**UNITED STATES BANKRUPTCY COURT**

**CENTRAL DISTRICT OF CALIFORNIA**

**LOS ANGELES DIVISION**

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| In re<br>**DAVID A. WILSON**,<br>Debtor. | Case No. 2:12-bk-16195-RK<br>Chapter 7<br>Adv. No. 2:12-ap-01317-RK |
| **THOMAS I. MCKNEW, IV and LISA A. MCKNEW, individually and as Trustees of the MCKNEW FAMILY TRUST DATED MAY 21, 2004,**<br>Plaintiffs,<br>vs.<br>**DAVID A. WILSON,**<br>Defendant. | **MEMORANDUM DECISION ON ADVERSARY COMPLAINT FOR NONDISCHARGEABILITY OF DEBTS** |

This adversary proceeding came on for trial before the undersigned United States Bankruptcy Judge on February 2, 2012, February 3, 2012, February 6, 2012, August 30, 2012, August 31, 2012, and September 6, 2012, on the complaint of plaintiffs Thomas I. McKnew IV and Lisa A. McKnew, individually and as Trustees of the McKnew Family Trust dated May 21, 2004 ("Plaintiffs"), to determine dischargeability of debts of debtor David A. Wilson ("Wilson" or "Defendant") pursuant to 11 U.S.C. §§ 523(a)(2), (4), and (6)

(the "Complaint"). Appearances were as noted on the record. After the close of evidence, the parties submitted post-trial briefs and proposed findings of fact and conclusions of law. The court took the matter under submission on March 7, 2013 after the last post-trial brief was filed.

Having considered the testimony of witnesses offered by both written declarations and oral testimony and the documentary evidence admitted into evidence, and the arguments of counsel made in the parties' briefs and during trial, the court hereby makes the following findings of fact and conclusions of law pursuant to Federal Rules of Civil Procedure 52(a), Federal Rules of Bankruptcy Procedure 7052 and 9014, and Local Bankruptcy Rule 7052-1.

**BACKGROUND**

David Wilson ("Wilson") and his wife Beata Wilson ("Beata") were married in 1985. *Joint Pretrial Order ("JPTO")* (AP Docket No. 118) at 5, ¶ 32. Beata is not a debtor in this bankruptcy case. *JPTO* at 5, ¶ 33. For all times relevant hereto, Wilson and Beata resided at 24352 Santa Clara, Dana Point, California (the "Residence"). The Wilsons still live in the Residence. *JPTO* at 4, ¶ 22, and 8, ¶ 57.

Thomas McKnew ("McKnew") is a licensed California loan broker who specializes in helping borrowers find capital for commercial real estate projects. *JPTO* at 4, ¶ 20; *Trial Testimony of Thomas McKnew*, February 3, 2012 at 10:49 a.m. McKnew first obtained his California broker's license in 1999 or 2000. *Trial Testimony of Thomas McKnew*, February 3, 2012 at 10:46 a.m.

On June 21, 2005, Parkside Ventures, LLC ("Parkside") was formed. *JPTO* at 4, ¶ 24. Parkside is a California limited liability company engaged in the conversion of a 120-unit apartment building located at 23925 Bay Avenue, Moreno Valley, California (the "Parkside Property") into condominiums for resale to the general public, as well as the development of an additional 28 units on the same property (the "Parkside Project"). *Amended Trial Declaration of Thomas McKnew, dated January 27, 2012 ("Amended Trial Declaration of Thomas McKnew")* at 2, ¶ 6; *Trial Declaration of Nikita (Nick) Volk, dated*

*September 22, 2009 ("Trial Declaration of Nick Volk")* at 2, ¶ 2. For all times relevant hereto, Wilson was one of the co-managing members of Parkside. *JPTO* at 7, ¶ 38.

Parkside purchased the Parkside Property through an acquisition loan from China Trust Bank (the "China Trust Loan"). *Trial Declaration of David Wilson, dated January 26, 2012 ("Trial Declaration of David Wilson")* at 2, ¶ 4. The China Trust Loan had a relatively short term (there is conflicting testimony that the term was either (12) months, or eighteen (18) months with a six (6) month extension, but this conflict is not material to this dispute). *Trial Declaration of David Wilson* at 2, ¶ 5 (12 months); *Trial Testimony of David Wilson*, August 30, 2012 at 9:23 a.m. (18 months with 6 month extension).

The Parkside Property was encumbered with two liens. China Trust Bank held a first priority deed of trust securing the China Trust Loan in the amount of $8,697,217. Bridge Capital, LLC ("Bridge Capital") held a second priority deed of trust securing a mezzanine loan in the amount of $8,662,225 (the "Bridge Capital Loan"). *See JPTO* at 2, ¶¶ 6-7 (amount of the loans); *Amended Trial Declaration of Thomas McKnew* at 2. ¶ 7 (priority of the liens). The Bridge Capital Loan was also secured by (i) a junior lien on the Residence; and (ii) a junior lien on an office building owned by Wilson and located at 34921 Calle Del Sol, Capistrano Beach, California (the "Office"). *Amended Trial Declaration of Thomas McKnew* at 8, ¶ 33.

In August 2006, McKnew was retained by Parkside on a non-exclusive basis to locate and broker take-out financing for the China Trust Loan. *Trial Declaration of David Wilson* 2-3, ¶¶ 7, 10. Under the terms of the engagement, when the take-out loan for the China Trust Loan funded McKnew would be owed a commission of 1% of the principal loan amount. *Amended Trial Declaration of Thomas McKnew* at 7, ¶ 29.

After his retention by Parkside, McKnew received certain summaries of David and Beata Wilsons' personal finances, which were to be used by McKnew to solicit take-out financing for the China Trust Loan (the "August 2006 Statements"). *See Plaintiffs' Trial Exhibits 50* (dated 1/1/2002); *49* (dated 4/22/2003); *35* (dated 7/7/2004); *34* (dated

6/21/2005); and *36* (dated 5/15/2006). These financial statements represented that David and Beata Wilson owned interests in the following real properties:

(i) a house located at 24363 Santa Clara, Dana Point, CA (the Residence);

(ii) an office located at 34921 Calle Del Sol, Capistrano Beach, CA (the Office);

(iii) a house located at 232 Morning Star Dr., Breckenridge, CO (the "Colorado Property"); and

(iv) by June 2005, a condominium located at 27926 Finisterra, Mission Viejo, CA (the "Mission Viejo Condo").

David and Beata jointly owned the Residence and the Office. Beata separately owned the Colorado Property and Mission Viejo Condo. *Trial Testimony of David Wilson*, August 30, 2012 at 9:39 a.m.; *see also Order Approving Compromise of Controversy Between Chapter 7 Trustee and Beata Wilson*, *Dated February 13, 2009* (finding that Beata owned the Colorado Property and Mission Viejo Condo as her sole and separate property) [BK Docket No. 86].

The August 2006 Statements were inaccurate to the extent that they indicated the Wilsons jointly owned the Colorado Property. However, the financial statements were not inaccurate as to Beata's separate ownership interest the Mission Viejo Condo. The August 2006 Statements that were dated between 2005 and 2006 list the Wilsons' interest Mission Viejo Condo as an "individual" interest. *See Plaintiffs' Trial Exhibits 34 and 36* (copies of financial statements dated 6/21/05 and 5/15/06, respectively). While that term is ambiguous as to whether Wilson or Beata owned the "individual" interest, the financial statements were nonetheless accurate because the Mission Viejo Condo was owned "individually" by Beata. *Id.* Further, there is no evidence or argument that these financial statements misrepresented the value of the assets or the amount of the liabilities.

By the fall of 2006, Parkside was actively seeking take-out financing for the China Trust Loan. *Trial Declaration of David Wilson* at 2, ¶ 4. According to Wilson, despite having limited cash available, it was critical for Parkside to keep the entitlement process

ongoing. *Trial Declaration of David Wilson* at 3, ¶ 11. To this end, in October 2006, Wilson approached McKnew and requested a short-term personal loan in the amount of $100,000 (the "Personal Loan") for the Parkside Project. *Amended Trial Declaration of Thomas McKnew* at 6, ¶ 23; *Trial Declaration of David Wilson* at 3, ¶ 11. Wilson represented to McKnew that he was expecting a large settlement from a hotel development project he was involved with in Hawaii, and that McKnew would be repaid from these funds (the "Hawaii Proceeds").[1] *Amended Trial Declaration of Thomas McKnew* at 6, ¶ 23. Based on this representation, McKnew lent $100,000 to Wilson. *Amended Trial Declaration of Thomas McKnew* at 6, ¶ 23. All such funds were used on behalf of the Parkside Project. *See Trial Declaration of David Wilson*, ¶ 11.

On October 31, 2006, a Promissory Note was executed by Wilson to memorialize the Personal Loan. *Plaintiffs' Trial Exhibit 1* (copy of the Promissory Note). The Personal Loan had a 45-day term (from November 1, 2006 through December 15, 2006) and accrued interest at 10% per annum. *Id.*

Simultaneous to the Personal Loan negotiations, McKnew, in his capacity as loan broker for the Parkside Project, negotiated for Parkside terms for take-out financing of the China Trust Loan with United Commercial Bank ("UCB"). *See Amended Trial Declaration of Thomas McKnew* at 6, ¶ 24.

In a letter, dated October 26, 2006 (the "UCB Letter of Interest"), UCB proposed terms for a take-out loan of the China Trust Loan (the "Proposed Loan"). *See Plaintiffs' Trial Exhibit 6* (copy of UCB Letter of Interest); *see also Amended Trial Declaration of Thomas McKnew* at 6, ¶ 25.

The Proposed Loan had a principal balance of $18,800,000, subject to a maximum 65% loan to value ("LTV"), and an 18-month term of interest-only payments. The Proposed Loan included initial maximum funding of $9,500,000, which would be used to

[1] Wilson's use of the Hawaii Proceeds is an issue arising in a related adversary proceeding pending for this court entitled *Richard Lara v. David Wilson*, Case No. 2:12-ap-01316-RK.

(i) pay off the China Trust Loan; (ii) pay loan fees of UCB and McKnew; (iii) pay unpaid project invoices; and (iv) pay all closing costs. *See Plaintiffs' Trial Exhibit 6*. Additional advances would be subject to obtaining final condo map approval, to be reviewed and approved by UCB. *Id.* Prior to UCB funding the Proposed Loan, Wilson would have to provide an additional $500,000 as a "project equity investment" and deposit an additional $200,000 into a UCB restricted account. *Id.*

The Proposed Loan was to be secured by a first priority deed of trust on the Parkside Property and personally guaranteed by Wilson and his construction company, A&W Builders of California ("A&W"). *See Plaintiffs' Trial Exhibit 6*. The parties anticipated that UCB would obtain a subordination agreement from Bridge Capital to acquire a senior deed of trust in the Parkside Property. *Trial Declaration of David Wilson* at 3, ¶13. Wilson represented to McKnew that he had a long-term relationship with Bridge Capital on past real estate transactions and Bridge Capital would agree to have their lien subordinated to UCB's lien. *Amended Trial Declaration of Thomas McKnew* at 7, ¶ 27; *Trial Declaration of Nick Volk* at 3, ¶ 6.

On November 8, 2006, UCB commissioned an appraisal of the Parkside Property. *See Plaintiffs' Trial Exhibit 17* at 3 (copy of a memorandum, dated February 26, 2008, prepared by Volk for Chris Lee, Volk's superior at UCB, which describes the history of the UCB Loan [the "Volk Memorandum"]). The appraisal valued the Parkside Property "as-is" at $15,000,000. The appraisal also estimated the Parkside Property's "bulk" value at $24,200,000 and "retail" value at $28,450,000. *Id.*

On November 29, 2006, Parkside executed a promissory note payable to UCB in the amount of $20,675,000 (the "Note" or "UCB Loan"). *JPTO* at 6, ¶ 42. The Note was secured by a Deed of Trust dated November 29, 2006, which encumbered the Parkside Property (the "Deed of Trust"). *Id.* (Neither the Note nor Deed of Trust has been admitted into evidence.) Pursuant to the terms of his engagement, McKnew was entitled to a commission of 1% of the UCB Loan, or $206,750 (the "Brokerage Fee"). *Amended Trial Declaration of Thomas McKnew* at 7, ¶ 29.

Originally, Parkside and UCB had agreed to hold back $9,575,000 (the "Holdback Amount") of the UCB Loan for certain uses as provided in a Holdback Agreement. *See Plaintiffs' Trial Exhibit 2* (Copy of the Cash Infusion Agreement, defined below, which summarizes the terms of the Holdback Agreement; a copy of the Hold Back Agreement has not been admitted into evidence). However, during the closing of the UCB Loan in late November or early December 2006, Bridge Capital unexpectedly refused to subordinate its deed of trust to UCB's new deed of trust, and demanded to be paid off immediately. *Amended Trial Declaration of Thomas McKnew* at 7, ¶ 30; *Trial Declaration of David Wilson* at 4, ¶ 13. This resulted in a "week of chaos" in which Parkside had to find take-out financing for the Bridge Capital Loan or come up with additional collateral to increase the principal of the UCB Loan enough for Parkside to pay off the Bridge Capital Loan in the amount of $8,662,225.00. *Amended Trial Declaration of Thomas McKnew* at 7, ¶ 31.

On December 5, 2006, McKnew proposed an interim solution wherein UCB would increase the principal of the UCB Loan enough for Parkside to pay off the Bridge Capital Loan. *See Defendant's Trial Exhibit B* (copy of December 5, 2006 email from McKnew to Wilson and Nikita Volk). In exchange, Wilson would (i) pay all of the Hawaii Proceeds (then estimated at $3,800,000) to UCB; (ii) refinance his Residence and Office with 75% loan-to-value (LTV) loans, which would net $2,300,000 that Wilson would contribute to the Parkside Project; and (iii) open a checking account with UCB.[2] *Id.* In this email, McKnew estimated that the Residence was worth $6,500,000. *Id.*

On December 6, 2006, Andre Hurst ("Hurst"), a partner in the Parkside Project who worked full-time on the entitlement process and marketing, emailed an appraisal of Wilson's Residence conducted on January 26, 2005 to Nikita (Nick) Volk ("Volk"), the

[2] During trial, McKnew testified that at this time Wilson repeatedly promised that he would sell his Residence to finance the Parkside Project and that the sale would net $9,800,000. *Amended Trial Declaration of Thomas McKnew* at 9-10, ¶¶ 36, 41. The December 5, 2006 email discredits such testimony as Wilson promised to refinance his Residence or take out a home equity line of credit (HELOC) and that such proceeds would total $2,000,000.

principal loan officer at UCB for the UCB Loan. *See Trial Declaration of Andre Hurst, dated January 26, 2012 ("Trial Declaration of Andre Hurst")* at 2, ¶ 4 (Hurst's role in Parkside Project); *Trial Testimony of Nick Volk,* February 2, 2006 at 10:07 a.m. (Volk's role in the UCB Loan); *Defendant's Trial Exhibit DDDD* (copy of email). The appraisal valued the Residence at $4,900,000. *Defendant's Trial Exhibit DDDD*. However, in the email Hurst wrote to Volk that the Residence was worth $6,500,000 based on comparable sales in the area. *See id.*

Thereafter, UCB ordered appraisals of Wilson's Residence and Office. *See Defendant's Trial Exhibit EEEE* (copy of UCB's order form for appraisal of Residence); *Defendant's Trial Exhibit H* (copy unsigned appraisal of Office referencing UCB ordering the appraisal).[3] The Residence was appraised for $12,500,000, as of December 8, 2006, by Jenny Orozco of Advance Real Estate Appraisal, Inc. (the "Advance Appraisal"). *See Plaintiffs' Trial Exhibit 12*; *Defendant's Trial Exhibit F* (copies of Advance Appraisal). The Office was appraised for $2,100,000, as of December 11, 2006, by Cushman & Wakefield of California, Inc. (the "Office Appraisal"). *See Defendant's Trial Exhibit H* (copy of Office Appraisal).

After receiving the appraisals and considering Wilson's other financial information, UCB was still not satisfied with the additional collateral offered by Wilson.[4] *Amended Trial Declaration of Thomas McKnew* at 9, ¶ 39. UCB then demanded another $2,500,000 of new collateral to satisfy the LTV ratios and requested assurance this was

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[3] During trial, McKnew and Volk testified that the Advance Appraisal, defined below, was originally ordered by Wilson and then assigned to UCB. *Amended Trial Declaration of Thomas McKnew* at 9, ¶¶ 36-37; *Trial Declaration of Nick Volk* at 4, ¶ 9. The court finds this unlikely as these documents indicate that UCB ordered the Advance Appraisal. Nonetheless, this issue is not dispositive because, as explained below, the court finds that (i) there is no evidence that Wilson improperly influenced the appraiser's judgment or was otherwise responsible for the inflated valuation; and (ii) McKnew did not rely on the Advance Appraisal before executing the Additional Collateral Agreement or Cash Infusion Agreement (defined below).

[4] UCB did not take the Mission Viejo Condo as additional collateral because it was already encumbered with liens, and did not take the Colorado Property as additional collateral because Wilson did not have a current appraisal on it and it was located outside the State of California. *Trial Declaration of Nick Volk* at 4, ¶ 10. UCB's decision was also influenced by the time constraints and the fact that the properties represented a small portion of Wilson's net worth. *Id.*

just a short-term solution for Bridge Capital's unexpected demand for payment. *Id.* UCB made clear that it would not fund the UCB Loan without this additional collateral. *Id.*

Thereafter, McKnew, Wilson, Ben Meeker ("Meeker") as counsel to Wilson and A&W, and Dennis McQuaid ("McQuaid") as counsel to McKnew, began negotiating a temporary solution for McKnew to pledge the additional collateral required by UCB in exchange for a membership interest in Parkside. *See Defendant's Trial Exhibit C* (copy of December 8, 2006 email from McKnew to Wilson, Meeker, and McQuaid to structure a "partnership agreement" between McKnew and Wilson to close the UCB Loan). This was intended as a stop gap measure until McKnew could broker a new mezzanine loan or Wilson could repay the additional amount (or some portion thereof) with the Hawaii Proceeds and the proceeds from selling or refinancing the Residence and Office. *Trial Testimony of Thomas McKnew*, February 3, 2012 at 9:24 a.m.; *Trial Declaration of Nick Volk* at 5, ¶ 11.[5]

On December 12, 2006, McKnew and his wife, Lisa McKnew, as Trustees of the McKnew Family Trust dated May 21, 2004, pledged additional collateral for Parkside by executing an "Agreement re Brokerage Account and Additional Collateral" with UCB (the "Additional Collateral Agreement"). *See Plaintiffs' Trial Exhibit 2* (copy of the Additional Collateral Agreement). Therein, UCB agreed to temporarily disburse $8,640,000 of the

[5] During trial, McKnew and Volk testified that Wilson agreed to sell his Residence for the benefit of the Parkside Project in December 2006. *Amended Trial Declaration of Thomas McKnew* at 10, ¶ 41; *Trial Declaration of Nick Volk* at 5, ¶ 11. The Court finds this testimony unpersuasive because the email records from this time period exclusively refer to Wilson refinancing his Residence. *See Defendant's Trial Exhibit B* (copy of December 5, 2006 email sent by McKnew), *Defendant's Trial Exhibit U* (copy of December 16, 2006 email sent by McKnew), *FF* (copy of December 30, 2006 email sent by McKnew), and *Defendant's Trial Exhibit GG* (copy of December 31, 2006 email sent by McKnew). Indeed, it was not until July 2007 that the McKnew began advocating for the sale of Wilson's Residence. *See Defendant's Trial Exhibit ZZ* (copy of July 20, 2007 email sent by McKnew).

McKnew further testified that Wilson published an undated, untitled, and unsigned financial statement (the "December 2006 Statement") which represents the Residence was worth $12,500,000 and that his and Beata's net worth was $22,525,000. *See Plaintiffs' Trial Exhibit 38* (copy of the December 2006 Statement); *Amended Trial Declaration of Thomas McKnew* at 8, ¶ 35 (misidentifying the financial statement as *Trial Exhibit 36*); *Trial Testimony of Thomas McKnew*, February 3, 2012 at 3:02 p.m. (testifying that his declaration should have referenced *Trial Exhibit 38*). Wilson denied that he prepared, authorized, or published this financial statement to McKnew. *Trial Declaration of David Wilson* at 5, ¶ 16(f).

Holdback Amount ($9,750,000) to Parkside to repay Bridge Capital's mezzanine loan in the amount $8,662,225 (the "Mezzanine Portion"). *Id.* In exchange, while McKnew searched for a new mezzanine lender, he would (i) forego his Brokerage Fee ($206,750); (ii) grant UCB first priority deeds of trust on his unencumbered condominiums located in San Francisco, CA and Lahaina, HI (the "McKnew Condominiums"); and (iii) maintain a minimum balance of $1,000,000 in a certain TD Ameritrade trading account (the "Trading Account") (collectively, the "Additional Collateral"). *Id.* at 2, ¶¶ 3.1, 4.1. Upon Parkside's default under the UCB Loan, UCB agreed that it would first attempt to foreclose upon its other collateral, including the Parkside Property, Residence and Office, before attempting to foreclose upon McKnew's Additional Collateral. *Id.* at 2, ¶ 5. UCB also agreed to reconvey the deeds of trust on the McKnew Condominiums upon McKnew making two payments totaling $2,500,000 by September 15, 2007. *Id.*

Thus, after the execution of the Additional Collateral Agreement, the UCB Loan was secured by (i) a first priority deed of trust in the Parkside Property; (ii) junior deeds of trust on Wilson's Residence and Office; and (iii) first priority deeds of trust in the McKnew Condominiums.

Thereafter, McKnew, Wilson, and Meeker negotiated (i) how McKnew would be compensated for pledging the Additional Collateral; and (ii) the extent of McKnew's future involvement in the Parkside Project.

On December 12, 2006, McKnew emailed Wilson and Meeker seeking further information about the Parkside Project and requesting secured positions on Wilson's Residence and Office as well as a preferred return from the Parkside Project. *Defendant's Trial Exhibit K* (copy of email). McKnew concludes the email with the following comments:

> The margins are very thin on this deal and I would prefer just to be paid my fee and move on and help you all on your next financing need. However, at this point I am not willing to put up this type of collateral and have an equal contribution in the deal per Schedule A. I would prefer that I am paid back all my capital plus $1 million in the next 12 months and I am out of the deal. You all get all the upside or you all take me out when a new mezz loan

> funds and pay me back all my initial capital of $400,000 plus $500,000 as you stated in the [amended] partnership agreement you sent me.

*Id.*

In a December 13, 2006 email to Wilson and Meeker, McKnew proposed the following deal structure. *See Defendant's Trial Exhibit O* (copy of email). Parkside would close the UCB Loan that week, and then finance a new mezzanine loan with an entity referred to as "Mee-Corp" and which would fund in mid-February 2007 after the Parkside Project's tentative tract map was approved and Wilson received the Hawaii Proceeds. *Id.* In the interim, Wilson would start refinancing his Residence and Office which, based on the Advance Appraisal and Office Appraisal, would net $8,400,000 in proceeds. *Id.* From the new mezzanine loan, McKnew would be paid (i) deferred fees and cash of $400,000; and (ii) a stand-by fee for McKnew's pledge of collateral that would total either $500,000 or $600,000 that depended upon whether McKnew was paid immediately upon closing the new mezzanine loan ($500,000) or if McKnew stayed in the deal ($600,000). *Id.*

In a December 14, 2006 email to Meeker and McQuaid, McKnew suggested the following changes to a draft second amended operating agreement for Parkside: (i) McKnew would have no personal liability on first mortgage loan amount (i.e., the non-mezzanine portion of the UCB Loan); (ii) McKnew would have no litigation risk to future construction lawsuits; and (iii) distribution to Parkside Members would be pro rata per ownership interest. *See Plaintiffs' Trial Exhibit T* (copy of email). McKnew also requested verification of Wilson's contribution of value to date, and proposed language for valuing his capital contribution. *Id.*

In a December 16, 2006 email to Meeker and Wilson, McKnew sought confirmation of the amounts of the existing liens on Wilson's Residence and Office. *See Plaintiffs' Trial Exhibit U* (copy of email). McKnew also expressed his desire that a memorandum of understanding be executed in the following 60 days with regard to which of Wilson's personal assets would be financed for the Parkside Project. *Id.* There is no evidence before the court that a memorandum of understanding was ever executed.

On December 18, 2006, the foregoing negotiations resulted in the execution of Parkside's "Second Amended and Restated Operating Agreement" (the "Second Amended Operating Agreement"). *See Plaintiffs' Trial Exhibit 24* (copy of Second Amended Operating Agreement). The Second Amended Operating Agreement credited McKnew with a $1,000,000 capital contribution to Parkside, which was calculated as follows: (i) the Brokerage Fee ($206,750) was converted into a $280,000 capital contribution; (ii) the Personal Loan ($100,000) was converted into a $120,000 capital contribution; and (iii) McKnew's pledge of the additional collateral was converted into a $600,000 capital contribution (as McKnew's membership interest was not repurchased by Parkside within 120 days after the Effective Date of the Second Amended Operating Agreement). *See id.*, at 23 & 36; *Trial Testimony of Thomas McKnew*, February 3, 2012 at 2:59 p.m.

On December 19, 2006, the UCB Loan closed. *JPTO* at 6, ¶ 43.

Shortly after the UCB Loan closed, McKnew introduced Wilson to Tracy Hirt ("Hirt") of Residential Pacific Mortgage ("RPM-Mortgage") to refinance Wilson's Residence. *Trial Testimony of Thomas McKnew*, February 3, 2012 at 9:19 a.m. McKnew then instructed Wilson to have the Advance Appraisal reissued to RPM-Mortgage. *See Plaintiffs' Trial Exhibit X* (copy of December 28, 2006 email from McKnew to Wilson instructing Wilson to have the Advance Appraisal reissued to RPM-Mortgage); *Plaintiffs' Trial Exhibit Y* (copy of January 4, 2007 email from Hurst to McKnew and Wilson attaching a copy of the Advance Appraisal reissued to RPM-Mortgage). RPM-Mortgage then had a review of Advance Appraisal conducted by Apple Appraisal, Inc. (the "Apple Review Appraisal"), which discovered that the Advance Appraisal overstated the value of the Residence and concluded:

> The [Advance Appraisal] exhibits a gross lack of credibility, so much so, that a new appraisal is required and that due to the complexity of the subject, the lack of credibility in the appraisal, and the limited nature of a review, the reviewer is unable to render a value conclusion. It is suggested that the client obtain a new appraisal from a qualified appraiser. Note that the appraiser indicates that they have an "AT" license. As the appraisal is not co-signed by a Supervisory Appraiser with credentials to complete a

> report of this complexity, the Appraiser is not legally qualified to complete an appraisal on the subject. It should also be noted that the Supervisor indicated in the report has likely severely lacked in his responsibilities to adequate [sic] supervise the AT appraiser.

*See Defendant's Trial Exhibit Z* (copy of Apple Review Appraisal), at 4.

In a January 5, 2007 email, McKnew requests Wilson and Hurst to carefully review the Apple Review Appraisal and express their thoughts of it. *See Defendant's Trial Exhibit Z* (copy of email). On January 9, 2007, McKnew participated in an email chain with Hirt during which McKnew repeatedly stated that a new appraisal of the Residence would value the property at $10,000,000. *See Defendant's Trial Exhibit AA* (copy of email chain).

On January 12, 2007, McKnew received an email from Hirt, requesting McKnew's thoughts of a "very similar" property "down the street" of the Residence that was listed for sale at $6,500,000 from December 2005 through June 2006 and never sold. *See Defendant's Trial Exhibit AA* (copy of email). Later that day, McKnew forwarded that email to Wilson and Hurst, writing "[t]he response back will be important." *Id.* Eventually, Wilson's negotiations with RPM-Mortgage ended in January 2007. *Trial Testimony of Thomas McKnew*, February 3, 2012 at 9:29 a.m. There is no evidence as to how McKnew and Wilson ultimately responded to the Apple Review Appraisal, or why the negotiations ended.

After learning the Advance Appraisal grossly overstated the value of the Residence, McKnew proceeded to discuss the remaining tasks associated with financing the Parkside Project. In separate emails to Wilson on January 30, 2007, McKnew represented that the outstanding balance on the Mezzanine Portion was $8,567,000, *see Defendant's Trial Exhibit DD* (copy of email at 12:07 p.m.), and that the remaining tasks to finance the Parkside Project were to acquire a line of credit against Wilson's Residence and find a new mezzanine lender, *see Defendant's Trial Exhibit FF* (copy of email at 6:26 p.m.).

In a January 31, 2007 email to Wilson and Volk, McKnew proposed the following financing structure for the remainder of the Parkside Project:

(i) A future UCB distribution (from its receipt of the Hawaii Proceeds) would pay down $1,000,000 of Wilson's credit card and personal debt (to improve Wilson's credit rating) and paying $600,000 toward a line of credit held by Alliance that was secured by junior liens against Wilson's Residence and Office (in exchange for Alliance releasing its junior lien on the Office);

(ii) A refinance of the Office (through an entity referred to as "Point Center") in the amount of $1,470,000, which loan proceeds would be used to pay off Zion Bank's existing first deed of trust against the Office in the amount of $470,000 and the remaining $1,000,000 would be paid to UCB;

(iii) Wilson would get a $2,000,000 home equity line of credit against the Residence with Washington Mutual Bank, of which $1,000,000 would be used to pay down UCB; and

(iv) McKnew would continue to search for a new mezzanine loan.

*See Defendant's Trial Exhibit GG* (copy of email); *see also Trial Testimony of Thomas McKnew*, February 3, 2012 at 9:44 a.m. (regarding purpose of paying Wilson's personal debts); *Trial Testimony of Thomas McKnew*, February 3, 2012 at 9:52 a.m. (regarding source of the UCB distribution to pay Wilson's personal debts).

Thereafter, McKnew continued his search for a new mezzanine loan and began negotiations with Western Peaks Financial Corporation ("Western Peaks") for a new mezzanine loan.

On February 6, 2007, McKnew emailed Mark Miller, president of Western Peaks, a copy of Wilson's financial statement that valued the Residence at $6,500,000 (i.e., the value of the comparable property referenced by Hirt). *See Defendant's Trial Exhibit HH* (copy of email).

In a letter dated March 12, 2007, Western Peaks offered Parkside a new mezzanine loan in the principal amount of $5,500,000 at 15% interest and over a 12-

month term. *See Plaintiffs' Trial Exhibit 18* (copy of letter). Wilson and Hurst believed the price was too high and that Parkside could get a better deal elsewhere. *Trial Testimony of Thomas McKnew*, February 3, 2012 at 9:32 a.m.; *see also Trial Declaration of Nick Volk* at 6, ¶ 18. Thus, Parkside did not immediately accept the Western Peaks offer.

By late March 2007, UCB received the Hawaii Proceeds (in the amount of $3,594,177) and the proceeds from Wilson's refinance of the Office (in the amount of $274,000). *JPTO* at 7, ¶ 53. UCB's receipt of these proceeds reduced the Mezzanine Portion from $8,667,247 to $4,799,070. *See id.* All of these funds were used to continue construction since virtually all the net proceeds of the UCB Loan were used to pay the China Trust Loan, Bridge Capital Loan, various mechanic liens, and closing costs. *Trial Declaration of Nick Volk* at 6, ¶ 16.

When Parkside did not accept the Western Peaks offer, McKnew began negotiating for mezzanine financing with an individual investor in the Bay Area referred to as Mr. Kim. In April 2007, McKnew sent two emails to Wilson representing that he could close a new mezzanine loan from Mr. Kim by the end of the month. *See Defendant's Trial Exhibit JJ* (copy of April 12, 2007 email from McKnew to Wilson); *Defendant's Trial Exhibit KK* (copy of April 20, 2007 email from McKnew to Wilson and Meeker).

Also around this time, Wilson was also trying refinance his Residence in the amount of $4,250,000, which would have netted Wilson $2,000,000 to pay down the UCB Loan. *See Trial Exhibit KK* at 3. In addition to negotiating a refinance loan with Washington Mutual, Wilson also deputized McKnew to broker the loan. *See Trial Testimony of David Wilson*, August 30, 2012 at 11:10 – 11:21 a.m. However, Wilson never refinanced the Residence because he purportedly never received an offer from a lender. *Id.* During his testimony at trial, Wilson did not explain why did not receive an offer to refinance the Residence .

By June 2007 a new mezzanine loan with Mr. Kim did not close. It is unclear why. In a June 12, 2007 email to Wilson and Volk, McKnew insisted that Parkside needed to

pursue the Western Peaks proposal as it was the only mezzanine loan available. *See Defendant's Trial Exhibit LL* (copy of email chain). In a response email sent June 18, 2007, Hurst balked at the Western Peaks proposal and described it as "usurious." *Id.* McKnew replied that "the market is what it is" and that "this was no small dunk deal ever – we all know that." *Id.*

In July 2007, McKnew attempted to negotiate with Western Peaks a revised structure for the proposed mezzanine loan. However, Western Peaks passed on the deal due to a general concern about the housing market. *See Defendant's Trial Exhibit TT* (copy of July 11, 2007 email from McKnew to Volk); *Defendant's Trial Exhibit VV* (copy of July 16, 2007 email from Western Peaks to McKnew); *Defendant's Trial Exhibit WW* (copy of July 17, 2007 email from McKnew to Wilson, Hurst, and Volk).

By mid-July 2007 and without any other prospective mezzanine lenders available, the Parkside members began contemplating a plan wherein Wilson would sell the 120 condominium units as quickly as possible.

In a July 22, 2007 email to Volk and Wilson, McKnew insisted that the Parkside Project would still be financially feasible even if Wilson and McKnew had to purchase the some of the units. *See Defendant's Trial Exhibit ZZ* (copy of email). McKnew expected that Wilson would begin selling units within 30 days (i.e., August 2007) and would be completely finished constructing all common area and unit improvements within 90 days (*i.e.*, October 2007). *Id.* McKnew proposed that if Wilson had not sold 50 units within 6 months, then Wilson would immediately liquidate his Residence and Office. *Id.* From those sale proceeds, Wilson would purchase 30 units at $200,000 per unit. *Id.* And if Wilson had not sold 70 units (including the sales to Wilson) within 12 months, then McKnew would immediately purchase another 30 units at $200,000 per unit. *Id.* McKnew concludes that if he and Wilson were required to buy half of 120 units, then the market would absorb the other 60 units, if not more, due to the price point and amenities. *Id.* Then the project would simply become a market absorption issue. *Id.*

However, by late July 2007, the Parkside Project was in jeopardy as UCB began threatening to stop funding construction because the Mezzanine Portion remained outstanding and was past due. *Amended Trial Declaration of Thomas McKnew* at 15, ¶ 59. A meeting was held in UCB's office in late July 2007 with Chris Lee (Volk's superior at UCB), Volk, Wilson, McKnew, Hurst, and Meeker to discuss how Parkside was going to pay off the outstanding Mezzanine Portion and continue the Parkside Project. *Trial Declaration of Nick Volk* at 7, ¶ 19; *Amended Trial Declaration of Thomas McKnew* at 15, ¶ 59. *Trial Declaration of David Wilson* at 6, ¶ 19; *Trial Declaration of Andre Hurst* at 6-7, ¶ 19. At that meeting, UCB told Wilson and McKnew that it was going to stop funding construction since the Mezzanine Portion was still outstanding. *Trial Declaration of Nick Volk* at 7, ¶ 20; *Amended Trial Declaration of Thomas McKnew* at 15, ¶ 59. To keep the Parkside Project moving forward, Wilson and McKnew offered to contribute additional equity into the Parkside Project. *Amended Trial Declaration of Thomas McKnew* at 15-16, ¶¶ 59-60. Wilson represented to Volk and Lee that he would immediately sell his home and contribute $2,750,000 of the sale proceeds to the Parkside Project if McKnew would convert his collateral (the McKnew Condominiums and Trading Account) into project equity immediately. *Id.* UCB agreed to this new strategy. *Trial Declaration of Nick Volk* at 7, ¶ 21; *Amended Trial Declaration of Thomas McKnew* at 15-16, ¶ 59-60.

Pursuant to these discussions, on August 10, 2007, an "Agreement for Cash Infusion and Release of Collateral" was executed by UCB, Parkside, Wilson, and McKnew (the "Cash Infusion Agreement"). *JPTO* at 8, ¶ 55; *Plaintiffs' Trial Exhibit 19* (copy of Cash Infusion Agreement); *Defendant's Trial Exhibit JJJ* (same). Pursuant to the Cash Infusion Agreement, UCB would release its liens on the McKnew Condominiums and Wilson's Residence and Office in exchange for the following three separate payments from McKnew and Wilson: (i) an immediate deposit by McKnew in the amount of $500,000 (the "First Deposit"); (ii) a second deposit by McKnew in the amount of $2,000,000 by September 15, 2007 (the "Second Deposit"); and (iii) a third deposit by

Wilson in the amount of $2,750,000 by December 31, 2007 (the "Third Deposit"). *Plaintiffs' Trial Exhibit 19* at 2.[6]

Upon McKnew's payment of the First and Second Deposits and the UCB Loan not otherwise being in default, UCB was to release its liens on the McKnew Condominiums. *Id.* at 4, ¶ 5; *see also, JPTO* at 8, ¶ 56 ("Pursuant to the Cash Infusion Agreement, UCB released its security interest in all the collateral provided by McKnew."). UCB also agreed to relinquish its previous requirement that McKnew maintain a minimum $1,000,000 balance in the Trading Account. *Plaintiffs' Trial Exhibit 19* at 5; *see also, JPTO* at 8, ¶ 55. Upon Wilson's payment of the Third Deposit and the UCB Loan not otherwise being in default, UCB was to release its liens on Wilson's Residence and Office. *Plaintiffs' Trial Exhibit 19* at 4, ¶ 5. In addition to the Third Deposit, Wilson was also obligated to provide UCB evidence that he was either obtaining financing or entering into a sales transaction for the Residence or the Office by October 1, 2007. *Id.* at 2, ¶ E(3). Wilson also agreed to get names of multiple realtors that UCB could speak with about listing the homes so that it could interview the agent and make sure that agent had experience selling high-end homes in the area. *Trial Declaration of Nick Volk* at 8, ¶ 22.

At the time the Cash Infusion Agreement was executed on August 10, 2007, construction on the Parkside Project had stopped because the UCB Loan was in default and UCB stopped funding the loan. *Trial Testimony of Thomas McKnew*, February 3, 2012 at 1:41 p.m. All parties (including UCB) then believed that, if construction was completed, Parkside could sell its condos for a minimum of $200,000 per unit which

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[6] The express terms of Wilson's agreement under the Cash Infusion Agreement were as follows:

> "3. Agreement to Provide Evidence of Loan and/or Sale. On or before October 1, 2007, Wilson agrees to provide Bank with evidence, in form and substance satisfactory to Bank, that Wilson is either obtaining financing or entering into a sales transaction relative to the Dana Point Property and/or Capistrano Beach Property." *Plaintiff's Trial Exhibit 19* (Cash Infusion Agreement), at 3.
>
> "2. Agreement to Make Deposits. … Wilson agrees to transfer the Third Deposit to Bank on or before December 31, 2007." *Id.* The "Third Deposit" is defined on the preceding page with the following language: "On or before December 31, 2007, Wilson deposits with Bank the sum of Two Million Seven Hundred Fifty Thousand and No/100 Dollars ("$2,750,000) ("Third Deposit")". *Id.* at 2.

would be sufficient to repay the UCB Loan from 100 sales and still have profit remaining as an incentive for Parkside to complete the Parkside Project. *See Plaintiffs' Trial Exhibit 17* at 2.

In a September 4, 2007 email, McKnew proposed that he and Wilson could each take out two personal loans from a credit union to purchase 40 units each. *See Defendant's Trial Exhibit TTT* (copy of email from McKnew to Wilson, Meeker, and Hurst). These four loans would each be secured by 20 units, allowing McKnew and Wilson to purchase 80 units. *Id.* The remaining 40 units could be sold to the public or purchased by McKnew and Wilson with individual loans. *Id.* McKnew suggested if they could lease the units for $1,200 to $1,300 a month and get all 120 units leased by December 2007, then the Parkside Project would only need a $2,000,000 cash infusion from the sale Wilson's Residence, which McKnew believed Wilson would list for sale that week. *Id.*[7]

In September 2007, Wilson listed the Residence for sale with Hurst, his business partner in Parkside (as of July 2007, Hurst was also a managing member of Parkside), as his sales representative despite Hurst not having any experience selling high-end homes in the area, and rather than an independent real estate brokerage agency. *Trial Testimony of Thomas McKnew*, February 3, 2012 at 10:28 a.m.; *Trial Testimony of Andre Hurst,* August 31, 2011 at 1:39-1:48 p.m. and 2:16-2:19 p.m. (Hurst acknowledging that he had no sales experience for high end Dana Point real estate properties); *Trial Testimony of Andre Hurst,* August 31, 2011 at 3:29-3:30 p.m. and 3:49-3:50 p.m. (Hurst stated that he started working with Wilson in late 2006 and handled administrative tasks for Wilson on his development projects); *Trial Declaration of Nick Volk* at 7, ¶ 23; *see also, Trial Declaration of Andre Hurst* at 6, ¶ 18 (denying that Wilson or his wife ever told Hurst that they would not show or sell the Residence); *Trial Testimony of David Wilson,*

[7] The court finds that Exhibit TTT is admissible. The Supplemental Declaration of Thomas I. McKnew IV, filed on September 10, 2012, lays a proper foundation that the exhibit is a true and correct copy of the email McKnew sent to Wilson, Meeker, and Hurst.

August 30, 2012 at 10:59 a.m. (as of July 2007, Hurst was a managing member of Parkside). Hurst never showed the Residence to prospective buyers. *Trial Testimony of Thomas McKnew*, February 3, 2012 at 10:34 a.m.; *see also, Trial Declaration of Andre Hurst* at 6, ¶ 18 (Hurst does not deny not showing the Residence).

In September 2007, Hurst listed Wilson's Residence for sale on the Multiple Listing Service ("MLS"). *See Trial Declaration of Andre Hurst* at 6, ¶ 18; *Defendant's Trial Exhibit UUU* (copy of September 5, 2007 email from Hurst to McKnew); *Trial Testimony of Thomas McKnew*, February 3, 2012 at 10:26 a.m. In a September 5, 2007 email to Hurst, McKnew wrote that it would be a "home run" for Wilson if he could sell his Residence for $6,500,000 to $7,000,000. *Defendant's Trial Exhibit UUU* (copy of email).

By September 15, 2007, McKnew had made the First and Second Deposits to UCB, pursuant to the Cash Infusion Agreement. *Trial Testimony of Thomas McKnew*, February 3, 2012 at 10:21 a.m. To make the First and Second Deposits, McKnew had to sell the McKnew Condominiums. *Trial Testimony of Thomas McKnew*, February 3, 2012 at 10:21 a.m.

By October 1, 2007, Wilson failed to provide UCB evidence that he was either obtaining financing or entering into a sales transaction relative to his Residence or the Office, as required by the Cash Infusion Agreement. *Trial Testimony of Thomas McKnew*, February 3, 2012 at 10:22 a.m.; *see also, Trial Declaration of David Wilson* at 7, ¶ 20 (Wilson acknowledged in his trial declaration that "[u]nfortunately, Parkside's efforts to restructure its loan with UCB were not successful," but nowhere in his trial declaration did Wilson deny that he failed to provide UCB with evidence of his obtaining refinancing or entering into a sale transaction for the Residence or the Office by October 1, 2007 as required by the Cash Infusion Agreement).

On November 7, 2007, Parkside recorded a final tract map for the Parkside Project. *Defendant's Trial Exhibit GGGG* (copy of recorded Condominium Plan).

In November 2007, Wilson told UCB that a competitor with a superior new town-home project, which had been on the market for $350,000 average per unit, had dropped

the price to a $240,000 average which then became similar to Parkside's projected average selling price of $235,000. *Plaintiffs' Trial Exhibit 17* (copy of Volk Memorandum) at 2. Then in December 2007, Wilson told UCB the same developer further dropped its price to $160,000 and still there were no sales reported. *Id.*

On December 20, 2007, Wilson signed an exclusive residential real estate listing agreement with First Team Real Estate to list the Residence for sale in the amount of $8,700,000. *Plaintiffs' Trial Exhibit 7* (copy of signed listing agreement); *Trial Declaration of Nick Volk* at 8, ¶ 23. Prior to retaining First Team Real Estate, Wilson did not obtain UCB's approval of the realtor, as required in the Cash Infusion Agreement. *Trial Declaration of Nick Volk* at 8, ¶ 23. After conducting some internet research, Volk discovered that the realtor did not have any experience selling high end homes in the area. *Id.*

By December 31, 2007, Wilson failed to make the Third Deposit ($2,750,000) with UCB, as required by the Cash Infusion Agreement. *Trial Testimony of Thomas McKnew*, February 3, 2012 at 10:22 a.m.; *Trial Testimony of David Wilson,* August 31, 2012 at 10:40-10:41 a.m. and 4:03-4:05 p.m.; *see also, Trial Declaration of David Wilson* at 7, ¶ 20 (Wilson acknowledged in his trial declaration that "[u]nfortunately, Parkside's efforts to restructure its loan with UCB were not successful," but nowhere in his trial declaration did Wilson deny that he failed to make the Third Deposit by December 31, 2007 as required by the Cash Infusion Agreement).

UCB thereafter stopped all further advances under the UCB Loan, with the exception of keeping the loan current and ordered new appraisals of all the properties then securing the UCB Loan. *Plaintiffs' Trial Exhibit 17* at 2-3; *see also Trial Declaration of Nick Volk* at 8, ¶ 23 (testifying UCB stopped funding the UCB Loan in early 2008).

On January 15, 2008, A&W recorded a mechanic's lien against the Parkside Property in the amount of $1,541,062. *Defendant's Trial Exhibit HHHH* (copy of mechanic's lien). The mechanic's lien was for additional expenses not previously

reimbursed and which were not in the remaining budget. *Plaintiffs' Trial Exhibit 17* (copy of Volk Memorandum) at 6.

On January 30, 2008, UCB commissioned a new appraisal of the Residence. *Trial Testimony of Nick Volk*, February 2, 2012 at 11:20 a.m.; *Plaintiffs' Trial Exhibit 11* (copy of appraisal). This appraisal valued the Residence at $3,900,000 (i.e., $4,800,000 less than the listing price). *See Plaintiffs' Trial Exhibit 11*; *JPTO* at 8, ¶ 59.

On February 4, 2008, UCB commissioned an appraisal of the Parkside Property. *See Plaintiffs' Trial Exhibit 17* at 4. The appraisal valued the Parkside Property "as-is" between $5,700,000 (if used as condos) and $7,000,000 (if used as apartments). *See id.*

On February 26, 2008, Volk prepared the Volk Memorandum, which describes the history of the UCB Loan and the Parkside Project. *Plaintiffs' Trial Exhibit 17* (copy of Volk Memorandum); *Trial Testimony of Nick Volk*, February 2, 2012 at 1:18 p.m. The Volk Memorandum was prepared for internal purposes and analyzed a proposal by Wilson and McKnew that UCB (i) advance an additional $2,500,000 in order to complete construction; and (ii) reduce the outstanding principal of the UCB Loan to $11,000,000. *Plaintiffs' Trial Exhibit 17* at 6. In the event the cost to complete construction exceeded $2,500,000, Wilson and/or McKnew would advance the additional funds necessary to complete construction. *Id.* A&W would release its mechanic's lien on the Parkside Property. *Id.* Any profits above the appraised value of the units would be shared equally by UCB and Parkside. *Id.* Wilson proposed to give UCB $1,275,000 in exchange for releasing its lien on Wilson's Residence. *Id.*

After analyzing the value of the Parkside Property "as-is" versus upon "stabilization" or "completion" and the attendant delay caused by Parkside's anticipated bankruptcy filing, Volk recommended that UCB advance Parkside an additional $2,500,000 to complete construction of the Parkside Project. *Id.* at 7. However, despite Volk's recommendation to accept Parkside's proposal, there is no evidence that UCB ever did or otherwise provide additional funds to complete construction.

On May 27, 2008, UCB filed an action to judicially foreclose against the Parkside Property. *JPTO* at 8, ¶ 58.

On August 13, 2008, Wilson initiated the underlying bankruptcy case by filing a voluntary petition for relief under Chapter 7 of the Bankruptcy Code. *JPTO* at 1, ¶ 1.

On August 27, 2008, Parkside filed a voluntary petition for Chapter 7 relief, initiating Case No. 8:12-bk-15150-TA. *JPTO* at 5, ¶ 30.

On November 20, 2008, UCB recorded a Notice of Default against the Parkside Property. *JPTO* at 8, ¶ 60.

On January 26, 2009, the McKnews initiated this adversary proceeding by filing a complaint against Wilson objecting to the discharge of their claim pursuant to 11 U.S.C. § 523(a)(2)(A)-(B), (4), and (6).

**DISCUSSION**

The court has jurisdiction over this adversary proceeding to determine dischargeability of debt pursuant to 28 U.S.C. §§ 157(a) and (b)(1) and (2)(I) and 1334. Venue is proper in this judicial district pursuant to 28 U.S.C. § 1409(a). This adversary proceeding is a core matter pursuant to 28 U.S.C. § 157(b)(2)(I).

In nondischargeability cases, the burden of proof is on creditors, "strictly construing exceptions to discharge in favor of debtors in order 'to effectuate the Congressional policy' of affording debtor's a 'fresh start.'" *Beneficial California, Inc. v. Brown* (*In re Brown*), 217 B.R. 857, 860 (Bankr. S.D. Cal. 1998), *citing, Gregg v. Rahm* (*In re Rahm*), 641 F.2d 755, 756-757 (9th Cir. 1981). Furthermore, "the standard of proof for the dischargeability exceptions in 11 U.S.C. § 523(a) is the ordinary preponderance-of-the-evidence standard." *Grogan v. Garner*, 498 U.S. 279, 291 (1991).

In the Complaint, McKnew asserted four claims for relief pursuant to § 523(a)(2)(A), (2)(B), (4), and (6). However, during opening and closing arguments, McKnew abandoned his claim for relief under § 523(a)(6). Thus, the Court will only analyze McKnew's claims from relief under § 523(a)(2)(A), (2)(B), and (4).

**I. Section 523(a)(2)(A)-(B) Claims**

11 U.S.C. § 523(a)(2) provides that:

> (a) A discharge under section 727 . . . of this title does not discharge an individual debtor from any debt –
>
> (2) for, money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained, by –
>
> (A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial situation;
>
> (B) use of a statement in writing--
>
> (i) that is materially false;
>
> (ii) respecting the debtor's or an insider's financial condition;
>
> (iii) on which the creditor to whom the debtor is liable for such money, property, services, or credit reasonably relied; and
>
> (iv) that the debtor caused to be made or published with intent to deceive

11 U.S.C. § 523(a)(2).

"Section 523(a)(2)(A) differs from section 523(a)(2)(B) only in that the former involves a non-written misrepresentation while the latter involves a false statement in writing; in addition, section 523(a)(2)(A) provides less detail as to what a creditor must show. We conclude that, because the two subsections of section 523 are substantially similar, adoption of the *Rubin* elements is appropriate for section 523(a)(2)(B) cases." *In re Siriani*, 967 F.2d 302, 304 (9th Cir. 1992) (citing *Rubin v. West (In re Rubin)*, 875 F.2d 755, 759 (9th Cir. 1989) (setting forth elements of a claim under § 523(a)(2)(A)).

Thus, to render a debt nondischargeable under § 523(a)(2)(A) or (B), the following five elements must be proven: "(1) misrepresentation, fraudulent omission or deceptive conduct by the debtor; (2) knowledge of the falsity or deceptiveness of his statement or conduct; (3) an intent to deceive; (4) justifiable reliance by the creditor on the debtor's statement or conduct; and (5) damage to the creditor proximately caused by its reliance on the debtor's statement or conduct." *Turtle Rock Meadows Homeowners Assoc. v. Slyman (In re Slyman)*, 234 F.3d 1081, 1085 (9th Cir. 2000), *citing Britton v. Price (In re Britton)*, 950 F.2d 602, 604 (9th Cir.1991). These elements, which "'mirror the elements of common law fraud' and match those for actual fraud under California law," *Tobin v.*

*Sans Souci Limited Partnership* (*In re Tobin*), 258 B.R. 199, 203 (9th Cir. BAP 2001), *quoting, Younie v. Gonya* (*In re Younie*), 211 B.R. 367, 373-374 (9th Cir. BAP 1997), are further discussed below:

1. Material Misrepresentation, Fraudulent Omission, or Deceptive Conduct

First, the debtor has to make a material misrepresentation, fraudulent omission or participate in otherwise deceptive conduct. *In re Slyman*, 234 F.3d at 1085. "A statement can be materially false if it includes information which is 'substantially inaccurate' and is of the type that would affect the creditor's decision making process. To except a debt from discharge, the creditor must show not only that the statements are inaccurate, but also that they contain important and substantial untruths." *Candland v. Insurance Company of North America (In re Candland)*, 90 F.3d 1466, 1470 (9th Cir. 1996), quoting *First Interstate Bank of Nevada v. Greene (In re Greene)*, 96 B.R. 279, 283 (9th Cir. BAP 1989).

2. Knowledge of Falsity or Deceptiveness

Second, the debtor must have knowledge of the falsity or deceptiveness of his or her statement or conduct. *Slyman*, 234 F.3d at 1085. Either actual knowledge of the falsity of a statement, or reckless disregard for its truth, satisfies the scienter requirement for nondischargeability of a debt. *Advanta National Bank v. Kong (In re Kong)*, 239 B.R. 815, 826 (9th Cir. BAP 1999); *Gertsch v. Johnson & Johnson, Finance Corp. (In re Gertsch)*, 237 B.R. 160, 167-68 (9th Cir. BAP 1999).

In the context of promissory fraud, a plaintiff can satisfy this element by showing a promise was made without intent to perform. *In re Tobin*, 258 B.R. 199, 203 (9th Cir. BAP 2001); *Palmacci v. Umpierrez*, 121 F.3d 791, 786 (1st Cir. 1997) ("'A representation of the maker's intention to do . . . a particular thing is fraudulent if he does not have the intention' at the time he makes the representation."), *quoting, Restatement (Second) of Torts* § 530(1). Thus, "a promise made with a positive intent not to perform or without a present intent to perform satisfies § 523(a)(2)(A)." *McCrary v. Barrack* (*In re Barrack*), 217 B.R. 598, 606 (9th Cir. BAP 1998), *citing*, *In re Rubin*, 875 F.2d at 759. "[I]n

determining whether the debtor had no intention to perform, a court may look at all the surrounding facts and circumstances." *In re Barrack*, 217 B.R. at 607, *citing, Baker v. Mereshian (In re Mereshian)*, 200 B.R. 342, 347 (9th Cir. BAP 1996). A promise can also be found fraudulent "where the promisor knew or should have known of his prospective inability to perform." *Id.* at 606, *quoting*, *McMillan v. Firestone (In re Firestone)*, 26 B.R. 706, 715 (Bankr. S.D. Fla. 1982).[8]

In the context of written financial statements, a plaintiff can satisfy this element by showing the debtor intentionally offered a knowingly false writing when viewed in the totality of the circumstances. *Waugh Real Estate Holdings, LLC v. Daecharkhom (In re Daecharkhom)*, 481 B.R. 641, 647 (Bankr. D. Nev., 2012), citing *Tustin Thrift & Loan Ass'n v. Maldonado (In re Maldonado)*, 228 B.R. 735, 738 (9th Cir. BAP 1999). In other words, a financial statement is fraudulent "if the maker (a) knows or believes that the matter is not as he represents it to be, (b) does not have the confidence in the accuracy of his representation that he states or implies, or (c) knows that he does not have the basis for his representation that he states or implies." *In re Gertsch*, 237 B.R. at 168 (quoting *Restatement (Second) of Torts* § 526 (1977)). "A representation may be fraudulent, without knowledge of its falsity, if the person making it 'is conscious that he has merely a belief in its existence and recognizes that there is a chance, more or less great, that the fact may not be as it is represented.'" *Id.* (citing *Restatement (Second) of Torts* § 526, cmt. e (1977)).

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[8] California law, which mirrors the elements of § 523(a)(2)(A), also recognizes that a "promise to do something necessarily implies the intention to perform; hence, where a promise is made without such intention, there is an implied misrepresentation of fact that may be actionable fraud." *Lazar v. Superior Court*, 12 Cal.4th 631, 638 (1996). A claim for promissory fraud is a claim in tort and separate from a claim for breach of contract. Thus, under California law, a claim for promissory fraud can, in some cases, be sought in addition to claim on the contract, subject however to the rule against double recovery of compensatory damages on tort and contract claims. *Id.*; *see also, Stop Loss Insurance Brokers, Inc. v. Brown & Toland Medical Group*, 143 Cal.App.4th 1036, 1057-1058 (2006).

3. Intention to Deceive

Third, the debtor must have intended to deceive the creditor at the time of making the misrepresentation. *Slyman*, 234 F.3d at 1085. Intent to defraud is a question of fact and can be inferred from the surrounding circumstances. *In re Kennedy*, 108 F.3d 1015, 1018 (9th Cir. 1997). "[A] court may infer an intent to deceive from a false representation." *In re Rubin*, 875 F.2d at 759, *citing, First Nat'l Bank v. Kimzey* (*In re Kimzey*), 761 F.2d 421, 424 (7th Cir. 1985).

4. Justifiable Reliance

Fourth, the creditor must have justifiably relied on the debtor's statement or conduct. *Slyman*, 234 F.3d at 1085. "[A] person is justified in relying on a representation of fact 'although he might have ascertained the falsity of the representation had he made an investigation.'" *Field v. Mans,* 516 U.S. 59, 70 (1995), citing *Restatement (Second) of Torts* § 540 (1977). Thus, the creditor's conduct does not need to conform to the standard of a reasonable man. *Id.*, citing *Restatement (Second) of Torts* § 545A, *cmt. b*. Rather, a creditor's reliance is not justifiable only where, under the circumstances, "the facts should be apparent to one of his knowledge and intelligence from a cursory glance, or he has discovered something which should serve as a warning that he is being deceived." *Id.* at 71, citing *W. Prosser, Law of Torts* § 108, p. 718 (4th ed. 1971).

5. Proximate Causation to Damages

Fifth, the creditor's damages must have been proximately caused by its reliance on the debtor's statement or conduct. *Slyman*, 234 F.3d at 1085. "Proximate cause is sometimes said to depend on whether the conduct has been so significant and important a cause that the defendant should be legally responsible." *Britton v. Price (In re Britton)*, 950 F.2d 602, 604 (9th Cir. 1991).

During his closing argument, McKnew argued that Wilson made four fraudulent misrepresentations to him during their involvement with the Parkside Project:

1. Wilson published inaccurate financial statements before McKnew accepted employment with Parkside or signed the Additional Collateral Agreement;

2. Wilson published an inaccurate appraisal (the Advance Appraisal) that overstated the value of the Residence prior to McKnew executing the Additional Collateral Agreement;

3. Wilson misrepresented his intention to perform his contractual obligations under the Cash Infusion Agreement; and

4. Wilson misrepresented his intention to liquidate his other personal assets to save the UCB funding.

*See Plaintiff's Closing Argument in Support of Judgment after Trial* (AP Docket No. 200), at 14. Each alleged misrepresentation will be fully addressed in turn:

**A. Financial Statements**

During trial, Plaintiffs alleged that, during two separate instances, Wilson provided false financial statements to McKnew. The first instance occurred in or around August 2006 and after McKnew was retained by Parkside, at which time Wilson allegedly provided McKnew several personal financial statements to McKnew to solicit take-out financing for the China Trust Loan (the August 2006 Statements). *See supra* at 4, referencing *Plaintiffs' Trial Exhibits 50* (dated 1/1/2002); *49* (dated 4/22/2003); *35* (dated 7/7/2004); *34* (dated 6/21/2005); and *36* (dated 5/15/2006). The second instance occurred in or around December 2006 and prior to the execution of the Additional Collateral Agreement, at which time Wilson allegedly provided McKnew a personal financial statement for negotiations with UCB regarding the refinancing of the Bridge Capital Loan (the December 2006 Statement). *See supra* at 9, note 6, referencing *Plaintiffs' Trial Exhibit 38* (undated). During trial and in closing argument, Plaintiffs argued that the August 2006 Statements misrepresented that Wilson owned a joint interest in the Colorado Property and an individual interest in the Mission Viejo Condo, and that the December 2006 Statement misrepresented the value of the Residence.

For the reasons stated below, the court finds that the August 2006 Statements and the December 2006 Statement do not constitute material misrepresentations and, even if

they did, McKnew did not actually rely upon the misrepresentations within the Statements.

1. Misrepresentation

With respect to the August 2006 Statements, the parties agree that the Colorado Property was always separately owned by Beata. Thus, the August 2006 Statements were inaccurate to the extent that they represented that Wilson owned an interest in the Colorado Property. However, the August 2006 Statements, to the extent they listed the Mission Viejo Condo, did not misrepresent that Wilson owned an interest in the Mission Viejo Condo. *See Plaintiffs' Trial Exhibits 34* and *36* (statements dated 6/21/05 and 5/15/06, respectively, providing that David or Beata owned an "individual" interest in Mission Viejo Condo). The August 2006 Statements accurately represent that the Mission Viejo Condo was owned individually, even if they do not specify whether Wilson or Beata owned the Mission Viejo Condo.

The court further finds that the misrepresentation regarding Wilson's interest in the Colorado Property was not of the type that would have affected McKnew's decision to work for Parkside. When accepting employment with Parkside, McKnew likely considered the feasibility of the Parkside Project and Wilson's financial condition. However, Wilson's stated joint ownership interest in the Colorado Property, which was a relatively minor, out-of-state property, likely did not materially affect McKnew's decision to accept employment with Parkside. *See Trial Declaration of Nick Volk* at 4, ¶ 10 (testifying that UCB did not take a security interest in the Colorado Property because (i) it represented a small portion of Wilson's alleged net worth; (ii) Wilson did not have a recent appraisal for the property; (iii) the property was located out of state; and (iv) the time constraints). Accordingly, the court finds that the August 2006 Statements are inaccurate but were not material misrepresentations that affected McKnew's decision making process to accept employment with Parkside.

With respect to the December 2006 Statement, the statement itself is untitled, undated, and unsigned. Within the four corners of the document, there is no reference to

Wilson at all. Further, the December 2006 Statement does not describe the type of interests held in the real properties. If the December 2006 Statement was intended to represent the total assets of Wilson and Beata, then the inclusion of the Colorado Property or Mission Viejo Condo was not a misrepresentation. Thus, the only misrepresentation within the December 2006 Statement is the valuation of the Residence at $12,500,000.

During trial, McKnew testified that Wilson provided this financial statement to him prior to the execution of the Additional Collateral Agreement. However, McKnew did not testify exactly as to when he received the statement or what representations Wilson made to McKnew when it was delivered. Most likely, the December 2006 Statement was prepared after the Advance Appraisal was completed on December 8, 2006. Because Advance Appraisal valued the Residence at $12,500,000, the December 2006 Statement likely quotes this appraised value of the Residence. Finally, during trial Wilson testified that he did not prepare the December 2006 Statement or provide it to McKnew. *Trial Declaration of David Wilson* at 5, ¶ 16(f). Wilson further testified that he believes, based on the formatting of the December 2006 Statement, that McKnew prepared the document. *Id.* Due to the conflicting testimony, which the court finds equally credible, and the inherent vagueness within the December 2006 Statement, the court finds that Plaintiffs have not proven by a preponderance of the evidence that the December 2006 Statement is a misrepresentation made by Wilson.

Accordingly, the first element of § 523(a)(2)(B) (misrepresentation) is not satisfied with respect to the August 2006 Statements or December 2006 Statement.

2. Reliance

Plaintiffs also have not proven that McKnew actually relied upon the August 2006 Statements or December 2006 Statement.

With respect to the August 2006 Statements, there is no evidence that McKnew ever considered Wilson's purported joint interest in the Colorado Property to be significant when deciding to (i) accept employment with Parkside; or (ii) extend the

Personal Loan to Wilson. There is no evidence that McKnew ever considered Wilson's purported equity in the Colorado Property as important for the Parkside Project's success. McKnew believed that the Personal Loan, which was unsecured, would be repaid from the Hawaii Proceeds. *Amended Trial Declaration of Thomas McKnew* at 6, ¶ 23. Further, the Colorado Property was never considered as collateral for the UCB Loan because (i) it represented a small portion of Wilson's alleged net worth; (ii) the property was located out of state; (iii) Wilson did not have a current appraisal for the property; and (iv) and the time constraints in funding the UCB Loan. *See Trial Declaration of Nick Volk* at 4, ¶ 10. Finally, there are no emails in the record showing that Wilson and McKnew ever discussed liquidating the Colorado Property to raise funds for the Parkside Project. Accordingly, the court finds that McKnew did not actually rely upon the representation within the August 2006 Statements that he owned a joint interest in the Colorado Property when he accepted employment with Parkside, made the Personal Loan to Wilson, or at any time thereafter.

With respect to the December 2006 Statement, the record indicates that McKnew never actually relied upon the $12,500,000 valuation of the Residence. On December 5, 2006, just three days before the Advance Appraisal was performed, McKnew sent an email to Volk wherein he wrote that the Residence was worth $6,500,000. *See Defendant's Trial Exhibit B* (copy of email). Furthermore, McKnew did not express surprise or disbelief when he received the Apple Review Appraisal, which questioned the $12,500,000 valuation of the Residence in the Advance Appraisal. *See Defendant's Trial Exhibit Z* (copy of January 5, 2007 email from McKnew to Wilson and Hurst, requesting that they carefully review the Apple Review Appraisal and share their thoughts); *Defendant's Trial Exhibit AA* (copy of January 12, 2007 email from McKnew to Wilson and Hurst, noting that their response to RPM-Mortgage about a comparable property at $6,500,000 would be "important"). Finally, when he executed the Additional Collateral Agreement on December 12, 2006, McKnew believed that he could broker a new mezzanine loan which proceeds would be used, in part, to buy out McKnew's interest in

the Parkside Project and release UCB's lien on the McKnew Condominiums. *See Defendant's Trial Exhibit O* (copy of December 13, 2006 email from McKnew to Wilson and Meeker stating that he could get a mezzanine loan from Mee-Corp to fund by mid-February 2007); *Plaintiffs' Trial Exhibit 18* (letter of intent, dated March 12, 2007, from Western Peaks proposing a new mezzanine loan for the Parkside Project); *Defendant's Trial Exhibit JJ* (copy of April 12, 2007 email from McKnew to Wilson stating that he could get a funded mezzanine loan from Mr. Kim by the end of April 2007). Therefore, the evidence suggests that McKnew never relied upon the December 2006 Statement because (i) McKnew never believed that the Residence was worth $12,500,000; and (ii) McKnew believed that he would obtain a mezzanine loan by early 2007, from which his interest in Parkside would have been bought out.

Accordingly, the court finds that the fourth element of § 523(a)(2)(B) (reliance) is not satisfied with respect to the August 2006 Statements or December 2006 Statement. Therefore, the court finds that the August 2006 Statements and December 2006 Statement do not establish a claim for relief under 11 U.S.C. § 523(a)(2)(B).

**B. Advance Appraisal**

During trial, Plaintiffs also contended that, through the Advance Appraisal, Wilson misrepresented the value of the Residence. *Amended Trial Declaration of Thomas McKnew* at 18, ¶ 73(A)-(B). This court recognizes there is split of authority as to what constitutes a "statement" regarding the debtor's "financial condition" and that this split affects whether the Advance Appraisal is a written statement respecting Wilson's "financial condition." *See Tallant v. Kaufman (In re Tallant)*, 218 B.R. 58, 70 (9th Cir. BAP 1998).[9] However, the court declines to decide whether the Advance Appraisal

[9] There is a broad view and narrow view as to what "financial condition" means under 11 U.S.C. § 523(a)(2)(B). Under the broad view, any statement respecting a debtor's financial condition will meet the definition of the term "financial statement." *In re Tallant*, 218 B.R. at 70 and n. 20, *citing Bellco First Federal Credit Union v. Kaspar (In re Kaspar)*, 125 F.3d 1358, 1361 (10th Cir.1997). Under the narrow view, "the ordinary usage of 'statement' in connection with 'financial condition' denotes a representation of the debtor's overall 'net worth' or the debtor's overall ability to generate income." *Id., quoting Jokay Co. v. Mercado (In re Mercado)*, 144 B.R. 879, 885 (Bankr. C.D. Cal. 1992). There is no Ninth Circuit authority on

constitutes a written statement respecting Wilson's "financial condition" because, for the reasons stated below, the court finds that Plaintiffs have failed to prove that (i) the Advance Appraisal constitutes a representation made by Wilson; or (ii) McKnew actually relied upon the Advance Appraisal when executing the Additional Collateral Agreement.

First, Plaintiffs have not alleged nor proven that Wilson was responsible for the Advance Appraisal's inflated valuation for the Residence. There is no evidence in the record that Wilson improperly influenced or controlled the appraiser's judgment. And while Wilson did publish the Advance Appraisal to McKnew, there is no evidence that Wilson knew at the time that the Advance Appraisal was inaccurate.

Second, for the reasons explained above, McKnew did not rely upon the Advance Appraisal (dated December 8, 2006) because he (i) believed, as of December 5, 2006, the Residence was worth $6,500,000, *see Defendant's Trial Exhibit B*; (ii) did not express surprise or disbelief when he received the Apple Review Appraisal, *see Defendant's Trial Exhibits Z and AA*; and (iii) believed, as of December 13, 2006, that he could broker mezzanine financing for Parkside by mid-February 2007, which would have bought out McKnew's interest in Parkside and released UCB's liens from McKnew's Additional Collateral, *see Defendant's Trial Exhibit O*. Therefore, even if the Advance Appraisal constitutes a misrepresentation by Wilson, McKnew did not rely upon such representation.

Therefore, the court determines that Plaintiffs have not proven by a preponderance of the evidence a claim for relief under 11 U.S.C. § 523(a)(2)(A) or (B) based on the Advance Appraisal.

**C. Cash Infusion Agreement**

During trial, Plaintiffs contended that Wilson misrepresented his intention to perform under the Cash Infusion Agreement. *Amended Trial Declaration of Thomas*

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this issue. *See Hopper v. Everett (In re Everett)*, 364 B.R. 711, 720 (Bankr. D. Ariz. 2007). In this matter, the Advance Appraisal would constitute a "financial statement" under the broad view, but not the narrow view.

*McKnew* at 18, ¶ 73(C). For the reasons stated below, the court finds that McKnew has established the five elements of a § 523(a)(2)(A) claim based upon Wilson's misrepresentation of his intention to perform under the Cash Infusion Agreement.

1. Material Misrepresentation

Under the Cash Infusion Agreement, Wilson agreed to (i) provide UCB evidence that he was either obtaining financing or entering into a sales transaction for the Residence and/or Office by October 1, 2007; and (ii) deposit $2,750,000 with UCB by December 31, 2007. *Plaintiffs' Trial Exhibit 19; see also, Trial Declaration of Nick Volk* at 6, ¶ 20 (at the meeting in August 2007 at UCB's offices in San Francisco, according to UCB bank officer Volk, "To keep the Parkside Project moving forward Mr. Wilson represented to me, Mr. Lee and Mr. McKnew that he would immediately sell his home. He said he could come up with the $2,750,000.00 that was needed if Mr. McKnew would convert his $2.5 million of collateral into project equity immediately."). Wilson's representation that he would perform his contractual obligations was not true as he failed to perform, and was not otherwise excused from, his obligations under the Cash Infusion Agreement. *Id.* This misrepresentation was material because it was the type that would affect McKnew's decision making process regarding whether to invest an additional $2,500,000 into the Parkside Project by making the First and Second Deposits under the Agreement. *See Amended Trial Declaration of Thomas McKnew* at 15-20, ¶¶ 56-74.

Regarding his obligations under the Cash Infusion Agreement, Wilson testified in his trial declaration:

> . . . Parkside made extraordinary efforts to keep the Project afloat, including several attempts to renegotiate the loan with UCB. Specifically, in July, 2007, Mr. McKnew, Andre Hurst, Benjamin Meeker, and I met with UCB officials in San Francisco to discuss potential loan restructuring. During the meeting, several ideas and possible solutions were discussed. Said issues were distilled into a final agreement containing all parties' duties, rights, and responsibilities. That agreement is entitled Agreement for Cash Infusion and Release of Collateral. Again, at no time did I represent that I could or would liquidate homes in Mission Viejo, California or Breckinridge, Colorado in order to fund the Project.

*Trial Declaration of David Wilson* at 6, ¶ 19. This testimony does not dispute Plaintiffs' allegations that Wilson promised to sell or refinance the Residence or the Office as it indicates that he specifically denied that he could or would sell other property, namely, the homes in Mission Viejo and Colorado. Moreover, this conclusion is supported by the trial testimony of Andre Hurst, who also attended the meeting with UCB loan officials in July 2007, stating: "At no time did I witness Mr. Wilson represent that he could or would liquidate homes in Mission Viejo, California or Breckinridge, Colorado in order to fund the Project." *Trial Declaration of Andre Hurst* at 6-7, ¶ 19. Again, this testimony does not dispute that Wilson promised to sell or refinance the Residence or the Office.

Accordingly, the court finds by a preponderance of the evidence that Wilson represented he would perform his contractual obligations under the Cash Infusion Agreement, including selling or refinancing the Residence or the Office. Thus, Plaintiffs have proven by a preponderance of the evidence the first element of § 523(a)(2)(A) that Wilson made a misrepresentation.

2. Knowledge of Falsity

Next, Plaintiffs must prove that Wilson knew when he signed the Cash Infusion Agreement that he did not intend to perform the contractual obligations therein. *Plaintiffs' Trial Exhibit 19; see also, In re Barrack*, 217 B.R. at 606. In determining whether Wilson had an intention to perform, the court may look at all of the surrounding facts and circumstances. *In re Barrack,* 217 B.R. at 607. Likewise, "'where the promisor knew or should have known of his prospective inability to perform, the promise can be found to be fraudulent." *Id.* at 606

Here, Wilson's actions after signing the Cash Infusion Agreement demonstrate that he never intended to perform his contractual obligations. First, after signing the Cash Infusion Agreement on August 10, 2007, with a tight deadline of October 1, 2007, Wilson waited several weeks before listing the Residence for sale in early September 2007. *See Trial Declaration of Andre Hurst* at 6, ¶ 18; *Defendant's Trial Exhibit UUU* (copy of September 5, 2007 email from Hurst to McKnew); *Trial Testimony of Thomas*

*McKnew*, February 3, 2012 at 10:26 a.m. Additionally, rather than listing the property with an independent real estate brokerage, Wilson listed the Residence for sale with Hurst, his business partner in Parkside, as his sales representative despite Hurst not having any experience selling high-end homes in the area. *Trial Testimony of Thomas McKnew*, February 3, 2012 at 10:28 a.m.; *Trial Testimony of Andre Hurst,* August 31, 2011 at 1:39-1:48 p.m. and 2:16-2:19 p.m. (Hurst acknowledging that he had no sales experience for high end Dana Point real estate properties); *Trial Testimony of Andre Hurst,* August 31, 2011 at 3:29-3:30 p.m. and 3:49-3:50 p.m. (Hurst stated that he started working with Wilson in late 2006 and handled administrative tasks for Wilson on his development projects); *Trial Declaration of Nick Volk* at 7, ¶ 23; *see also, Trial Declaration of Andre Hurst* at 6, ¶ 18 (denying that Wilson or his wife ever told Hurst that they would not show or sell the Residence). Hurst never showed the Residence to prospective buyers. *Trial Testimony of Thomas McKnew*, February 3, 2012 at 10:34 a.m.; *see also, Trial Declaration of Andre Hurst* at 6, ¶ 18 (Hurst does not deny not showing the Residence).

Wilson failed to provide UCB evidence that he was obtaining financing or entering a sales transaction by the October 1, 2007 deadline. *Trial Testimony of Thomas McKnew*, February 3, 2012 at 10:22 a.m.; *see also, Trial Declaration of David Wilson* at 6, ¶ 19 (in his direct testimony, Wilson does not explain why he did not provide UCB the evidence that he was refinancing or selling the Residence or the Office by the October 1, 2007 deadline). As a result, the UCB Loan went into default, and UCB threatened to foreclose upon its collateral. *Trial Testimony of Thomas McKnew*, February 3, 2012 at 10:22 a.m.

Only thereafter, on December 20, 2007, did Wilson sign an exclusive residential real estate listing agreement with an experienced real estate brokerage agency. *See Plaintiffs' Trial Exhibit 7* (copy of listing agreement); *see also, Trial Declaration of Nick Volk* at 7, ¶ 23. However, the listing price, $8,700,000, greatly exceeded the value of the property. *See Defendant's Trial Exhibit UUU* (copy of September 5, 2007 email from

McKnew to Hurst stating it would be a "home run" if Wilson could sell the Residence for $6,500,000 to $7,000,000); *Plaintiffs' Trial Exhibit 11* (January 20, 2008 appraisal performed for UCB valuing the Residence at $3,900,000); *Trial Declaration of Nick Volk* at 7, ¶ 23. Additionally, Wilson did not provide UCB an opportunity to review the appraiser's credentials, as provided in the Cash Infusion Agreement, and the realtor selected by Wilson did not have any experience selling high-end homes in the area. *Plaintiffs' Trial Exhibit 19; Trial Declaration of Nick Volk* at 8, ¶ 23. As a result, the Residence was not sold in time to enable Wilson to make the Third Deposit by December 31, 2007. In his direct testimony in his trial declaration, Wilson provides no explanation of why he failed to meet his contractual obligations under the Cash Infusion Agreement wherein he agreed to (i) provide UCB evidence that he was either obtaining financing or entering into a sales transaction for the Residence and/or Office by October 1, 2007; and (ii) deposit $2,750,000 with UCB by December 31, 2007. *Plaintiffs' Trial Exhibit 19; Trial Declaration of David Wilson.*

Based on the foregoing, the evidence indicates that Wilson failed to make any reasonable effort after signing the Cash Infusion Agreement to fulfill his contractual obligations to sell or refinance the Residence or the Office to raise the funds he promised UCB and McKnew under the Agreement. Even though the meeting with UCB at which Wilson promised to sell or refinance the Residence took place in late July 2007, the Cash Infusion Agreement memorializing this promise was executed on August 10, 2007 and Wilson had an October 1 deadline for entering into a sales or refinancing transaction for the Residence, Wilson waited until September to list the property with his business partner, Hurst, rather than an independent real estate broker. Hurst had no meaningful sales experience handling high end properties like Wilson's residence, and he did not show the property to any prospective buyers. Wilson finally engaged an independent real estate brokerage to sell the Residence on December 20, 2007, but this was just days before he was obligated to deposit the $2,750,000 with the bank on December 31, 2007, presumably from the sale of the Residence. As Volk observed, Wilson and Hurst were

"un-cooperative" when the bank made inquiries of them of Wilson's efforts to sell the Residence pursuant to the Cash Infusion Agreement, and it appeared that Wilson really had no intention to sell the Residence as he had promised. *Trial Declaration of Nick Volk* at 7, ¶ 23. The totality of these circumstances indicating a lack of reasonable effort to market the Residence and meet the deadlines under the Cash Infusion Agreement demonstrates that Wilson never intended to perform his contractual obligations as he promised McKnew and the bank at the late July 2007 meeting and in the Cash Infusion Agreement. Accordingly, the court finds by a preponderance of the evidence that Wilson had actual knowledge that he did not intend to perform his contractual obligations under the Cash Infusion Agreement as promised to UCB and McKnew when Wilson executed the Agreement on August 10, 2007. Thus, Plaintiffs have proven by a preponderance of the evidence the second element of § 523(a)(2)(A) that Wilson had actual knowledge of the falsity of his representation to perform under the Cash Infusion Agreement.

3. Intention to Deceive

The foregoing evidence also demonstrates that Wilson intended to deceive McKnew. First, Wilson never informed McKnew or UCB that he would not perform under the Cash Infusion Agreement. *Amended Trial Declaration of Thomas McKnew* at 14-15, ¶¶ 56-60. Second, Wilson took several minimal steps toward performing his obligations to convince McKnew that he was making progress towards fulfilling his obligations and induce McKnew into making the First and Second Deposits, but which were not significant enough to make any real progress towards fulfilling Wilson's own obligations. *See Amended Trial Declaration of Thomas McKnew* at 15-20, ¶¶ 56-74; *Trial Declaration of Nick Volk* at 6-8, ¶¶ 19-25. For example, Wilson initially listed the Residence for sale with Hurst, his business partner in Parkside (as a managing member of Parkside), as his real estate agent, who had no experience selling high-end homes in the area. *Id.; see also, Trial Testimony of Andre Hurst,* August 31, 2011 at 1:39-1:48 p.m. and 2:16-2:19 p.m., 3:29-3:30 p.m. and 3:49-3:50 p.m; *Trial Testimony of David Wilson,* August 30, 2012 at 10:59 a.m. While the Residence was listed for sale, Hurst did not show the

Residence to prospective buyers. *Id.; see also, Trial Declaration of Andre Hurst.* Further, it was only when UCB threatened to foreclose upon the Parkside Property that Wilson listed the Residence for sale with a professional realtor. *Id.; Trial Declaration of Nick Volk.* However, the realtor was also inexperienced selling high-end homes in the area and the listing price far exceeded the Residence's market value. *Id.* These facts demonstrate that Wilson took affirmative steps to deceive McKnew for as long as possible of his intention to not perform under the Cash Infusion Agreement.

In addition, the circumstances also demonstrate that Wilson had the motive to make the misrepresentation in the Cash Infusion Agreement. *Plaintiffs' Trial Exhibit 19.* First, the misrepresentation caused McKnew to further invest in the troubled Parkside Project by depositing an additional $2,500,000 with UCB on behalf of the Parkside Project. *See Amended Trial Declaration of Thomas McKnew* at 15-20, ¶¶ 56-74. When the Cash Infusion Agreement was executed, it was believed that, if construction was completed, Parkside could sell the condos for a minimum of $200,000 per unit, which would be sufficient to repay the UCB Loan from 100 sales and still have profit remaining as an incentive for Parkside to complete the Parkside Project. *See Plaintiffs' Trial Exhibit 17* at 2 (copy of Volk Memorandum). Thus, while the Parkside Project was clearly troubled at this time, McKnew's additional investment through the Cash Infusion Agreement provided Wilson a last chance to complete construction, sell the remaining units, and salvage a profit from the Parkside Project. *See Amended Trial Declaration of Thomas McKnew* at 15-20, ¶¶ 56-74; *see also, Trial Declaration of David Wilson* at 6-7, ¶¶ 19-20 (acknowledging the problems that the Parkside Project was having and the Cash Infusion Agreement was executed to attempt to solve those problems). Second, the misrepresentation delayed UCB's foreclosure of its collateral for several months. *Id.* When the Cash Infusion Agreement was executed, the Parkside Property had depreciated significantly and only partially secured the UCB Loan. *Id.* And, pursuant to the Additional Collateral Agreement, UCB would foreclose upon the Residence and Office before the McKnew Condominiums to satisfy the outstanding balance under the

UCB Loan. *Id.* Thus, by misrepresenting his intention to perform under the Cash Infusion Agreement, Wilson was able to delay UCB's foreclosure of the Residence and the Office, in addition to the Parkside Property. *Id.*

Based upon the totality of these circumstances, the court finds by a preponderance of the evidence that Wilson intended to deceive McKnew in making promises under the Cash Infusion Agreement. Thus, Plaintiffs have proven the third element of § 523(a)(2)(A) by a preponderance of the evidence.

4. Actual and Justifiable Reliance

During trial, McKnew testified that he actually relied upon Wilson's representation that he would perform his obligations under the Cash Infusion Agreement. *See Amended Trial Declaration of Thomas McKnew* at 20, ¶ 74. Such testimony is corroborated by McKnew making the First and Second Deposits to UCB, which constituted full performance of his individual obligations under the Cash Infusion Agreement. *Idi.; Trial Testimony of Thomas McKnew*, February 3, 2012 at 10:21 a.m.; *Trial Testimony of David Wilson,* August 31, 2012 at 4:03-4:05 p.m. Additionally, McKnew's reliance was justifiable because he had no reason to believe that Wilson did not intend to perform his obligations under the Cash Infusion Agreement. *Id.* Therefore, based upon the totality of these circumstances, the court finds by a preponderance of the evidence that McKnew actually and justifiably relied upon Wilson's misrepresentation. Thus, McKnew has proven the fourth element of § 523(a)(2)(A).

5. Proximate Cause and Damages

The court finds that Wilson's misrepresentation to perform under the Cash Infusion Agreement actually caused McKnew to further invest into the Parkside Project by making the First and Second Deposits under the Cash Infusion Agreement. But for Wilson's representation to perform under the Cash Infusion Agreement, McKnew would not have made the First and Second Deposits to UCB and on behalf of the Parkside Project. Further, Wilson's failure to (i) provide evidence as to his efforts to market and sell the Residence; and (ii) make the Third Deposit placed the Parkside Project in default and

caused the certain failure of the Parkside Project. Thus, Wilson's misrepresentation actually caused McKnew to suffer $2,500,000 in damages (the amount of McKnew's First and Second Deposits).

The court further finds that Wilson's misrepresentation proximately caused Plaintiffs' damages. "A fraudulent misrepresentation is a legal cause of a pecuniary loss resulting from action or inaction in reliance upon it if, but only if, the loss might reasonably be expected to result from the reliance." *Restatement (Second) of Torts* § 548A (1977). Here, Plaintiffs' damages could be reasonably expected to result from Wilson's misrepresentation because UCB had not to foreclose on its loan if the terms of the Cash Infusion Agreement were satisfied, which included the First and Second Deposit by McKnew and the Third Deposit by Wilson. As noted above, when the Cash Infusion Agreement was executed on August 10, 2007, the UCB Loan was in default. The Parkside Project was in jeopardy, but its failure was not certain. However, after Wilson's nonperformance under the Cash Infusion Agreement, it could be reasonably expected that UCB would foreclose upon the Parkside Property, causing the failure of the Parkside Project and wiping out McKnew's equity investment of $2,500,000 under the Cash Infusion Agreement.

Accordingly, the court finds by a preponderance of the evidence that Wilson's misrepresentation actually and proximately damaged Plaintiffs in the amount of $2,500,000. Therefore, Plaintiffs have proven the five elements of a § 523(a)(2)(A) claim with respect to Wilson's misrepresentation based on his promises that he intended to perform his obligations under the Cash Infusion Agreement.

**D. Other Personal Assets**

Finally, Plaintiffs argue that Wilson misrepresented his intention to "liquidate his other personal assets to save UCB funding." *Plaintiffs' Closing Argument* at 14. During trial, McKnew and Volk testified that Wilson represented that he could quickly liquidate the Colorado Property and Mission Viejo Condo to raise capital and would contribute such funds to the Parkside Project. *See Amended Trial Declaration of Thomas McKnew*

at 11, ¶ 46; *Trial Declaration of Nick Volk* at 4, ¶ 10. However, for the reasons stated below, Plaintiffs have not proven any of the elements necessary for a § 523(a)(2)(A) claim to be based upon such allegations.

First, Plaintiffs have not proven with the requisite specificity that Wilson made this representation. Other than the Trial Declarations of McKnew and Volk, there is no evidence within the extensive record before this court that the parties ever contemplated the sale of the Colorado Property or Mission Viejo Condo. *See also, Trial Declaration of David Wilson* at 6, ¶ 19; *Trial Declaration of Andre Hurst* at 6-7, ¶ 19. Of the numerous emails admitted into evidence, none discuss the sale of these properties.

Second, Plaintiffs have not proven that Wilson made this representation with knowledge of the falsity or intention to deceive. Plaintiffs have only alleged that Wilson promised to sell these properties and failed to do so. Plaintiffs have not alleged the circumstances surrounding these specific representations from which Wilson's fraudulent intent can be inferred.

Third, Plaintiffs have not proven that he actually or justifiably relied upon this representation. As mentioned above, other than the testimony of McKnew and Volk, there is no evidence before the court that the parties ever contemplated the sale of these properties.

Fourth, Plaintiffs have not proven that his damages were actually or proximately caused by this representation. There is no evidence that, had Wilson sold the Colorado Property and Mission Viejo Condo and contributed such proceeds to the Parkside Project, the Parkside Project would not have failed or McKnew would not have suffered similar losses.

Therefore, Plaintiffs have not proven any of the elements of a § 523(a)(2)(A) claim with respect to Wilson's alleged representation that he would sell the Colorado Property and Mission Viejo Condo and contribute such proceeds to the Parkside Project.

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**III. Section 523(a)(4) Claim**

11 U.S.C. § 523(a)(4) states, "[a] discharge under section 727 . . . of this title does not discharge an individual debtor from any debt – (4) for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny." Plaintiffs contend that their damages were also caused by Wilson's fraud and defalcation while acting in a fiduciary capacity.

In order for Plaintiffs to prevail under § 523(a)(4), they must demonstrate, by a preponderance of the evidence, the following: (1) an express or technical trust existed; (2) the debt at issue was caused by fraud or defalcation; and (3) the debtor was a fiduciary to the creditor at the time the debt was created. *Nahman v. Jacks (In re Jacks)*, 266 B.R. 728, 735 (9th Cir. BAP 2001).

Section 523(a)(4) requires an express or technical trust in existence before and independently of the defalcation. *In re Jacks*, 266 B.R. at 736, *citing Lewis v. Scott (In re Lewis)*, 97 F.3d 1182, 1185 (9th Cir.1996). Within the meaning of § 523(a)(4), an express or technical trust must be "imposed before, and without reference to, the wrongdoing that caused the debt as opposed to a trust *ex maleficio*, constructively imposed because of the act of wrongdoing from which the debt arose." *Honkanen v. Hopper* (*In re Honkanen*), 446 B.R. 373, 379 (9th Cir. BAP 2011). Further, "[w]hether a fiduciary is a 'trustee in that strict and narrow sense,' is determined in part by reference to state law." *In re Lewis*, 97 F.3d at 1185, *quoting, Ragsdale v. Haller*, 780 F.2d 794, 795 (9th Cir.1986).

Plaintiffs argue that "[u]nder California state law it is clear that a joint venturer or a partner is a fiduciary under circumstances involving their principal's or partnership's property within the meaning of § 523(a)(4)." *Plaintiffs' Closing Argument* at 23. Under California law, "partners or joint venturers have a fiduciary duty to act with the highest good faith towards each other regarding affairs of the partnership or joint venture. The essential element of a joint venture is an undertaking by two or more persons to carry out a single business enterprise jointly for profit. 'The rights and liabilities of joint adventurers, as between themselves, are governed by the same rules which apply to

partnerships.' Whether a joint venture relationship exists is a question of fact, depending on the intention of the parties." *Pellegrini v. Weiss*, 165 Cal. App. 4th 515, 524-25 (2008) (citations omitted).

Here, there is no evidence that McKnew or Wilson ever considered themselves to be in a partnership. McKnew and Wilson were members within the same limited liability company. Membership in the same company does not form a partnership. *See* CAL. CORP. CODE § 16202(b) ("An association formed under a statute other than this chapter, a predecessor statute, or a comparable statute of another jurisdiction is not a partnership under this chapter.").

Therefore, Plaintiffs have not proven that Wilson owed McKnew a fiduciary duty. (Because it was not argued, the court makes no findings about whether a fiduciary relationship existed pursuant to their membership in Parkside. *See* CAL. CORP. CODE § 17153 ("The fiduciary duties a manager owes to the limited liability company and to its

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members are those of a partner to a partnership and to the partners of the partnership.").)

**CONCLUSION**

For the foregoing reasons, the court determines that the debt from Plaintiffs' damages arising from Wilson's fraudulent misrepresentation of his intention to perform under the Cash Infusion Agreement is excepted from discharge pursuant to 11 U.S.C. § 523(a)(2)(A). All other claims for relief are denied. Plaintiffs shall submit a proposed judgment within 30 days of the entry of this memorandum decision consistent with the decision.

IT IS SO ORDERED.

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Date: September 27, 2013

Robert Kwan
United States Bankruptcy Judge

# NOTICE OF ENTERED ORDER AND SERVICE LIST

Notice is given by the court that a judgment or order entitled (*specify*) **MEMORANDUM DECISION ON ADVERSARY COMPLAINT FOR NONDISCHARGEABILITY OF DEBTS** was entered on the date indicated as "Entered" on the first page of this judgment or order and will be served in the manner indicated below:

**I. SERVED BY THE COURT VIA NOTICE OF ELECTRONIC FILING ("NEF")** – Pursuant to controlling General Order(s) and Local Bankruptcy Rule(s), the foregoing document was served on the following person(s) by the court via NEF and hyperlink to the judgment or order. As of **September 27, 2013**, the following person(s) are currently on the Electronic Mail Notice List for this bankruptcy case or adversary proceeding to receive NEF transmission at the email address(es) indicated below:

- James Andrew Hinds jhinds@jhindslaw.com, zbilowit@jhindslaw.com
- Hye Jin Jang hjang@jhindslaw.com
- Hye Jin Jang hjang@jhindslaw.com
- Weneta M Kosmala (TR) Weneta.Kosmala@7trustee.net, ca15@ecfcbis.com;wkosmala@kosmalalaw.com;dfitzger@kosmalalaw.com;kgeorge@kosmalalaw.com
- Paul R Shankman pshankman@jhindslaw.com
- United States Trustee (SA) ustpregion16.sa.ecf@usdoj.gov

**II. SERVED BY THE COURT VIA U.S. MAIL:** A copy of this notice and a true copy of this judgment or order was sent by U.S. Mail, first class, postage prepaid, to the following person(s) and/or entity(ies) at the address(es) indicated below:

**Debtor:**
David A Wilson
24352 Santa Clara
Dana Point, CA 92629

William Burd
200 w. Santa Ana Blvd
Suite 400
Santa Ana, CA 92701

Jon-Michael A Marconi
668 N Coast Hwy #309
Laguna Beach, CA 92651

**III. TO BE SERVED BY THE LODGING PARTY**: Within 72 hours after receipt of a copy of this judgment or order which bears an "Entered" stamp, the party lodging the judgment or order will serve a complete copy bearing an "Entered" stamp by U.S. Mail, overnight mail, facsimile transmission or email and file a proof of service of the entered order on the following person(s) and/or entity(ies) at the address(es), facsimile transmission number(s) and/or email address(es) indicated below: