (*DKN Holdings LLC v. Faerber* (2015) 61 Cal.4th 813, 822.)

to the Department, FNE's bank records did not match Gardner's escrow records.

D. *Shawbeth Sues Diversified and Loses*

A year after obtaining its default judgment against Gardner, Shawbeth filed this action. Shawbeth alleged that "[t]his action involves 'lapping', a form of a Ponzi scheme, facilitated by Karen Gardner . . . who . . . illegally diverted [Shawbeth's] money," and that "[t]he entire scheme collapsed when there was not enough money left in the escrow trust account to close all of the legitimate escrows due to the embezzlement and illegal disbursement of funds by Gardner to her co-conspirators." Although the complaint included various parties and claims, by the time of trial Shawbeth was the only plaintiff, Diversified and Oralabs were the only defendants, and conversion and constructive trust were the only causes of action.

The case proceeded to a court trial. Although (or perhaps because) Gardner did not testify, her accounting records and their admissibility were significant issues at the trial. Diversified argued that Gardner's escrow records were inadmissible because "[t]he entire goal of Gardner's scheme was deception[,] not to properly and accurately record the malfeasance," and therefore Shawbeth "cannot establish the trustworthiness of the records." Shawbeth argued Gardner's records were admissible because "the entries on the records constitute 'verbal acts' whereby the personnel at FNE actually changed the character of funds," and the records were reliable because, "[a]lthough Ms. Gardner performed unauthorized and

probably criminal acts in her work at FNE, those acts are reflected in the records of the Escrow."

The trial court expressed its concern over the admissibility of Gardner's accounting records: "If it's correct that you have been painting the person who is making [the] records with a fraudulent brush, then I'm not so sure that you're going to be able to get them admitted into evidence." Counsel for Shawbeth initially argued the court's concern went "to weight, not to admissibility." Counsel for Shawbeth subsequently argued that, because Gardner's records had "an effect in the escrow account [that] empowers other people . . . to then have control of that money," the act of making an entry in the computer program "actually effectuates the transfer."

The court concluded Gardner's records were admissible, but ultimately determined they were not credible. The court ruled in its statement of decision: "On the whole, the evidence provided is inadequate to find that [Diversified was] paid with [Shawbeth's] funds." The court found "the statements [Gardner's records] themselves demonstrate their lack of reliability and show transactions that would be impossible given the attributed balance on the accounting statements," and, "given Ms. Gardner's malfeasance and her clear ethical violations, the accuracy of any document she created is questionable." Reviewing the evidence admitted with respect to the single, commingled account, the court could not find that Diversified was paid with Shawbeth's money.

The court entered judgment for Diversified. Shawbeth timely appealed.

DISCUSSION

A. *Applicable Law and Standard of Review*

"""""Conversion is the wrongful exercise of dominion over the property of another. The elements of a conversion claim are: (1) the plaintiff's ownership or right to possession of the property; (2) the defendant's conversion by a wrongful act or disposition of property rights; and (3) damages."""""" (*Applied Medical Corporation v. Thomas* (2017) 10 Cal.App.5th 927, 936.) "[T]o establish a conversion claim, a "'plaintiff must establish an actual interference with his ownership or right of possession."'" (*AmerUS Life Ins. Co. v. Bank of America, N.A.* (2006) 143 Cal.App.4th 631, 641, emphasis omitted.) "Money may be the subject of conversion if the claim involves a specific, identifiable sum; it is not necessary that each coin or bill be earmarked." (*Welco Electronics, Inc. v. Mora* (2014) 223 Cal.App.4th 202, 209.) "California cases permitting an action for conversion of money typically involve those who have misappropriated, commingled, or misapplied specific funds held for the benefit of others." (*PCO, Inc. v. Christensen, Miller, Fink, Jacobs, Glaser, Weil & Shapiro, LLP* (2007) 150 Cal.App.4th 384, 396.)

When a plaintiff alleges a cause of action but fails to prove it, the standard of review on appeal is not, as the parties suggest, whether substantial evidence supports the judgment. (See *Dreyer's Grand Ice Cream, Inc. v. County of Kern* (2013) 218 Cal.App.4th 828, 838.) "On appeal from a determination of failure of proof at trial, the question for the reviewing court is 'whether the evidence compels a finding in favor of the appellant as a matter of law.'" (*Almanor Lakeside Villas Owners Association v. Carson* (2016) 246 Cal.App.4th 761, 769.)

"'Specifically, the question becomes whether the appellant's evidence was (1) "uncontradicted and unimpeached" and (2) "of such a character and weight as to leave no room for a judicial determination that it was insufficient to support a finding."'" (*Dreyer's Grand Ice Cream, Inc.*, at p. 838; accord, *Atkins v. City of Los Angeles* (2017) 8 Cal.App.5th 696, 734.) "Where, as here, the judgment is against the party who has the burden of proof, it is almost impossible for him to prevail on appeal by arguing the evidence compels a judgment in his favor. That is because unless the trial court makes specific findings of fact in favor of the losing plaintiff, we presume the trial court found the plaintiff's evidence lacks sufficient weight and credibility to carry the burden of proof. [Citations.] We have no power on appeal to judge the credibility of witnesses or to reweigh the evidence." (*Bookout v. State of California ex rel. Dept. of Transportation* (2010) 186 Cal.App.4th 1478, 1486.)

B. *The Evidence Does Not Compel a Finding in Shawbeth's Favor*

All of the funds in FNE's escrow accounts were deposited into one, commingled bank account. Thus, in order for Shawbeth to show that Diversified received Shawbeth's money (and not money belonging to Diversified or another escrow client), Shawbeth had to trace the money it claimed Diversified converted. (See *ITT Commercial Finance Corp. v. Tech Power, Inc.* (1996) 43 Cal.App.4th 1551, 1557 ["'"in certain special circumstances, a secured party may trace 'identifiable proceeds' through a commingled bank account and into the hands of a recipient who lacks the right to keep them"'"]; *Chrysler Credit Corp. v. Superior Court* (1993) 17 Cal.App.4th 1303, 1312-1313

[where, after bankruptcy, "a debtor wrongfully commingles . . . funds" of secured and unsecured creditors, the unsecured creditors must trace the funds]; see also *Cunningham v. Brown* (1924) 265 U.S. 1, 11 [investors in Charles Ponzi's scheme failed to trace their money].)[4] Even where accounting records reflect transfers of funds, if the funds are commingled a plaintiff seeking to recover specific money must trace its funds through the commingled account. (See *In re Catholic Diocese of Wilmington, Inc.* (Bankr. D. Del. 2010) 432 B.R. 135, 150 [because an "accounting system may serve to divvy out the pieces of the pie, but the pieces are all in one dish," investors who seek to recover outside bankruptcy "must identify and trace their piece of pie"].)[5]

---

[4] Whether a particular method of tracing funds is acceptable depends on the type of funds that the commingler (usually a debtor, trustee, spouse, or attorney) has commingled. For example, where "'a secured party's proceeds are commingled in a general bank account,'" "'a presumption arises that general payments are first made from general funds and that the security interest is only eroded as the balance in the account drops below the amount of proceeds deposited.'" (*ITT Commercial Finance Corp. v. Tech Power, Inc.*, *supra*, 43 Cal.App.4th at p. 1558.) This is the "lowest intermediate balance rule." (*Ibid.*) In marriage dissolution cases, a commingled account is one that contains both "separate and community funds," and a party to a dissolution proceeding may use bank account statements to trace funds through the commingled account. (See *In re Marriage of Ficke* (2013) 217 Cal.App.4th 10, 25, 27.)

[5] In *In re Catholic Diocese of Wilmington, Inc.*, the bankruptcy court found that investors' funds were commingled with the debtor's funds in one investment account, noting that "*the accounting sub-funds are not actual, separate bank accounts*.

In order to trace its money to Diversified, Shawbeth relied exclusively on Gardner's escrow records. The trial court, however, found that those records were unreliable. (See, e.g., *In re Mark Benskin & Co., Inc.* (Bankr. W.D. Tenn. 1991) 135 B.R. 825, 827, 834 [in tracing money from a commingled investment account, the court relied on bank records, rather than crediting the "fictitious" statements the ponzi-scheme debtor created for his individual investors].) We must accept the trial court's credibility determination. (See *Thompson v. Asimos* (2016) 6 Cal.App.5th 970, 981 ["[i]t is not our role as a reviewing court to reweigh the evidence or to assess witness credibility"]; *Bookout v. State of California ex rel. Dept. of Transportation*, *supra*, 186 Cal.App.4th at p. 1486 [same].)

Shawbeth argues that, "[i]n addition to being trustworthy and reliable for their hearsay value, FNE's escrow records relied upon by [Shawbeth] also constitute non-hearsay verbal acts." According to Shawbeth, "Verbal acts constitute a well-established exception or departure from the hearsay rule in cases where the very act in controversy is whether certain things were said or done, not whether these things were true or false. In such cases, the words or acts are admissible not as hearsay but as original evidence. . . . In these situations, the words themselves, written or oral, are 'operative facts.'" Shawbeth gives an example:

Rather, they are an accounting method by which the money in the 12 separate sub-accounts . . . are earmarked for the participants in the pooled investment program." (*In re Catholic Diocese of Wilmington, Inc.*, *supra*, 432 B.R. at p. 150.) The court ruled that the investors had failed to trace funds that were transferred only "by an accounting entry" from one account to another. (*Id.* at p. 158.)

"Checks fall squarely in this category of legally-operative verbal acts that are not barred by the hearsay rule."

Shawbeth confuses admissibility with credibility. Shawbeth is essentially arguing that, once the court admits accounting documents, the court must accept them as true. For example, Shawbeth cites *Spurlock v. C.I.R.* (2003) 85 T.C.M. (CCH) 1236, which states that "[a] check is . . . a legally operative document, and falls within the category of 'verbal acts' which are excludable from the hearsay rule." (*Id.* at p. 4.) True enough. But if a party presents evidence the bank that allegedly cashed the check acted fraudulently, the trier of fact may choose not to credit the (non-hearsay, admissible) evidence of the check and find that no money actually transferred from one account to another. (See *Acme Paper Co. v. Goffstein* (1954) 125 Cal.App.2d 175, 179 [a cashed check was evidence of conversion because the defendant signed the name of the intended beneficiary of the check, cashed the check, and kept the proceeds].) Similarly, an escrow agent's records may reflect a payment from one escrow account to a bank account, but the escrow company's bank records may nevertheless show that no money ever transferred. Indeed, the Department of Corporations alleged just such impropriety in its administrative action against Gardner.

Therefore, we reject Shawbeth's arguments that an escrow officer's accounting records are per se accurate and the trial court had to find them credible. Nor can we adopt Shawbeth's contention that the evidence established as a matter of law "that entries on the escrow records of FNE did not merely provide a contemporaneous recording of events, but actually transferred control over the funds from the principals of one escrow to the principals of another escrow." Under Shawbeth's theory, the trier

of fact would have to accept the escrow agent's records as true despite their inaccuracy. To be sure, there may be cases where a plaintiff can use reliable escrow records to trace funds in a commingled escrow account to prove conversion. Because the trial court found Gardner's escrow records were not reliable, however, this is not that case. Shawbeth's evidence was not "uncontradicted and unimpeached" nor was it "of such a character and weight as to leave no room for a judicial determination that it was insufficient to support a finding." (*Dreyer's Grand Ice Cream, Inc.*, *supra*, 218 Cal.App.4th at p. 838.)

The cases Shawbeth cites are distinguishable. Except for *United States v. Arteaga* (9th Cir. 1997) 117 F.3d 388, they involve the admissibility of evidence, not the credibility or weight of evidence.[6] (See, e.g., *Stuart v. UNUM Life Ins. Co. of America* (9th Cir. 2000) 217 F.3d 1145, 1154 [an insurance policy is "excluded from the definition of hearsay and is admissible evidence because it is a legally operative document that defines the rights and liabilities of the parties"]; *Spurlock v. C.I.R.*, *supra*, 85 T.C.M. (CCH) 1236, at p. 5 [checks are admissible under the Federal Rules of Evidence].) Here, the trial court found that Gardner made the escrow records (and admitted them into evidence), but the court did not credit them because Gardner's accounting entries were suspicious and her conduct was fraudulent.[7] Nothing in the cases cited by Shawbeth

---

[6] *Arteaga* involved neither admissibility nor weight of the evidence.

[7] Shawbeth argues that, because the conversion was "complete" when Diversified received its refund, the court erred

suggests that a court must accept the truth of accounting documents admitted into evidence.

Finally, because the evidence does not compel a finding in Shawbeth's favor on its conversion cause of action, the trial court properly entered judgment against Shawbeth on its request for imposition of a constructive trust. "A constructive trust is not a true trust but an equitable remedy available to a plaintiff seeking the recovery of specific property in a number of widely differing situations." (5 Witkin, Cal. Procedure (5th ed. 2008) Pleading, § 840, p. 255.) Shawbeth's claim for a constructive trust was based on its conversion cause of action, which Shawbeth failed to prove.

DISPOSITION

The judgment is affirmed. Diversified is to recover its costs on appeal.

SEGAL, J.

We concur:

ZELON, Acting P. J. SMALL, J. *

---

by looking at any of Gardner's accounting records that post-dated the refund. Shawbeth does not explain why entries relating to "subsequent events" are not relevant to whether "the escrow records were unreliable."

*Judge of the Los Angeles Superior Court, assigned by the Chief Justice pursuant to article VI, section 6 of the California Constitution.