



**UNITED STATES BANKRUPTCY COURT
CENTRAL DISTRICT OF CALIFORNIA
LOS ANGELES DIVISION**

In re

DAVID A. WILSON,

Debtor.

Case No. 2:12-bk-16195-RK

Chapter 7

Adv. No. 2:12-ap-01316-RK

RICHARD LARA,

Plaintiff,

vs.

DAVID A. WILSON,

Defendant.

**MEMORANDUM DECISION ON
ADVERSARY COMPLAINT TO
DETERMINE DISCHARGEABILITY OF
DEBT**

This adversary proceeding came on for trial before the undersigned United States Bankruptcy Judge on July 29, September 29 and October 14, 2011 on the complaint of plaintiff Richard Lara ("Lara") to determine dischargeability of debt of debtor David A. Wilson ("Wilson") 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

1 court took the matter under submission on November 25, 2011 after the last post-trial
2 brief was filed.

3 Having considered the testimony of witnesses, the exhibits received into
4 evidence, and the oral and written arguments of the parties, the court hereby makes the
5 following findings of fact and conclusions of law pursuant to Federal Rule of Civil
6 Procedure 52(a), Federal Rules of Bankruptcy Procedure 7052 and 9014, and Local
7 Bankruptcy Rule 7052-1.

8 **BACKGROUND**

9 By his adversary complaint, Lara seeks a determination that debts based on his
10 two separate claims for damages against Wilson are nondischargeable. The first claim
11 for damages is based on Lara's allegations that Wilson assigned Lara a 4½%
12 membership interest in PK Holdings, Inc. ("PK Holdings"), subsequently assigned and
13 encumbered Lara's interest without Lara's knowledge or consent, and later
14 misappropriated Lara's share of a distribution from PK Holdings in the amount of
15 \$1,260,193.79. The second claim for damages is based on Lara's allegations that Wilson
16 assigned Lara an 8¾% membership interest in MT Investors, LLC ("MT Investors") and
17 Lara received less than he was entitled in two distributions made by MT Investors due to
18 wrongful actions of Wilson. For clarity, the following factual summary separately
19 addresses the chronology of each claim for damages.

20 PK DISTRIBUTION

21 In 1995, Lara first met Wilson and began working for Wilson's construction
22 company, A&W Builders, Inc. ("A&W"). *Amended Joint Pretrial Order ("Amended JPTO")*
23 at 2, ¶ 5; *Direct Trial Testimony Declaration of Richard Lara ("Lara Declaration")* at 1, ¶ 2.
24 Lara was a 10-year employee for Wilson and A&W. *Id.* During Lara's employment with
25 A&W, Lara and Wilson developed a very close personal relationship. *Id.* Lara
26 considered Wilson a strong friend, upon whom he could thoroughly trust and rely. *Lara*
27 *Declaration* at 2, ¶ 4.

1 Lara rose to the position of Executive Vice President of Operations of A&W.
2 *Amended JPTO* at 2, ¶ 6; *Lara Declaration* at 2, ¶ 3. As the Executive Vice President of
3 Operations, Lara oversaw and managed all of A&W's field operations and construction
4 projects, and was in charge of accounting, estimating and awarding contracts. *Id.*

5 During the beginning of Lara's employment with A&W, Lara was compensated by
6 way of salary with a car allowance, gas card, and cell phone. *Amended JPTO* at 2, ¶ 7.
7 Lara was also allowed and reimbursed for health insurance costs. *Amended Direct Trial*
8 *Testimony Declaration of David A. Wilson ("Wilson Declaration")* at 1, ¶ 2.

9 In 1999, Lara left the employ of A&W to work for another company. *Amended*
10 *JPTO* at 2, ¶ 8. In or around 2001, Lara was induced to return to A&W by a promise by
11 Wilson that Lara would receive increased compensation. *Amended JPTO* at 2, ¶ 9; *Lara*
12 *Declaration* at 2, ¶ 5. Wilson promised Lara a compensation structure that entitled Lara
13 to a bonus equal to ten percent (10%) of the cost savings on each construction project
14 Lara managed for A&W (the "Cost Savings Compensation Scheme"). *Amended JPTO* at
15 2, ¶ 10. After Wilson promised to pay Lara such bonus compensation, Lara began
16 tracking the cost savings on the projects he managed. *Id.* at 2, ¶ 11; *Trial Testimony of*
17 *Richard Lara*, September 29, 2011 at 11:31-11:32 a.m. Based on the Cost Savings
18 Compensation Scheme, Lara was entitled to receive a bonus of \$137,000 on a project
19 renovating a condo development located in Santa Monica, CA (the "Santa Monica
20 Project"). *Lara Declaration* at 2, ¶ 11. Of the \$137,000 bonus earned on the Santa
21 Monica Project, Lara ultimately received a check in the sum of \$75,000 as partial
22 payment for the amount that as owed (the "Partial Payment"), leaving the sum of \$62,000
23 unpaid. *Id.* at 3, ¶ 12.

24 In tracking the cost savings on the projects he managed for A&W, Lara discovered
25 that Wilson was using A&W funds to pay personal expenses, including payments to his
26 girlfriend for living expenses and luxury cars. *Lara Declaration* at 2, ¶¶ 9-11; *Trial*
27 *Testimony of Richard Lara*, September 29, 2011 at 11:27-11:32 a.m.. After completion of
28 the Santa Monica Project, Lara presented Wilson with his calculation of the cost savings

1 on that project. *Lara Declaration* at 3, ¶¶ 10-11. Lara did not include Wilson's personal
2 expenses because they caused the cost savings to be understated. *Id.* However, Wilson
3 insisted those expenses be included. *Id.*

4 Lara grew frustrated with tracking the cost savings of A&W projects. *Lara*
5 *Declaration* at 3, ¶ 11; *Trial Testimony of Richard Lara*, September 29, 2011 at 11:31-
6 11:32 a.m. Thereafter, Lara and Wilson agreed that Lara's bonuses would no longer be
7 calculated as a percentage amount under the Cost Savings Compensation Scheme.
8 *Amended JPTO* at 3, ¶ 14. Wilson promised to pay Lara a flat \$100,000 bonus per
9 project that Lara managed. *Id.* Lara earned \$100,000 fees for projects in West Covina,
10 CA (the "West Covina Project") and San Pedro, CA (the "San Pedro Project"). *Id.* Wilson
11 did not pay Lara the \$100,000 bonuses owed for the West Covina Project and the San
12 Pedro Project. *Amended JPTO* at 3, ¶ 15.

13 Thus, by the first quarter of 2004, Wilson promised but failed to pay Lara a total of
14 \$262,000 for the Santa Monica, West Covina, and San Pedro Projects (the "Unpaid
15 Bonus Compensation"). *Amended JPTO* at 3, ¶ 16; *Lara Declaration* at 3, ¶ 14.

16 In the fall of 2003, Wilson purchased a membership interest in Presidio Kauai, LLC
17 ("Presidio Kauai"), along with Edward "Ned" DeLorme ("DeLorme"), Sushil Patel ("Patel"),
18 and Bridge Capital, LLC ("Bridge Capital"). *Amended JPTO* at 3, ¶ 18; *Wilson*
19 *Declaration* at 2, ¶ 4. (The court acknowledges that the *Amended JPTO*, as well as the
20 Wilson's Trial Declaration, state that Wilson purchased a *security* interest in Presidio
21 Kauai, and the testimony of the witnesses and the exhibits relating to Presidio Kauai
22 indicate that Wilson purchased a *membership* interest in Presidio Kauai rather than
23 taking a security interest as a lender.) At the time, Presidio Kauai owned the real
24 property located as the "Kauai Coconut Beach Hotel" in Hawaii (the "Kauai Hotel"). *Lara*
25 *Declaration* at 3, ¶ 15. Presidio Kauai's sole purpose was to purchase and renovate the
26 Kauai Hotel (the "Kauai Project"). *Amended JPTO* at 3, ¶ 18; *Lara Declaration* at 3, ¶ 15.
27 Thereafter, PK Holdings, LLC, a Hawaii limited liability company ("PK Holdings"), was
28 formed as a holding company for Presidio Kauai. *Wilson Declaration* at 2, ¶ 4; *Lara*

1 *Declaration* at 4, ¶ 18. Wilson, DeLorme, and Patel were “Initial Managers” of PK
2 Holdings as such term is defined in the First Amended and Restated Operating
3 Agreement of PK Holdings, LLC (the “First Amended Operating Agreement”). See
4 *Plaintiff’s Trial Exhibit 107*, at 10, Article II, ¶ 31.

5 A&W was the construction company working on the Kauai Project, and Lara
6 worked on the Kauai Project in his capacity as A&W’s Executive Vice President of
7 Operations. *Amended JPTO* at 3, ¶ 20.

8 In 2003 (and prior to the formation of PK Holdings), Wilson orally assigned to Lara
9 a 5% membership interest in Presidio Kauai (the “Oral PK Assignment”). *Amended*
10 *JPTO* at 4, ¶ 23; *Lara Declaration* at 3, ¶ 15; *Trial Testimony of Richard Lara*, September
11 29, 2011 at 11:59 a.m. The Oral PK Assignment was understood by Lara as
12 consideration for Lara’s future work on the Kauai Project. See *Lara Declaration* at 4, ¶
13 17; *Trial Testimony of Richard Lara*, September 29, 2011 at 12:00-12:02 p.m.

14 Soon thereafter, Lara insisted that the Oral PK Assignment be put in writing. *Lara*
15 *Declaration* at 4, ¶ 20. Wilson approached A&W’s then counsel, Irina Drill (“Drill”), and
16 asked that she draft an agreement memorializing the terms of the Oral PK Assignment.
17 *Lara Declaration* at 4, ¶ 21; *Trial Testimony of Richard Lara*, September 29, 2011 at
18 11:33-11:34 a.m. Thereafter, on or about June 7, 2004, Drill prepared a draft assignment
19 (the “Drill Assignment”) by Wilson to Lara of a 5% membership interest in Presidio Kauai.
20 *Id.*; see also *Plaintiff’s Trial Exhibit 5* (copy of the Drill Assignment). The Drill Assignment
21 reflected Lara’s understanding of the Oral PK Assignment in that it absolutely assigned to
22 Lara a 5% membership interest in Presidio Kauai. *Lara Declaration* at 4, ¶ 22; *Trial*
23 *Testimony of Richard Lara*, September 29, 2011 at 11:34-11:36 a.m. Wilson refused to
24 sign the Drill Assignment because he believed it had too much “legalese” and needed to
25 be simplified. *Lara Declaration* at 4, ¶ 23.

26 In or about 2004, Lara demanded that Wilson execute a written assignment for the
27 Oral PK Assignment. *Lara Declaration* at 5, ¶¶ 25-30. Wilson agreed, but insisted on
28 modifying the terms of the Oral PK Assignment to make it economically worse for Lara.

1 *Lara Declaration* at 5, ¶ 31. Specifically, Wilson insisted that Lara's Unpaid Bonus
2 Compensation, totaling \$262,000, act as a capital contribution for a new written
3 assignment of a portion of Wilson's membership interest in PK Holdings (which had now
4 been formed as a holding company for Presidio Kauai). *Id.* Wilson also insisted that
5 Lara provide a further capital contribution for the written assignment in the form of a
6 \$150,000 payment from Lara's home equity line of credit to A&W to pay for Kauai Project
7 expenses. *Id.* Finally, Wilson informed Lara that he would only receive a 4½%
8 membership interest in PK Holdings under the written assignment, as opposed to the
9 5.0% membership interest Lara was promised in the Oral PK Assignment. *Lara*
10 *Declaration* at 6, ¶ 32.

11 To induce Lara to accept the new terms, Wilson promised to Lara that Lara would
12 receive a return of his capital contributions, plus interest, and a share of the profits of PK
13 Holdings. *Lara Declaration* at 6, ¶ 34. Thus, Lara would receive far more than the
14 amount of the capital contributions that Lara would use to procure such written
15 assignments. *Id.* In reliance upon Wilson's promises, Lara agreed to the new terms.
16 *Lara Declaration* at 6, ¶ 35.

17 In March 2005, Wilson then approached Eric Dean ("Dean"), PK Holdings' and MT
18 Investors' attorney, to prepare a written assignment that would replace the terms of the
19 Oral PK Assignment. See *Lara Declaration* at 6, ¶ 36. Wilson and Lara met with Dean
20 and described the written assignment that they wanted him to draft. *Lara Declaration* at
21 6, ¶ 37.

22 On March 15, 2005, Wilson and Lara executed a written assignment of a share of
23 Wilson's interest in PK Holdings to Lara (the "Written PK Assignment"). *Amended JPTO*
24 at 4, ¶ 27; see also *Plaintiff's Trial Exhibit 1* (copy of the Written PK Assignment). Dean
25 drafted the Written PK Assignment. *Amended JPTO* at 4, ¶ 26.

26 In the Written PK Assignment, Wilson assigned Lara a 4½% of his "capital account
27 and percentage interest" in PK Holdings. *Amended JPTO* at 4, ¶ 27; see also *Plaintiff's*
28 *Trial Exhibit 1*. In exchange, Lara forgave the Unpaid Bonus Compensation (\$262,000)

1 and contributed an additional \$150,000 to A&W, for a total consideration of \$412,000.

2 *Amended JPTO* at 4, ¶ 29.

3 The Written PK Assignment was a valid assignment and effective to transfer a
4 4½% interest in and to Wilson's membership interest in PK Holdings, and thereby reduce
5 Wilson's membership interest in PK Holdings to 25½%, and was made for valid
6 consideration as recited in the total sum of \$412,000. *Amended JPTO* at 5, ¶ 36. Wilson
7 had actual knowledge that the Written PK Assignment was a valid assignment and was
8 not a term sheet. *Amended JPTO* at 5-6, ¶¶ 37-40.

9 After executing the Written PK Assignment, Wilson made three (3) separate
10 attempts to assign and/or encumber his original 30% interest in PK Holdings even though
11 Wilson only owned a 25½% interest in PK Holdings after the Written PK Assignment.
12 These attempts necessarily impaired the 4½% interest in PK Holdings that he previously
13 assigned to Lara. *See Lara Declaration* at 10, ¶ 54.

14 In October 2005, approximately seven (7) months after executing the Written PK
15 Assignment, Wilson first attempted to re-assign and encumber the portion of the
16 membership interest in PK Holdings he already transferred to Lara. *Id.* At that time,
17 Wilson owned a controlling interest in another company, Parkside Ventures, LLC
18 ("Parkside"). *Id.* On or about October 24, 2005, Wilson caused Parkside to obtain a loan
19 from Bridge Capital in the amount of \$4.85 million (the "October 2005 Loan"). *Id.* As
20 security for the October 2005 Loan, Wilson executed, or caused to be executed, several
21 instruments:

22 a. A security agreement granted by A&W in favor of Bridge Capital,
23 whereby Bridge Capital received a security interest on all of A&W's
accounts receivable from PK Holdings;

24 b. A pledge agreement executed by Wilson in favor of Bridge Capital,
25 whereby Wilson pledged a first priority lien on a 30% membership interest
in PK Holdings, and any future distributions therefrom (the "October 2005
Pledge Agreement");

26 c. An assignment by Wilson, as assignor, to Bridge Capital, as
27 assignee, of a 30% membership interest in PK Holdings (the "October 2005
Assignment").

1 *Id.*; see also *Plaintiff's Trial Exhibits* 6-8. The October 2005 Pledge Agreement and the
2 October 2005 Assignment represent Wilson's first attempt to encumber or assign the
3 4½% interest in PK Holdings that Wilson already transferred to Lara. *Id.*

4 Meanwhile, in or about late 2005, the Kauai Hotel was sold. *Lara Declaration* at
5 10, ¶ 57. A dispute arose between Wilson, on the one hand, and the other members of
6 PK Holdings, including DeLorme and Patel (collectively, the "Members"), on the other
7 hand, regarding *inter alia* the distribution of the sale proceeds from the Kauai Hotel. *Lara*
8 *Declaration* at 11, ¶ 58. This dispute resulted in litigation, which was subsequently sent
9 to arbitration in Hawaii (the "Hawaii Arbitration"). *Id.* Lara was not a party to the Hawaii
10 Arbitration. *Lara Declaration* at 11, ¶ 63. Pending the resolution of the Hawaii
11 Arbitration, the sale proceeds from the Kauai Hotel (the "Kauai Sale Proceeds") were
12 deposited in an escrow account with Title Guaranty Escrow Services, Inc. ("TG Escrow").
13 *Lara Declaration* at 11, ¶ 58.

14 On November 29, 2005, Wilson was removed as a managing member of PK
15 Holdings. *Wilson Declaration* at 6, ¶ 33. Lara did not participate in the vote to remove
16 Wilson. See *Trial Testimony of Sushil Patel*, September 29, 2011 at 9:57 a.m.

17 In December 2005, Wilson's counsel, Benjamin Meeker ("Meeker"), approached
18 Lara and asked that he sign a declaration in support of Wilson in the Hawaii Arbitration.
19 *Wilson Declaration* at 7, ¶ 40; *Lara Declaration* at 11, ¶ 59. Lara refused to sign the
20 proposed declaration as drafted because he believed it contained numerous
21 inaccuracies. *Lara Declaration* at 11, ¶ 59. Instead, Lara signed a declaration in support
22 of DeLorme and Patel. *Id.*; see also *Wilson Declaration* at 7, ¶ 41-42.

23 Shortly thereafter, by a letter dated January 18, 2006 from Meeker to Marshall
24 Mintz, counsel for Lara, Wilson denied the validity of the Written PK Assignment. *Lara*
25 *Declaration* at 11, ¶ 60; see also *Plaintiff's Trial Exhibit 100*.

26 On May 1, 2006, Lara filed a complaint for declaratory relief regarding the validity
27 of the Written PK Assignment against Wilson ("Lara State Court Complaint") in the
28 Superior Court of California, County of Orange, commencing the lawsuit of *Richard Lara*

1 v. *David Wilson*, Case No. 06CC05599. *Amended JPTO* at 7, ¶ 56. Those proceedings
2 are further described below.

3 On May 9, 2006, Wilson procured another loan from Bridge Capital (the “May 2006
4 Loan”). *Amended JPTO* at 8, ¶ 60. The May 2006 Loan was a personal loan to Wilson
5 in an amount of \$1.5 million. *Amended JPTO* at 8, ¶ 61. As security for the May 2006
6 Loan, Wilson once again assigned to Bridge Capital a 30% membership interest in PK
7 Holdings (the “May 2006 Assignment”), despite only owning a 25½% membership
8 interest after the Written PK Assignment. *Amended JPTO* at 8, ¶ 62; *see Plaintiff’s Trial*
9 *Exhibit 10* (copy of May 2006 Assignment). The May 2006 Assignment represents
10 Wilson’s second attempt to encumber or assign Lara’s 4½% interest in PK Holdings.

11 On or around November 2, 2006, the Hawaii Arbitration panel entered the
12 *Arbitrators’ Partial Final Award* (the “Partial Hawaii Award”), providing that Wilson and
13 the Members should each receive a distribution of a return of their capital, plus interest,
14 and a percentage share of the Kauai Sale Proceeds (the “PK Distribution”). *Amended*
15 *JPTO* at 8, ¶ 63; *see also Plaintiff’s Trial Exhibit 11* (copy of the Partial Hawaii Award).

16 Because Lara was not a party to the Hawaii Arbitration, the Partial Hawaii Award
17 did not provide Lara a share of the PK Distribution. *Lara Declaration* at 11, ¶ 63; *see also*
18 *Plaintiff’s Trial Exhibit 11*. Instead, the Partial Hawaii Award awarded Wilson a
19 distribution on account of a 30% membership interest, rather than the 25½% interest he
20 actually owned. *Id.*

21 The Members, through counsel, informed the Hawaii Arbitration panel of the
22 Written PK Assignment and Lara’s right to a portion of the PK Distribution attributable to
23 Wilson’s former or original 30% membership interest in PK Holdings. *Direct Trial*
24 *Testimony Declaration of Sushil Patel* (“*Patel Declaration*”) at 5, ¶ 26; *Direct Trial*
25 *Testimony Declaration of Edward DeLorme* (“*DeLorme Declaration*”) at 5, ¶ 27. Wilson
26 did not inform the Hawaii Arbitration panel of the Written PK Assignment or otherwise
27 disclose during the Hawaii Arbitration that he assigned 4½% of his membership interest
28 in PK Holdings to Lara. *Patel Declaration* at 5, ¶ 27; *DeLorme Declaration* at 5, ¶ 28. In

1 fact, during the course of the Hawaii Arbitration, Wilson denied that he assigned a 4½%
2 membership interest in PK Holdings to Lara. *Id.*

3 On December 19 and 20, 2006, the Hawaii Arbitration panel entered a final order
4 directing TG Escrow to make the PK Distribution (“Final Hawaii Award”). *Amended JPTO*
5 at 8, ¶ 64.

6 Lara tried to enjoin TG Escrow from distributing his share of the PK Distribution to
7 Wilson. *Lara Declaration* at 12, ¶ 67; *Patel Declaration* at 6, ¶ 28; *DeLorme Declaration*
8 at 6, ¶ 29; *see also Plaintiff’s Trial Exhibit 118*. In particular, on or about December 21,
9 2006, Lara filed a motion with the Circuit Court of the State of Hawaii to enjoin TG
10 Escrow from making distributions that were inconsistent with the Written PK Assignment.
11 *Id.*

12 On November 2, 2006, Bridge Capital initiated an action against Wilson to
13 foreclose on its lien under the October 2005 Pledge Agreement, the October 2005
14 Assignment and/or the May 2006 Assignment. *Amended JPTO* at 9, ¶ 70.

15 In or about November 2006, to prevent foreclosure by Bridge Capital, Wilson
16 secured another loan from United Commercial Bank (the “United Commercial Loan”).
17 *Amended JPTO* at 9, ¶ 71. United Commercial agreed to pay off the October 2005 Loan
18 and/or the May 2006 Loan, in return for which Wilson promised to immediately transfer to
19 United Commercial the entire share of the PK Distribution attributable to his former 30%
20 membership interest in PK Holdings (the “United Commercial Assignment”). *Wilson*
21 *Deposition (July 13, 2007)* at 178:16-183:22. The United Commercial Assignment
22 represents Wilson’s third attempt to encumber or assign Lara’s 4½% interest in PK
23 Holdings.

24 Thereafter, Wilson actually received the gross sum of approximately \$4.5 million
25 from the PK Distribution. *Amended JPTO* at 9, ¶ 74. On account of Lara’s 4½% interest
26 in PK Holdings, Lara was entitled to a portion of the PK Distribution in the amount of
27 \$1,260,193.79. *See Amended JPTO* at 8, ¶ 65.

1 After his paying attorneys' fees, Wilson immediately paid the balance of the PK
2 Distribution, including Lara's share, to United Commercial pursuant to the United
3 Commercial Assignment. *Lara Declaration* at 13, ¶ 73; see also *Amended JPTO* at 8, ¶¶
4 67, 74.

5 Therefore, Wilson breached the Written PK Assignment by failing to pay Lara his
6 share of the PK Distribution. *Amended JPTO* at 8, ¶ 68. Wilson's failure to pay to Lara
7 his share of the PK Distribution was not justified or excused. *Id.* As a result of this
8 breach, Lara was damaged and entitled to recover \$1,260,193.79. *Amended JPTO* at 8,
9 ¶ 69.

10 MT DISTRIBUTION

11 In addition to his membership in PK Holdings, Wilson was also a member of MT
12 Investors, LLC ("MT Investors"), a company that owned and was renovating several
13 properties in Alabama and Oklahoma. *Amended JPTO* at 4, ¶ 22. Sushil Patel was a
14 managing member of MT Investors. *Patel Declaration* at 2, ¶ 4. Edward DeLorme was a
15 "member of the manager" of MT Investors. *DeLorme Declaration* at 2, ¶ 4.

16 A few months after Wilson and Lara entered into the Oral PK Assignment
17 (described above) in late 2003, Lara was personally involved in negotiating a settlement
18 of a dispute between A&W and a third party regarding the San Pedro Project (the
19 "Settlement"), pursuant to which A&W received a payment of \$1,950,000 (the "Settlement
20 Proceeds"). *Amended JPTO* at 4, ¶ 23. Wilson promised or gave Lara \$250,000 of the
21 Settlement Proceeds as compensation for his services (the "Settlement Compensation").
22 *Amended JPTO* at 4, ¶ 24 (stating that Wilson "gave" Lara \$250,000). The Settlement
23 Compensation was then used by Lara as a capital contribution in exchange for Wilson's
24 oral assignment to Lara of 50% of Wilson's Class "A" shares (or 8¾% of outstanding
25 shares) and 50% of Wilson's Class "B" shares in MT Investors (the "Oral MT
26 Assignment"). *Amended JPTO* at 4, ¶ 24.

27 In or about August 2004, MT Investors sold a hotel property in Mobile, Alabama,
28 commonly known as the "Crowne Plaza Hotel," and made a distribution of the proceeds

1 from such sale to its members, including Wilson (the “First MT Distribution”). *Lara*
2 *Declaration* at 5, ¶ 25; *Trial Testimony of Richard Lara*, September 29, 2011 at 11:37-
3 11:38 a.m.; *see also Amended JPTO* at 4, ¶ 25. Due to the Oral MT Assignment, Lara
4 was entitled to a share of the First MT Distribution, pursuant to which each member of
5 MT Investors received their respective original capital contributions. *Lara Declaration* at
6 5, ¶ 26. Wilson did not inform Lara of the First MT Distribution. *See Lara Declaration* at
7 5, ¶¶ 25-27. Patel and DeLorme were aware of the Oral MT Assignment through
8 conversations with Wilson and Lara, and informed Lara of the sale of the Crowne Plaza
9 Hotel and the First MT Distribution. *Patel Declaration* at 2, ¶¶ 6-7; *DeLorme Declaration*
10 at 2, ¶¶ 6-7; *see also, Lara Declaration* at 5, ¶ 25. After being informed of the First MT
11 Distribution by Patel, Lara confronted Wilson and demanded that Wilson turn over Lara’s
12 share of the First MT Distribution. *Lara Declaration* at 5, ¶ 27; *Trial Testimony of Richard*
13 *Lara*, September 29, 2011 at 11:39 a.m. In response, Wilson informed Lara that he
14 needed additional funds for other projects, and, therefore, despite the Oral MT
15 Assignment, Lara would not receive his share of the First MT Distribution. *Lara*
16 *Declaration* at 5, ¶ 28. Lara did not receive his share of the First MT Distribution. *See id.*
17 Wilson promised Lara that he (Wilson) would ensure that Lara received Lara’s share of
18 any future distributions from MT Investors. *Lara Declaration* at 5, ¶ 29.

19 As a result of the First MT Distribution, Lara demanded that Wilson execute written
20 assignments for the Oral PK Assignment (discussed above) and the Oral MT
21 Assignment. *Lara Declaration* at 5, ¶ 30. Wilson agreed, but insisted on modifying the
22 terms of the Oral MT Assignment to make it economically worse for Lara. *See Lara*
23 *Declaration* at 5, ¶ 31.

24 Specifically, Wilson informed Lara that a written assignment of his interests in MT
25 Investors would only grant Lara 50% of Wilson’s Class “A” shares in MT Investors (8¾%
26 of outstanding shares), and would not grant Lara any of Wilson’s Class “B” shares, as
27 provided in the Oral MT Assignment. *Lara Declaration* at 6, ¶ 33.

1 To induce Lara to accept the new terms of the written assignment, Wilson
2 promised to Lara that Lara would receive a return of his capital contributions, plus
3 interest, and a share of the profits of MT Investors. *Lara Declaration* at 6, ¶ 34. Thus,
4 Wilson promised Lara that he would receive far more than the amount of the capital
5 contributions that Lara would use to procure such written assignments. *Id.*

6 On March 15, 2005, Wilson executed a written assignment to replace the terms of
7 the Oral MT Assignment. *See Amended JPTO* at 5, ¶ 32. In the written assignment,
8 Wilson assigned to Lara one-half of his 17½% Class “A” interest, or 8¾% of the
9 outstanding Class “A” equity, in MT Investors (the “Written MT Assignment”). *Amended*
10 *JPTO* at 5, ¶ 32; *Lara Declaration* at 7, ¶ 39; *see also Plaintiff’s Trial Exhibit 3.*

11 In the Written MT Assignment, Wilson acknowledged that Lara had “provided
12 funds to [Wilson] in the amount of Two Hundred Sixty Two Thousand Five Hundred
13 Dollars (\$262,500). . . .” *Amended JPTO* at 5, ¶ 33; *see also Lara Declaration* at 6, ¶ 37.
14 The \$262,500 represented the \$250,000 Wilson owed Lara from the Settlement
15 Proceeds, plus interest. *Amended JPTO* at 5, ¶ 34; *Lara Declaration* at 6, ¶ 37.

16 Lara was not required to pay any additional or other consideration for the Written
17 MT Assignment. *Amended JPTO* at 5, ¶ 35. Wilson understood this. *Amended JPTO* at
18 6, ¶ 46. Lara did not breach the Written MT Assignment by failing to actually pay the
19 Settlement Compensation to Wilson. *See Amended JPTO* at 6, ¶ 47. The Written MT
20 Assignment was a valid assignment, which Wilson knowingly agreed to. *Amended JPTO*
21 at 6, ¶ 41. The Written MT Assignment was not a term sheet, nor did Wilson believe it to
22 be a term sheet. *Amended JPTO* at 6, ¶¶ 44-45.

23 In early July 2005, approximately four (4) months after the execution of the Written
24 MT Assignment, MT Investors was preparing to make a distribution to its members from
25 the proceeds of the sale of a commercial office building in Mobile, Alabama, commonly
26 known as “Riverview Plaza” (the “Second MT Distribution”). *Patel Declaration* at 2, ¶ 9;
27 *Lara Declaration* at 7, ¶ 42; *Trial Testimony of Richard Lara*, September 29, 2011 at
28 11:41 a.m.

1 Despite Wilson knowing that he previously assigned to Lara an 8¾% Class “A”
2 interest in MT Investors pursuant to the Written MT Assignment, Wilson did not inform
3 Lara of the Second MT Distribution. *Lara Declaration* at 7, ¶ 43.

4 Wilson represented to Patel, DeLorme, and the escrow company holding the
5 proceeds from the sale of the Riverview Plaza property (the “Riverview Escrow
6 Company”) that he was entitled to a portion of the Second MT Distribution based on his
7 original 17½% Class “A” interest in MT Investors, instead of based on the 8¾% Class “A”
8 interest that he actually owned at the time. *Patel Declaration* at 2, ¶ 9; *DeLorme*
9 *Declaration* at 2, ¶ 9.

10 Because DeLorme was aware of the Written MT Assignment, he contacted Lara to
11 inform him of Wilson’s statements and that Wilson was attempting to obtain Lara’s share
12 of the Second MT Distribution. See *Lara Declaration* at 7, ¶ 43; *DeLorme Declaration* at
13 2, ¶ 9. DeLorme also urged Lara to obtain counsel to protect his interest in the Second
14 MT Distribution. *Id.*

15 Subsequently, Lara confronted Wilson about the Second MT Distribution, and
16 Wilson told Lara that Lara would not be receiving Lara’s share of the Second MT
17 Distribution. *Lara Declaration* at 8, ¶ 44.

18 Immediately thereafter, Lara resigned from A&W and hired counsel to enforce his
19 rights under the Assignments. *Amended JPTO* at 7, ¶ 53.

20 By a letter dated July 14, 2005 (the “Demand Letter”), Lara’s counsel made a
21 formal claim to Patel, DeLorme, and Wilson, for Lara’s share of any future distributions,
22 including the Second MT Distribution. *Amended JPTO* at 7, ¶ 54; *Lara Declaration* at 8, ¶
23 45; see also *Plaintiff’s Trial Exhibit 4* (copy of the Demand Letter).

24 Due to the conflicting claims of Wilson and Lara, Dean, on behalf of MT Investors,
25 urged and required Wilson to obtain joint escrow instructions regarding how the portion of
26 the Second MT Distribution attributable to Wilson’s original 17½% Class “A” interest
27 should be allocated and disbursed among the competing claimants. *Lara Declaration* at
28 8, ¶ 47; *Trial Testimony of Richard Lara*, September 29, 2011 at 11:46 a.m. *Trial*

1 *Testimony of Sushil Patel*, September 29, 2011 at 10:10 a.m.; see also *Plaintiff's Trial*
2 *Exhibit 50*.

3 After Lara's counsel sent the Demand Letter and before the Joint Escrow
4 Instructions (defined below) were submitted, Wilson continued to attempt to obtain all or a
5 portion of Lara's share of the Second MT Distribution for himself. See *Patel Declaration*
6 at 3, ¶ 13; *DeLorme Declaration* at 3, ¶ 14. Specifically, Wilson represented to DeLorme,
7 Patel, and the Riverview Escrow Company that Lara had agreed: (1) to limit his share of
8 the Second MT Distribution to \$100,000; and (2) that Wilson should receive Lara's share
9 of the Second MT Distribution, which Wilson would then forward to Lara. *Id.*

10 On July 17, 2005, Lara and Wilson executed joint escrow instructions regarding
11 the allocation and distribution of the portion of the Second MT Distribution attributable to
12 Wilson's original 17½% Class "A" interest in MT Investors (the "Joint Escrow
13 Instructions"). *Amended JPTO* at 7, ¶ 55; see also *Plaintiff's Trial Exhibit 73* (copy of the
14 Joint Escrow Instructions); *Defendant's Trial Exhibit I* (copy of the Joint Escrow
15 Instructions).

16 Prior to the Second MT Distribution, Wilson had assigned shares of his
17 membership interest in MT Investors to lender Bridge Capital, as security for loans from
18 Bridge Capital. *Lara Declaration* at 9, ¶ 52. As a result, and pursuant to the Joint Escrow
19 Instructions, Bridge Capital received \$510,138.96 from the Second MT Distribution. See
20 *id.*; *Plaintiff's Trial Exhibit 73*. Because Wilson did not inform Lara of the First MT
21 Distribution and refused to pay Lara his share of the First MT Distribution, in which each
22 member of MT Investors received a return of their respective original capital
23 contributions, and because Bridge Capital received \$510,138.96 of the Second MT
24 Distribution, Lara received \$28,169.59 less than he was entitled to under the Written MT
25 Assignment. *Lara Declaration* at 9, ¶ 52; see also *Plaintiff's Trial Exhibit 70* (copy of
26 email correspondence from Marshall Mintz to David Wilson).

27 As compensation, Wilson promised Lara to make up this shortfall out of future
28 distributions from MT Investors' other property, namely a property located in Tulsa,

Oklahoma, or from a “future distribution from the Kauai deal.” *Lara Declaration* at 9, ¶ 53;
Plaintiff’s Trial Exhibit 70.

Lara received disbursements totaling approximately \$200,000 pursuant to the terms and provisions of the Written MT Assignment and was owed the further and remaining sum of \$28,169.59 prior to Wilson filing for bankruptcy protection. *Amended JPTO* at 6, ¶ 49; *Trial Testimony of Richard Lara*, September 29, 2011 at 2:47 p.m.

Wilson breached the terms of the Written MT Assignment by failing to pay Lara the remaining sums due pursuant to the Written MT Assignment, and, as a result, Lara was damaged in the sum of \$28,169.59. *Amended JPTO* at 6, ¶ 50.

STATE COURT LITIGATION

As mentioned above, on May 1, 2006, Lara filed a complaint for declaratory relief regarding the validity of the Written PK Assignment against Wilson in the Superior Court of California, County of Orange, commencing the lawsuit *Richard Lara v. David Wilson*, Case No. 06CC05599 (the “Lara State Court Complaint”). *Amended JPTO* at 7, ¶ 56.

On January 3, 2007, Wilson filed a separate complaint against Lara for breach of contract and declaratory relief related to the Written MT Assignment (Case No. 07CC00159). *Amended JPTO* at 7, ¶ 57.

On February 21, 2007, Lara filed a cross-complaint for damages resulting from Wilson’s breach of the Written PK Assignment and the Written MT Assignment and for declaratory relief (altogether with the Lara State Court Complaint, the “State Court Litigation”). *Amended JPTO* at 7, ¶ 58.

On October 9, 2007, Lara and Wilson agreed to resolve the State Court Litigation in binding arbitration (the “Arbitration”). *Amended JPTO* at 9, ¶ 75.

On May 28, 2008, the arbitrator, Judge Judith M. Ryan (ret.) (the “Arbitrator”), rendered a final award (the “Final California Award”), finding for Lara on all issues, and awarding Lara all amounts requested in the total sum of \$1,288,363.38, plus prejudgment interest thereon. *Plaintiff’s Trial Exhibit 14* (copy of Final California Award). The

1 Arbitrator made many factual findings and determinations and ultimately concluded the
2 following:

3 a. The Written PK Assignment was valid and effective to transfer a
4 $4\frac{1}{2}\%$ interest in and to Wilson's membership interest in PK Holdings;

5 b. The Written MT Assignment was valid and effective to transfer an
6 $8\frac{3}{4}\%$ interest in and to Wilson's membership interest in MT Investors;

7 c. Wilson breach the Written PK Assignment by failing to pay Lara his
8 share of the PK Distribution in the amount of \$1,260,193.79; and

9 d. Wilson breached the Written MT Assignment by failing to pay Lara
10 the remaining \$28,169.59 owed under the First and Second MT
11 Distributions.

12 *Amended JPTO* at 9, ¶ 76.

13 Arbitrator further denied Wilson's claims that Lara had breached the Written MT
14 Assignment and that the Written PK Assignment was not valid, and concluded that
15 Wilson was not entitled to the relief he sought on his breach of contract and declaratory
16 relief claims as to the Written MT Assignment. *Id.*

17 On August 12, 2008, the Superior Court of California for the County of Orange
18 entered a judgment confirming the Final California Award (the "Judgment"). *Amended*
19 *JPTO* at 10, ¶ 77; *see also Plaintiff's Trial Exhibit 15*. Under the Judgment, Lara is owed
20 \$1,288,363.38, with interest thereon at an annual statutory rate on judgments of ten
21 percent (10%) from May 1, 2006, until paid. *See Plaintiff's Trial Exhibit 15*.

22 On August 13, 2008, the day after entry of the Judgment, Wilson commenced this
23 bankruptcy case by filing his voluntary petition for relief under Chapter 7 of the
24 Bankruptcy Code. *Amended JPTO* at 10, ¶ 78.

25 On January 23, 2009, Lara initiated this adversary proceeding by timely filing the
26 Complaint, alleging *inter alia* that Wilson's debt to Lara under the Judgment is
27 nondischargeable pursuant to 11 U.S.C. § 523(a)(2)(A), (4), and (6). *Amended JPTO* at
28 10, ¶ 79; *see also, Complaint*.

On April 15, 2011, this court entered an "Order Granting Plaintiff's Motion to
Confirm Arbitrator's Findings" (Docket No. 89), wherein the court ordered that certain

findings of the Arbitrator in the Final California Award are entitled to preclusive effect and may not be relitigated in this adversary proceeding, including the amount of damages (i.e., damages from Wilson’s breach of the PK Assignment total \$1,260,193.79, and damages from Wilson’s breach of the MT Assignment total \$28,169.59).

DISCUSSION

The court has jurisdiction over this adversary proceeding to determine dischargeability of debts 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).

Lara contends that Wilson’s liabilities to him under the Judgment are excepted from discharge pursuant to 11 U.S.C. §§ 523(a)(2)(A), (4), and (6). In debt dischargeability 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). Because the Judgment awards damages for two separate injuries—Lara’s failures to receive the PK Distributions and MT Distributions—each injury will be separately analyzed under each claim for relief.

I. Section 523(a)(2)(A) Claim

11 U.S.C. § 523(a)(2)(A) provides that, “[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.” To render a debt nondischargeable under § 523(a)(2)(A), the following five elements must be met: (1) the debtor made the representations; (2) that at the time he knew they were false; (3) that he

made them with the intention and purpose of deceiving the creditor; (4) that the creditor relied on such representations; and (5) that the creditor sustained the alleged loss and damage as the proximate result of the representations having been made. *Citibank (South Dakota), N.A. v. Eashai (In re Eashai)*, 87 F.3d 1082, 1086 (9th Cir. 1996); *Britton v. Price (In re Britton)*, 950 F.2d 602, 604 (9th Cir. 1991); *see also, In re Sabban*, 600 F.3d 1219, 1222 (9th Cir. 2010). The § 523(a)(2)(A) elements “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).

A. Representations Made by Wilson

Under 11 U.S.C. § 523(a)(2)(A), Lara must prove that Wilson made the representations at issue. *Eashai*, 87 F.3d at 1086.

Regarding Lara’s damages arising from the PK Distribution, in 2003, Wilson orally assigned Lara a 5.0% membership interest in PK Holdings as consideration for Lara’s future work on the Kauai Project (the Oral PK Assignment). *Amended JPTO* at 4, ¶ 23. Thereafter Lara demanded a written assignment be executed. Wilson agreed, but insisted on modifying the terms of the Oral PK Assignment to the detriment of Lara. On March 15, 2005, Wilson and Lara executed a written assignment (the Written PK Assignment) wherein Wilson assigned Lara a 4½% membership interest in PK Holdings in consideration for Lara contributing \$412,000 of capital, including \$262,000 in Unpaid Bonus Compensation and \$150,000 in new capital, to pay A&W’s expenses on the Kauai Project. *Amended JPTO* at 4, ¶ 27; *see also Plaintiff’s Trial Exhibit 1* (copy of Written PK Assignment). And, pursuant to the implied covenant of good faith within the Written PK Assignment, Wilson implicitly represented to Lara that he would not interfere with Lara’s right to distributions vis-à-vis the assigned 4½% interest in PK Holdings. *Id.* To induce Lara to accept the new terms, Wilson promised to Lara that Lara would receive a return of his capital contributions, plus interest, and a share of the profits of PK Holdings. *Lara Declaration* at 6, ¶ 35.

Regarding Lara's damages arising from the MT Distribution, in late 2003, Wilson promised to pay Lara \$250,000 for Lara's services in resolving a dispute between A&W and a third party (the Settlement Compensation), which sum was to be used as a capital contribution to obtain 50% of Wilson's Class "A" interest (or 8¾% of outstanding Class "A" shares) and 50% of Wilson's Class "B" interest in MT Investors (the Oral MT Assignment). *Amended JPTO* at 4, ¶ 24. Thereafter, and despite the Oral MT Assignment, Wilson failed to distribute to Lara his share of the First MT Distribution because Wilson needed the funds for other projects. *Lara Declaration* at 5, ¶ 28. However, Wilson promised Lara that he (Wilson) would ensure that Lara receive his share of any future distributions from MT Investors. *Id.* at ¶ 29. As a result of the First MT Distribution, Lara demanded a written assignment be executed. Wilson agreed, but insisted on modifying the terms of the Oral MT Assignment to the detriment of Lara. On March 15, 2005, Wilson and Lara executed a written assignment (the Written MT Assignment) wherein Wilson assigned Lara 50% of his Class "A" interest in MT Investors but did not assign Lara any of his Class "B" interest. *Id.* at ¶¶ 30-33. Like the Oral MT Assignment, Wilson contributed the Settlement Compensation as a capital contribution in exchange. *Id.* And, pursuant to the implied covenant of good faith within the Written MT Assignment, Wilson implicitly represented to Lara that he would not interfere with Lara's right to distributions vis-à-vis the assigned 8¾% Class "A" interest in MT Investors. See *Plaintiff's Trial Exhibit 3* (copy of Written MT Assignment). To induce Lara to accept the new terms of the Written MT Assignment, Wilson promised to Lara that Lara would receive a return of his capital contributions, plus interest, and a share of the profits of MT Investors. *Lara Declaration* at 6, ¶ 34.

Wilson argues that Lara cannot establish this element of a representation: "Perhaps even more problematic for LARA is that he has never, and cannot now, identify a single express statement by WILSON that was made on or around March 15, 2005 that demonstrates a false representation." *Defendant's Trial Brief* at 6. In this case, Lara has offered credible evidence of promises made by Wilson to him that he would assign him

1 membership interests in PK Holdings and MT Investors. While “[t]he failure to perform a
2 mere promise is not sufficient to make a debt nondischargeable, even if there is no
3 excuse for the subsequent breach,” 4 Resnick and Sommer, *Collier on Bankruptcy*, ¶
4 523.08[1][d] at 523-45 – 523-46 (16th ed. 2012), “section 523(a)(2)(A) may make a
5 creditor’s claim nondischargeable if the debtor had no intention of performing any of the
6 obligations under the contract.” *Id.*, ¶ 523.08[1][d] at 523-46. “This intent may be inferred
7 from the fact that the debtor failed to take any steps to perform under the contract.” *Id.*,
8 *citing inter alia*, *Merchants Nat’l Bank & Trust Co. v. Pappas (In re Pappas)*, 661 F.2d 82
9 (7th Cir. 1981). Thus, “a promise made with a positive intent not to perform or without a
10 present intent to perform satisfies § 523(a)(2)(A)” and may constitute a material
11 misrepresentation under this section. *Rubin v. West (In re Rubin)*, 875 F.2d 755, 759 (9th
12 Cir. 1989).

13 Accordingly, the court finds that Lara has shown by a preponderance of the
14 evidence that Wilson represented that he would assign Lara a 4½% membership interest
15 in PK Holdings and an 8¾% membership interest (Class “A” shares) in MT Investors and
16 implicitly represented that he would not interfere with Lara’s right to distributions vis-à-vis
17 the assigned interests. Thus, Lara has proven by a preponderance of the evidence the
18 first element of § 523(a)(2)(A) that Wilson made these representations, and the court
19 rejects Wilson’s argument that Lara has not met his burden of proof as to this element.

20 **B. Knowledge of Falsity**

21 Second, under § 523(a)(2)(A), Lara must prove that at the time Wilson made the
22 representations at issue, Wilson knew they were false. Wilson argues that Lara cannot
23 establish this element of falsity of any of his alleged misrepresentations: “Similarly, LARA
24 cannot identify facts showing whatever statement(s) WILSON was alleged to have made
25 were made with knowledge of falsity or with the specific intent (i.e., scienter) to deceive.”
26 *Defendant’s Trial Brief* at 6.

27 In the context of promissory fraud, which is the allegation in this case, a plaintiff
28 can satisfy this element of falsity by showing a promise was made without intent to

1 perform. *In re Tobin*, 258 B.R. at 203; *Palmacci v. Umpierrez*, 121 F.3d 791, 786 (1st Cir.
2 1997) (“A representation of the maker’s intention to do . . . a particular thing is fraudulent
3 if he does not have the intention’ at the time he makes the representation.”), *quoting*,
4 Restatement (Second) of Torts § 530(1). Thus, “a promise made with a positive intent
5 not to perform or without a present intent to perform satisfies § 523(a)(2)(A).” *McCrary v.*
6 *Barrack (In re Barrack)*, 217 B.R. 598, 606 (9th Cir. BAP 1998), *citing*, *In re Rubin*, 875
7 F.2d at 759.

8 California law, which mirrors the elements of § 523(a)(2)(A) (*see In re Tobin*, 258
9 B.R. at 203), recognizes that “[a]n action for promissory fraud may lie where a defendant
10 fraudulently induces the plaintiff to enter into a contract.” *Lazar v. Superior Court*, 12 Cal.
11 4th 631, 638-639 (1996) (citations omitted). Promissory fraud may also exist where one
12 is induced to accept employment by promises of increased compensation and the
13 employer has no intention to perform. *Id.* Likewise, “‘where the promisor knew or should
14 have known of his prospective inability to perform,’ the promise can be found to be
15 fraudulent.” *In re Barrack*, 217 B.R. at 606 (citation omitted). “[I]n determining whether
16 the debtor had no intention to perform, a court may look at all the surrounding facts and
17 circumstances.” *In re Barrack*, 217 B.R. at 607 (citation omitted).

18 Regarding Lara’s damages arising from the PK Assignment, Wilson’s intent not to
19 perform is evident from the totality of the circumstances. Just months after the Written
20 PK Assignment was executed on March 15, 2005, Wilson attempted to reassign and
21 encumber Lara’s 4½% membership interest in PK Holdings in the October 2005 Pledge
22 Agreement, the October 2005 Assignment, the May 2006 Assignment, and the United
23 Commercial Assignment (in November 2006). *See Plaintiff’s Trial Exhibits 7* (copy of
24 October 2005 Pledge Agreement); *8* (copy of October 2005 Assignment); and *10* (copy of
25 May 2006 Assignment). Then in the Hawaii Arbitration, Wilson did not inform the
26 arbitration panel of Lara’s interest in PK Holdings, and denied ever assigning Lara an
27 interest when Patel and DeLorme informed the panel of the assignment. Wilson had no
28 reasonable basis for this position. *Patel Declaration* at 5, ¶¶ 26-27; *DeLorme Declaration*

1 at 5, ¶¶ 27-28. Finally, when Wilson received the PK Distribution, Wilson knew that he
2 had received Lara's share of the PK Distribution and knowingly transferred Lara's share
3 of the PK Distribution to United Commercial, instead of to Lara. *Lara Declaration* at 13, ¶
4 73; *Amended JPTO* at 8, ¶¶ 73-74, 9, ¶ 74.

5 Regarding Lara's damages arising from the MT Distribution, Wilson's intent not to
6 perform is evident from the totality of the circumstances. First, after making the Oral MT
7 Assignment, Wilson did not inform Lara of the First MT Distribution and later refused to
8 distribute to Lara his share of the First MT Distribution because Wilson needed the funds
9 for other projects. *Lara Declaration* at 5, ¶¶ 25-27. Thereafter, Wilson resisted Lara's
10 attempts to memorialize the Oral MT Assignment. When Wilson finally agreed to
11 executed a written assignment, Wilson reneged on the terms of the Oral MT Assignment
12 and insisted on new terms to the detriment of Lara. *Id.* at 5, ¶ 31. After the Written MT
13 Assignment was executed, Wilson again failed to inform Lara of the Second MT
14 Distribution. *Lara Declaration* at 7, ¶ 43. After DeLorme notified Lara of the Second MT
15 Distribution and Lara confronted Wilson about it, Wilson told Lara that he (Lara) would
16 not receive his share of the Second MT Distribution. *Lara Declaration* at 7-8, ¶ 43-44.
17 Lara then sent a demand letter to legal counsel for MT Investors (Dean). *Lara*
18 *Declaration* at 8, ¶ 45; *Plaintiff's Trial Exhibit 4* (copy of the Demand Letter). Even after
19 Lara delivered the demand letter, Wilson continued to falsely represent to Dean that Lara
20 had agreed to (i) accept \$100,000 as his share of the Second MT Distribution, and (ii)
21 allow Wilson to collect Lara's share of the Second MT Distribution who would then
22 forward payment to Lara. *Patel Declaration* at 3, ¶ 13; *DeLorme Declaration* at 3, ¶ 13.
23 Neither of these representations were true. *Lara Declaration* at 8, ¶ 46.

24 During trial, Wilson argued that his knowledge and intent when executing the
25 Written PK and MT Assignments (hereinafter, the "Written Assignments") could be
26 established by subsequent events. *See Defendant's Trial Brief* at 6. The court
27 disagrees. While most of the events described above occurred after the Written
28 Assignments were executed, they represent consistent patterns of behavior aimed at

1 depriving Lara of any distributions from the assigned interests. Absent any evidence to
2 the contrary, these patterns of behavior constitute circumstantial evidence that Wilson
3 never intended to allow Lara to receive distributions from the assigned interests, and
4 therefore knew at the time he executed the Written Assignments that the representations
5 he was making therein were false.

6 Wilson also argued that the identical language used in the Written Assignments is
7 indicative that he intended to perform his obligations when he executed the Written
8 Assignments. *See Defendant's Trial Brief* at 6. Again, the court disagrees. The
9 language used in an assignment bears on what representations were made, but it is not
10 indicative of whether Wilson knew such representations were false when he made them.

11 Finally, Wilson testified during trial that he had a good-faith belief that Lara had not
12 paid full consideration due under the Written Assignments. *See Amended Trial*
13 *Declaration of David Wilson* at 4, ¶ 22, 9, ¶ 51. Wilson gave the same testimony during
14 the State Court Litigation. *See Plaintiff's Trial Exhibit 14* at 6-8 (copy of Final California
15 Award). There, the Arbitrator, after reviewing circumstances surrounding the execution of
16 the Written Assignments, found such testimony not credible:

17 In sum, the preponderance of the evidence, if not the clear weight of the
18 evidence, supports that the [*sic.*] Richard Lara and David Wilson discussed
19 and ultimately entered into assignments for the interests in PK Holdings,
20 LLC and MT Investors, LLC as specifically set forth in the Exhibits in
21 evidence as set forth above. . . . Mr. Wilson did not offer credible contrary
22 testimony.

23 Specifically, there was no testimony or evidence presented, that Mr. Wilson
24 at anytime contemporaneous with the signing of the assignments ever
25 objected to or took any other action that was contrary to the assignments or
26 the provisions of the assignment. Further, there was no evidence
27 presented as to any objection as to the amount of the recited consideration
28 and how that amount was determined from the perspective of Mr. Wilson or
that there was any disagreement with those sums. Mr. Wilson in his
capacity as Claimant has not met his burden by a preponderance of the
evidence to support his position as to either of the assignments.

Id. at 8-9.

Similarly, for the following reasons this court finds that Wilson did not at any point
have a "good-faith belief" that the Written Assignments were not enforceable against him

1 for Lara's failure to pay consideration. First, the Written Assignments provide that the
2 Wilson had already received value for the assignments. *See Plaintiff's Trial Exhibits 1*
3 *and 3* ("For value received, David Wilson, ("Assignor") hereby assigns to Richard Lara
4 ("Assignee"), a portion of his capital interest and percentage interest"). Second,
5 Wilson's testimony is not credible because it is conclusory, vague, and unsupported by
6 other evidence. Wilson did not testify specifically as to what amounts Lara failed to pay
7 for the Written Assignments, or how and when Lara was to pay such amounts. *See*
8 *Wilson Declaration* at 4, ¶ 22, 9, ¶ 51. Lara's testimony is far more credible as it is
9 supported by the language of the Written Assignments and the subsequent actions of the
10 parties. For example, when the parties executed the Joint Escrow Instructions, Wilson
11 did not dispute the validity of the Written MT Assignment. *See Plaintiff's Trial Exhibit 73.*

12 Accordingly, the court finds by a preponderance of the evidence that at the time
13 Wilson executed the Written Assignments he had actual knowledge that he did not intend
14 to perform his obligations therein. Thus, Lara has proven by a preponderance of the
15 evidence the second element of § 523(a)(2)(A) that Wilson knowingly made false
16 representations by making promises without intending to perform.

17 **C. Intent to Deceive**

18 To satisfy the third element to a § 523(a)(2)(A) claim, the creditor must prove that
19 the debtor had the intent and purpose to deceive the creditor. Just like the second
20 element, "direct proof of intent to deceive is nearly impossible to obtain." *In re Brown*,
21 217 B.R. at 861. Thus, "the element of intent may be inferred from proof of the
22 surrounding circumstances 'if the facts and circumstances of a particular case present a
23 picture of deceptive conduct by the debtor.'" *Id.*, citing, *In re Eashai*, 87 F.3d at 1087.
24 Furthermore, "a court may infer an intent to deceive from a false representation." *In re*
25 *Rubin*, 875 B.R. at 759 (citation omitted).

26 Wilson's intent to deceive Lara with the Written Assignments can be inferred from
27 Wilson's intention to not perform his obligations therein by purporting to own, transfer
28 and/or encumber the transferred interests after assigning them to Lara. Moreover, the

1 court also finds that Wilson had motives to deceive Lara. Specifically, Wilson's
2 misrepresentations induced Lara to forego terminating his employment with A&W and
3 seeking to collect the Unpaid Bonus Compensation and Settlement Compensation. In
4 addition, Wilson's misrepresentations induced Lara to transfer \$150,000 from his home
5 equity line of credit to Wilson's construction company, A&W.

6 Accordingly, the court finds by a preponderance of the evidence that at the time
7 Wilson executed the Written Assignments he had an intention to deceive Lara. Thus,
8 Lara has proven by a preponderance of the evidence the third element of § 523(a)(2)(A)
9 that Wilson made the representations with the intention of deceiving him.

10 **D. Plaintiff's Reliance**

11 Fourth, under § 523(a)(2)(A), Lara must prove that he justifiably relied on Wilson's
12 representations. *In re Eashai*, 87 F.3d at 1086. In regards to the fourth element of
13 § 523(a)(2)(A), Lara must show that his reliance on Wilson's promise to assign the
14 membership interests in PK Holdings and MT Investors was "justified." *Field v. Mans*,
15 516 U.S. 59, 73-76 (1995) (holding that reliance need not reach a level of
16 "reasonableness" to establish nondischargeability under § 523(a)(2)(A), but must still be
17 justifiable). There cannot be justifiable reliance upon a representation if Lara knew it is
18 false or its falsity is obvious. 4 March, Ahart and Shapiro, *California Practice Guide:*
19 *Bankruptcy*, ¶ 22:481 at 22-59 (2011), *quoting*, *In re Kirsh*, 973 F.2d 1454, 1459 (9th Cir.
20 1992) ("[A] person cannot purport to rely upon preposterous representations or close his
21 eyes to avoid discovery of the truth.").

22 Regarding Lara's damages arising from the PK Distribution, Lara justifiably relied
23 upon Wilson's representations that he would assign Lara an interest in PK Holdings.
24 Lara forewent his Unpaid Bonus Compensation and contributed \$150,000 of new capital
25 in exchange for the Written PK Assignment. *Amended JPTO* at 4, ¶ 29. Lara's reliance
26 on Wilson's representations was justified because Lara and Wilson were close personal
27 friends at the time the representations were made and had worked together since at least
28 1995. *See Lara Declaration* at 1, ¶ 2. There is also no evidence that Lara had any

1 reason to believe that Wilson would later impede Lara's efforts to receive the distributions
2 entitled to him pursuant to the assigned interest.

3 Similarly, regarding Lara's damages arising from the MT Distributions, Lara
4 justifiably relied upon Wilson's representations in the MT Assignments (both Oral and
5 Written) for the same reasons. Lara agreed to forego his Settlement Compensation in
6 exchange for the Written MT Assignment. *Amended JPTO* at 5, ¶ 33-34; *Lara*
7 *Declaration* at 6, ¶ 37. At the time of the Oral MT Assignment in 2003 and the Written
8 MT Assignment in March 2005, Lara had no reason to believe that Wilson's
9 representations were fraudulent.

10 Accordingly, the court finds by a preponderance of the evidence that Lara
11 justifiably relied upon Wilson's representations. Thus, Lara has proven by a
12 preponderance of the evidence the fourth element of § 523(a)(2)(A) that Lara justifiably
13 relied upon Wilson's representations.

14 **E. Damages**

15 Finally, under § 523(a)(2)(A), "a creditor must establish that a claim sought to be
16 discharged arose from an injury proximately resulting from its reliance on a
17 representation that was made with an intent to deceive." *In re Brown*, 217 B.R. at 862
18 (citation omitted). Furthermore, "proximate cause is sometimes said to depend on
19 whether the conduct has been so significant and important a cause that the defendant
20 should be legally responsible." *Id.*

21 Regarding Lara's damages arising from the PK Distribution, the court finds that
22 Wilson's fraudulent representations in the PK Assignments (both Oral and Written) were
23 the proximate cause of Lara's failure to receive his share of the PK Distribution. Based
24 upon Wilson's fraudulent representations in the PK Assignments, Lara forewent his
25 Unpaid Bonus Compensation and contributed \$150,000 of new capital to A&W. But for
26 Wilson's fraudulent representations, Lara would not have suffered damages from the PK
27 Distribution. Furthermore, the court finds there was no intervening cause for Lara's
28 damages from the PK Distribution that limits Wilson's liability for the fraudulent

1 representations. Wilson's fraudulent representations are "so significant and important a
2 cause" for Lara's damages from the PK Distributions that Wilson should be held legally
3 responsible for them.

4 Regarding Lara's damages arising from the MT Distributions, the court finds that
5 Wilson's fraudulent representations were **not** the proximate cause of Lara's failure to
6 receive his share of the MT Distributions. On July 27, 2005, Wilson and Lara executed
7 the Joint Escrow Instructions for the Second MT Distribution. Lara agreed to subordinate
8 his claim to the Second MT Distribution to that of Bridge Capital. Lara has not explained
9 why he agreed to the subordination. Lara also has not explained what interests in MT
10 Investors Wilson assigned to Bridge Capital or when that purported assignment occurred.
11 If the assignment to Bridge Capital occurred **before** the MT Assignments to Lara, Lara
12 has not alleged that Wilson failed to notify him of the Bridge Capital assignment. If the
13 assignment to Bridge Capital occurred **after** the MT Assignments to Lara, Lara has not
14 alleged how the MT Assignments to Lara were perfected. Thus, Lara has not proven that
15 Wilson's assignment to Bridge Capital was **not** an intervening cause.

16 Accordingly, the court finds by a preponderance of the evidence that Wilson's
17 representations in the PK Assignments were the proximate cause of Lara's damages
18 from the PK Distribution. However, the court also finds that Wilson's fraudulent
19 representations in the MT Assignments were **not** the proximate cause of Lara's damages
20 from the MT Distributions. Thus, Lara has proven by a preponderance of the evidence
21 the fifth element of § 523(a)(2)(A) that Lara's damages from the PK Distribution were
22 proximately caused by Wilson's representations in the PK Assignments. However, Lara
23 has **not** proven by a preponderance of the evidence the fifth element of § 523(a)(2)(A)
24 that Lara's damages from the MT Distributions were proximately caused by Wilson's
25 representations in the MT Assignments.

26 Therefore, Lara has proven by a preponderance of the evidence the five elements
27 for a § 523(a)(2)(A) claim with respect to his damages from the PK Distribution.
28 However, Lara has not proven by a preponderance of the evidence the five elements of

§ 523(a)(2)(A) claim with respect to his damages from the MT Distributions. The court determines that the portion of the Judgment attributable to Lara's damages from the PK Distribution is excepted from discharge pursuant to 11 U.S.C. § 523(a)(2)(A), but that the portion of the Judgment attributable to Lara's damages from the MT Distributions is not excepted from discharge pursuant to 11 U.S.C. § 523(a)(2)(A).

II. 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." Lara alleges that his damages from the PK Distribution and MT Distributions were caused by Wilson's fraud and defalcation while in a fiduciary capacity. *See Complaint*, ¶ 32.

Lara did not allege that Wilson committed embezzlement for purposes of § 523(a)(4) until his closing argument. Further, the Amended JPTO does not list whether Lara committed embezzlement as an issue to be litigated. Allowing Lara to first raise an embezzlement claim at closing arguments would be unduly prejudicial to Wilson because the issue was not listed in the Amended JPTO. Therefore, the court finds that Lara has waived his right to claim embezzlement as a basis for a § 523(a)(4) claim for relief.

Finally, while the Complaint and Amended JPTO indicate that Lara is pleading a § 523(a)(4) claim for the entire debt owed by Wilson (i.e., Lara's damages arising from the PK Distribution and MT Distributions), Lara's counsel limited his § 523(a)(4) arguments made in his Trial Brief (Docket No. 107) and during trial to Lara's damages from the PK Distribution. Moreover, Lara has not clearly articulated why Wilson's debt to Lara from the MT Distributions constitutes fraud or defalcation while in a fiduciary capacity. Specifically, Lara has not alleged that Wilson was a managing member of MT Investors, explained why Wilson owed Lara any fiduciary duties with respect to Lara's interest in MT Investors, or introduced the applicable operating agreement for MT Investors into evidence. Therefore, the court finds that Lara has not proven by a

1 preponderance of the evidence that his damages arising from the MT Distributions are
2 nondischargeable pursuant to § 523(a)(4).

3 Thus, the only issue before the court is whether Lara's damages from the PK
4 Distribution are nondischargeable under § 523(a)(4) on the basis that the debt arose from
5 fraud or defalcation while in a fiduciary capacity. In order for Lara to prevail under §
6 523(a)(4), he must demonstrate, by a preponderance of the evidence, the following: (1)
7 an express or technical trust existed; (2) the debt at issue was caused by fraud or
8 defalcation; and (3) the debtor was a fiduciary to the creditor at the time the debt was
9 created. *Nahman v. Jacks (In re Jacks)*, 266 B.R. 728, 735 (9th Cir. BAP 2001), *citing*,
10 *Otto v. Niles (In re Niles)*, 106 F.3d 1456, 1459 (9th Cir. 1997).

11 **A. Nature of Lara's Interest in PK Holdings**

12 Before the court can determine whether an express or technical trust exists, the
13 court must first determine the nature of Lara's interests in PK Holdings. The parties
14 dispute whether the Written PK Assignment made Lara a member of PK Holdings or only
15 granted Lara a distributional interest in PK Holdings as an assignee.

16 When the Written PK Assignment was executed on March 15, 2005, the "First
17 Amended and Restated Operating Agreement of PK Holdings, LLC" was in effect. See
18 *Plaintiff's Trial Exhibit 174* (copy of First Amended Operating Agreement). (The Second
19 Amended Operating Agreement was not executed until September 30, 2005 and only
20 became effective upon the filing of the Articles of Organization with the Department of
21 Commerce and Consumer Affairs, State of Hawaii. See *Plaintiff's Trial Exhibit 175* (copy
22 of Second Amended Operating Agreement), at 3, Art. I, ¶ 4.)

23 The First Amended Operating Agreement of PK Holdings provides two methods
24 for transferring a membership interest in PK Holdings. First, Article XIII, paragraph 2,
25 provides that "an Assignee of a Membership Interest shall be so admitted only with the
26 approval, which may be withheld in their sole and absolute discretion, of all of the
27 Managers and of Members having ninety percent (90%) of the Sharing Ratios of all
28

Members.” *Plaintiff’s Trial Exhibit 174* at 33. Second, Article VII, paragraph 8.1 provides in pertinent part:

Notwithstanding any other provisions or requirements of this Operating Agreement, within two (2) year of the Effective Date [August 26, 2004], the Initial Managers [including Wilson] may sell or otherwise transfer portions of their Membership Interest as reflected in Schedule A to raise additional capital for the Company of its operations.

Plaintiff’s Trial Exhibit 174 at 22. Article VII, paragraph 8.3 further provides: “In the event there is an assignment pursuant to this Paragraph 8, the Assignee shall have all rights of a Member executing this Operating Agreement, including voting rights.” *Plaintiff’s Trial Exhibit 174* at 23. Paragraph 8 includes no requirement that the assignment be approved by other Members of PK Holdings.

The court finds that the Written PK Assignment did not comply with Article XIII, paragraph 2, because Members, as defined by Article II, paragraph 41, having 90% of the Sharing Ratios of all Members did not vote to approve the Written PK Assignment.

However, the court finds that the Written PK Assignment, which was executed on March 15, 2005, complied with Article VII, paragraph 8.1, because (i) it was executed within two years of the Effective Date, which was August 26, 2004 (Article II, ¶ 31); (ii) Wilson was an Initial Member of PK Holdings (Article II, ¶ 28); (iii) Wilson owned a 30% interest in PK Holdings (Exhibit A); and (iv) the \$412,000 contributed by Lara “were used by [Wilson] in relation to funding of improvements to the assets of [PK Holdings]” (*Plaintiff’s Trial Exhibit 1* (Written PK Assignment), Recitals D-E). Thus, the court finds that the Written PK Assignment made Lara a member of PK Holdings because Lara was granted “all rights of a Member executing [the First Amended Operating Agreement], including voting rights.” See *Plaintiff’s Trial Exhibit 174* at 23.

At trial, Wilson’s counsel argued that the Written PK Assignment is unenforceable because it explicitly required the concurrent execution of a subscription agreement and other documents signed by other members of PK Holdings:

Concurrent with the execution of this Assignment, Assignee will sign a subscription agreement and other documents signed by other members of Company and receive a copy of the Operating Agreement of Company and

1 a copy of this Assignment will be provided the [sic] Managers of Company
2 by Assignor with instructions to reflect this Assignment on the books and
records of Company effective as of the date of this Assignment.

3
4 *See Plaintiff's Trial Exhibit 1* (copy of the Written PK Assignment), ¶ 2. The Written PK
Assignment was executed on March 15, 2005, and other members of PK Holdings did
5 not execute a subscription agreement until Patel and DeLorme signed a confirmation of
6 the Written PK Assignment (the "Confirmation of Assignment") on December 6, 2005.

7 *See Plaintiff's Trial Exhibit 2.* The belated execution of the Confirmation of Assignment
8 did not satisfy the "concurrent subscription agreement requirement" of the Written PK
9 Assignment. However, the court interprets the "concurrent subscription agreement
10 requirement" as an obligation owed to Lara to protect Lara's interest from any objections
11 to the Written PK Assignment by other members of PK Holdings. The plain language of
12 the Written PK Assignment does not suggest that the "concurrent subscription agreement
13 requirement" was a condition precedent to the enforceability of the assignment against
14 Wilson. Thus, the court finds that the belated execution of the Confirmation of
15 Assignment does not render the Written PK Assignment unenforceable against Wilson.

16
17 Finally, Patel's trial testimony that Lara did not sign any operating agreements of
18 PK Holdings or participate in the vote to remove Wilson as managing member of PK
19 Holdings does not prove that Lara was *not* granted the membership rights in the PK
20 Holdings pursuant to Article VII, paragraph 8.1 of the First Amended Operating
21 Agreement. *See Trial Testimony of Sushil Patel*, September 29, 2011 at 9:56-10:00 a.m.
22 This evidence only suggests that Lara was not actively involved in the management of
23 PK Holdings, which is not dispositive as to whether the Written PK Assignment complied
24 with Article VII, paragraph 8 of the First Amended Operating Agreement. Thus, the court
finds that the Written PK Assignment made Lara a member of PK Holdings.

25 **B. Express Trust**

26
27 Section 523(a)(4) requires an express or technical trust in existence before and
28 independently of the defalcation. *In re Jacks*, 266 B.R. at 736, *citing Lewis v. Scott (In re*

1 Lewis), 97 F.3d 1182, 1185 (9th Cir.1996). Within the meaning of § 523(a)(4), an express
2 or technical trust must be “imposed before, and without reference to, the wrongdoing that
3 caused the debt as opposed to a trust *ex maleficio*, constructively imposed because of
4 the act of wrongdoing from which the debt arose.” *Honkanen v. Hopper (In re*
5 *Honkanen)*, 446 B.R. 373, 379 (9th Cir. BAP 2011). Further, “[w]hether a fiduciary is a
6 ‘trustee in that strict and narrow sense,’ is determined in part by reference to state law.”
7 *In re Lewis*, 97 F.3d at 1185, *quoting, Ragsdale v. Haller*, 780 F.2d 794, 795 (9th Cir.
8 1986).

9 Hawaii law applies in this case because PK Holdings is a Hawaii limited liability
10 company. *In re Lewis*, 97 F.3d at 1185, *quoting, Ragsdale v. Haller*, 780 F.2d at 795.
11 Lara argues that the Hawaii Limited Liability Company Act, Chapter 428 of the Hawaii
12 Revised Statutes (“HRS”), creates an express trust and imposes a duty on manager
13 members to act as trustees. Pursuant to HRS § 428-409(h)(2), “a manager is held to the
14 same standard of conduct prescribed for members in subsections (b) to (f).” Haw. Rev.
15 Stat. § 428-409(h)(2). As such, under HRS § 428-409, the manager of a manager-
16 managed limited liability company is held to the following fiduciary duties:

17 (b) A member's duty of loyalty to a member-managed limited liability
18 company and its other members is limited to the following:

19 (1) To account to the company and to hold as trustee for it any
20 property, profit, or benefit derived by the member in the conduct or
21 winding up of the company's business or derived from a use by the
22 member of the company's property, including the appropriation of a
23 company's opportunity;

24 (2) To refrain from dealing with the company in the conduct or
25 winding up of the company's business as or on behalf of a party
26 having an interest adverse to the company; and

27 (3) To refrain from competing with the company in the conduct of
28 the company's business before the dissolution of the company.

(c) A member's duty of care to a member-managed limited liability
company and its other members in the conduct of and winding up of the
company's business is limited to refraining from engaging in grossly
negligent or reckless conduct, intentional misconduct, or a knowing
violation of law.

1 (d) A member shall discharge the duties to a member-managed limited
2 liability company and its other members under this chapter or under the
3 operating agreement and exercise any rights consistent with the obligation
of good faith and fair dealing.

4 Haw. Rev. Stat. § 428-409(b)-(d) (1996).

5 A bankruptcy court in Montana recently held that a Montana statute with the exact
6 same language as HRS § 428-409(b) created an express trust relationship recognized by
7 federal law for purposes of § 523(a)(4) because the statute:

8 (1) defines the trust res: “any property, profit, or benefit derived by the
9 member in the conduct or winding up of the company's business or derived
10 from a use by the member of the company's property;” (2) spells out the
11 trustee's fiduciary duties: “account to the company and to hold as trustee for
it;” and (3) imposes a trust on the funds prior to the act which created the
debt: the obligation arises with membership in the LLC and does not
depend on any subsequent conduct.

12 See *Blixseth v. Blixseth (In re Blixseth)*, 459 B.R. 444 (Bankr. D. Mont. 2011) (analyzing
13 Mont. Code Ann. § 35-8-310(2)-(4)).

14 The *Blixseth* court distinguished the Montana statute with a similar California
15 statute analyzed in *Ragsdale v. Haller, supra*. *Id.* at 459-460. In *Ragsdale*, the court was
16 asked to determine whether, under California law, partners in a partnership hold
17 partnership assets as trustees. 780 F.2d at 796. The relevant California statute
18 provided:

19 Every partner must account to the partnership for any benefit, and *hold as*
20 *trustee* for it any profits derived by him *without the consent* of the other
21 partners from any transaction connected with the formation, conduct, or
liquidation of the partnership or from any use by him of its property.

22 *Blixseth*, 459 B.R. at 460 (quoting Cal. Corp. Code § 15021(1)). The Ninth Circuit in
23 *Ragsdale* concluded that the California statute did not create a trust relationship for
24 purposes of § 523(a)(4) because “the trust arises only when the partner derives profits
25 without the consent of the partnership” 780 F.2d at 796. The *Blixseth* court
26 distinguished *Ragsdale* by acknowledging that:

27 . . . *Ragsdale* contemplate[s] a statute in which the trust arises only when
28 the [partner] acts without consent. Such a statute creates a trust *ex*
maleficio. By contract, MCA § 35-8-310 contains no similar qualification on

1 the imposition of the trustee relationship. This difference is sufficient to
2 distinguish MCA § 35-8-310 from the statute[] . . . in *Ragsdale*.

3 *Id.* at 460.

4 This court agrees with the reasoning in *Blixseth*. The applicable Hawaii statute,
5 HRS § 428-409(b), contains identical language as to that in the Montana statute, Mont.
6 Code Ann. § 35-8-310(2). Like the Montana statute, HRS § 428-409(b)(1) imposes an
7 unqualified duty of loyalty on members of an LLC who hold company property to act as a
8 trustee. HRS § 428-409(b) also (1) defines the trust res: “any property, profit, or benefit
9 derived by the member in the conduct or winding up of the company's business or
10 derived from a use by the member of the company's;” (2) spells out the trustee’s fiduciary
11 duties: “account to the company and to hold as trustee for it;” and (3) imposes a trust on
12 the funds prior to the act which created the debt: the obligation arises with membership in
13 the LLC and does not depend on any subsequent conduct. See *Blixseth*, 459 B.R. at
14 459. Thus, based on the language of HRS § 428-409(b) and based on the same
15 reasoning in *Blixseth*, the court finds an express trust was created and Wilson was a
16 trustee during his time as a manager of PK Holdings.

17 However, this fiduciary relationship only existed during the time that Wilson served
18 as a managing member for PK Holdings. Indeed, HRS § 428-409(h)(1) provides: “A
19 member who is also not a manager owes no duty to the company or to the other
20 members solely by reason of being a member.” Thus, the court finds that Wilson’s
21 fiduciary duties to PK Holdings’ other members ceased when Wilson was removed as a
22 managing member, which occurred in November 2005.

23 **C. Fraud**

24 For reasons stated above, Lara has proven that Wilson made fraudulent
25 representations in the PK Assignments. However, there is no evidence that Wilson
26 committed fraud while he served in a fiduciary capacity. The fiduciary relationship
27 between Wilson and Lara began on March 15, 2005 with the execution of the Written PK
28 Assignment and ended in November 2005 when Wilson was removed as a managing

1 member of PK Holdings. Thus, all of Wilson's fraudulent representations made prior to
2 the execution of the Written PK Assignment, including the Oral PK Assignment, were
3 made *before* the fiduciary relationship between Wilson and Lara existed. Likewise,
4 Wilson's fraudulent assignments and encumbrances of Lara's 4½% interest made after
5 Wilson's removal as managing member, including the May 2006 Assignment and the
6 Unite Commercial Assignment, were made *after* the fiduciary relationship terminated.

7 Due to the short duration of the fiduciary relationship, the only fraudulent action
8 that Wilson could have committed while acting in his fiduciary capacity was when he
9 executed the October 2005 Pledge Agreement and the October 2005 Assignment
10 (collectively, the "October 2005 Transactions"). The October 2005 Transactions pledged
11 and assigned Wilson's original 30% membership interest in PK Holdings as security for a
12 loan to Wilson's company, Parkside Ventures. Thus, the October 2005 Transactions
13 necessarily encumbered the 4.5% interest in PK Holdings that Wilson had previously
14 assigned to Lara.

15 The court finds that the October 2005 Transactions did not breach Wilson's duty of
16 loyalty to PK Holdings and its members, as provided in HRS § 428-409(b), because
17 Wilson did not (1) fail to account for PK Holdings' property; (2) deal with PK Holdings on
18 behalf of a party having an adverse interest to PK Holdings; or (3) compete with PK
19 Holdings. The court further finds that the October 2005 Transactions did not breach
20 Wilson's duty of care to PK Holdings and its other members, as provided in HRS § 428-
21 409(c), or Wilson's obligation of good faith and fair dealing, as provided in HRS § 428-
22 409(d), because the October 2005 Transactions did not affect Wilson's management of
23 PK Holdings in any way. Rather, the October 2005 Transactions only affected the private
24 agreement between Wilson and Lara. The court finds that the scope of HRS § 428-409
25 was not intended to include transactions that have no bearing whatsoever on the
26 management of limited liability company. Lara has not provided any authority to the
27 contrary. Thus, the court finds that Lara failed to show Wilson committed a fraud that
28 also breached a fiduciary duty Wilson owed to Lara.

D. Defalcation

“A ‘defalcation’ is the misappropriation of trust funds or money held in any fiduciary capacity, or the failure to properly account for such funds.” *Lewis v. Scott (In re Lewis)*, 97 F.3d 1182, 1186 (9th Cir. 1996), *citing*, Black’s Law Dictionary 417 (6th ed. 1990); *see also*, *Bullock v. BankChampaign, N.A.*, 133 S.Ct. 1754, 1758-1759 (2013)(setting out various dictionary definitions of defalcation). Black’s Law Dictionary defines misappropriation as “[t]he application of another’s property or money dishonestly to one’s own use.” Garner, Black’s Law Dictionary at 1088 (9th ed. 2009). Further, as clarified by the Supreme Court in *Bullock v. BankChampaign, N.A.*, defalcation is an intentional act that includes :not only conduct that the fiduciary knows is improper but also reckless conduct.” 133 S.Ct. at 1759-1760. ¹

Wilson received Lara’s share of the PK Distribution and, instead of remitting the funds to Lara as he should have, he used them for his own personal benefit. However, at the time of the misappropriation, Wilson was not acting in a fiduciary capacity. Wilson was removed as a manager of PK Holdings in November 2005. It was not until December 2006, that Wilson received the proceeds from the distribution as a member of PK Holdings, though more than he was entitled, having assigned part of his membership interest to Lara to whom part of the distribution should have went. Nevertheless, because Wilson was not acting in a fiduciary capacity when he misappropriated Lara’s share of the PK distribution, there was no defalcation. Therefore, the court finds that Lara has not established by a preponderance of the evidence the necessary elements for a § 523(a)(4) claim. Lara is not entitled to judgment on his claim under § 523(a)(4).

¹ In *Bullock v. BankChampaign, N.A.*, the Supreme Court addressed the issue of the scienter requirement for defalcation under Section 523(a)(4) as opposed to the scope of the conduct within the meaning of the term “defalcation”: “In resolving these differences, we note that this longstanding disagreement concerns state of mind, not whether ‘defalcation’ can cover a trustee’s failure (as here) to make a trust more than whole. We consequently shall assume without deciding that the statutory term is broad enough to cover the latter type of conduct and answer only the ‘state of mind’ question.” 133 S.Ct. at 1759.

1 **III. Section 523(a)(6) Claim**

2 Section 523(a)(6) of the Bankruptcy Code excepts from discharge any debt “for
3 willful and malicious injury by the debtor to another entity or to the property of another
4 entity.” 11 U.S.C. § 523(a)(6). “The willful injury requirement of § 523(a)(6) is met when
5 it is shown either that defendant had a substantive motive to inflict the injury or that
6 defendant believed that injury was substantially certain to occur as a result of his
7 conduct.” *Petralia v. Jercich (In re Jercich)*, 238 F.3d 1202, 1208 (9th Cir. 2001). In other
8 words, “§ 523(a)(6) renders debt nondischargeable when there is either a *subjective*
9 intent to harm, or a *subjective* belief that harm is substantially certain.” *Carillo v. Su (In re*
10 *Su)*, 290, F.3d 1140, 1145 (9th Cir. 2002) (emphasis added). In *Jercich*, the Ninth Circuit
11 rejected the objective substantial certainty approach. See *id.* at 1145-1146. However,
12 when determining “willfulness,” the debtor is charged with the knowledge of the natural
13 consequences of his actions. *Ormsby v. First American Title Co. of Nevada (In re*
14 *Ormsby)*, 591 F.3d 1199, 1206 (9th Cir. 2010)(citations omitted). The “malicious injury”
15 requirement of § 523(a)(6) is met when the injury is caused by a wrongful act, done
16 intentionally, which necessarily causes injury, and which is done without just cause or
17 excuse. *In re Jercich*, 238 F.3d at 1208.

18 “[A]lthough § 523(a)(6) *generally* applies to torts rather than to contracts and an
19 intentional breach of contract *generally* will not give rise to a nondischargeable debt,
20 where an intentional breach of contract is accompanied by tortious conduct which results
21 in willful and malicious injury, the resulting debt is excepted from discharge under
22 § 523(a)(6).” *In re Jercich*, 238 F.3d at 1205 (emphasis in original). To determine
23 whether Wilson’s actions were tortious, the court must look to state law. *Id.* at 1206. The
24 parties agree that California law applies based on the underlying California Judgment.
25 However, “[w]hether the actions constitute the tort of conversion under California state
26 law are not dispositive of whether the underlying claims are nondischargeable under
27 § 523(a) of the Bankruptcy Code.” *Andrews v. Manser (In re Manser)*, 99 B.R. 434, 435-
28 436 (9th Cir. BAP 1989). “Generally, outside the insurance context, ‘a tortious breach of

1 contract . . . may be found when . . . the breach is accompanied by a traditional common
2 law tort, such as fraud or conversion” *Stop Loss Insurance Brokers, Inc. v. Brown &*
3 *Toland Medical Group*, 143 Cal. App. 4th 1036, 1057-1058 (2006), *quoting Erlich v.*
4 *Menezes*, 21 Cal. 4th 543, 553-554 (1999).

5 **1. Fraud**

6 Under California law, the tort of fraud consists of the following elements:

7 (1) misrepresentation (false representation, concealment, or nondisclosure);
8 (2) knowledge of falsity (or ‘scienter’); (3) intent to defraud, i.e., to induce reliance;
9 (4) justifiable reliance; and (5) resulting damage. *Lazar v. Superior Court*, 12 Cal.4th
10 631, 638 (1996). These elements are identical to elements required to prove a claim for
11 fraud under 11 U.S.C. § 523(a)(2)(A). *See Britton v. Price (In re Britton)*, 950 F.2d 602,
12 604 (9th Cir. 1991). Because this court already found that Wilson’s representations in the
13 PK Assignments were fraudulent for purposes of § 523(a)(2)(A), this court necessarily
14 finds that Wilson’s representations in the PK Assignments were also fraudulent under
15 California law.

16 As a matter of law, Wilson’s fraudulent representations in the PK Assignments
17 constitute willful and malicious injuries to Lara within the meaning of § 523(a)(6). *See In*
18 *re Diamond*, 285 F.3d 822, 828-829 (9th Cir. 2002) (holding that a state court judgment
19 for fraud under Washington law, which necessarily required a finding that the defendant
20 “intentionally caused injury”, had preclusive effect with regard to a § 523(a)(6) claim).

21 The court further finds that Wilson’s fraudulent representations in the PK
22 Assignments were “willful” because Wilson, who is charged with the natural
23 consequences of his actions, had a *subjective* belief that his fraudulent representations in
24 the PK Assignments were substantially certain to harm Lara. The court also finds that
25 Wilson’s fraudulent representations in the PK Assignments were “malicious” because
26 they were wrongful acts, done intentionally, which necessarily caused injury, and which
27 were done without just cause or excuse. Thus, Lara has proven by a preponderance of
28

1 the evidence that Wilson's fraudulent representations in the PK Assignments were
2 "willful" and "malicious" for purposes of § 523(a)(6).

3 **2. Conversion**

4 During trial, Lara also argued that Wilson converted his share of the PK
5 Distribution, but conceded that Wilson did not convert Lara's share of the MT
6 Distributions. See *Closing Argument of Lara*, October 14, 2011 at 2:16 p.m.

7 Under California law, the tort of conversion consists of the following elements:
8 (1) the creditor's ownership or right of possession of the property at the time of
9 conversion; (2) the debtor's conversion by a wrongful act or disposition of property rights;
10 and (3) damages. *Thiara v. Spycher Brothers (In re Thiara)*, 285 B.R. 420, 427 (9th Cir.
11 BAP 2002), citing, *Farmers Insurance Exchange v. Zerin*, 53 Cal. App. 4th 445, 451
12 (1997). Further, "It is not necessary that there be a manual taking of the property; it is
13 only necessary to show an assumption of control or ownership over the property, or that
14 the alleged converter has applied the property to his own use." *Farmers Insurance*
15 *Exchange v. Zerin*, 53 Cal. App. 4th at 451-452. "Neither legal title or absolute ownership
16 of the property is necessary. . . . A party need only allege it is 'entitled to immediate
17 possession at the time of conversion.'" *Id.* (citations omitted).

18 "Money can be the subject of an action of conversion if a specific sum capable of
19 identification is involved." *Id.* at 452. But, "it is not necessary that each coin or bill be
20 earmarked." *Weiss v. Marcus*, 51 Cal. App. 3d 590, 599 (1975), citing, *Haigler v.*
21 *Donnelly*, 18 Cal. 2d 674, 681 (1941). Rather, the plaintiff need only identify a specific
22 sum of money that was received by the defendant, of which a portion belonged to the
23 plaintiff. See *id.* (holding that the plaintiff stated a claim for conversion where the plaintiff
24 alleged that the defendant received settlement proceeds in the sum of \$35,000, of which
25 \$6,750 belonged to the plaintiff pursuant to a lien on such proceeds).

26 Regarding Lara's damages arising from the PK Distribution, the court finds that
27 each of the three elements for conversion has been satisfied. First, it is a determined fact
28 Lara was entitled to and had a right to possess 4½% of the PK Distribution, which totaled

1 \$1,260,193.79, vis-à-vis Lara's ownership of a 4½% membership interest in PK Holdings.
2 The court finds that Wilson knew this despite his repudiation of the Written PK
3 Assignment in January 2006. Second, Wilson admitted to receiving the net sum of
4 approximately \$3.4 million from the PK Distribution, after the payment of approximately
5 \$1.2 million to his attorneys. Wilson further admitted to knowingly using all of the net
6 proceeds from the PK Distribution, including Lara's share, to repay the United
7 Commercial Loan. Wilson's use of Lara's share of the PK Distribution was not authorized
8 by Lara, or otherwise excused or justified. Third, it is a determined fact that Lara suffered
9 \$1,260,193.79 in damages from Wilson's conversion of Lara's share of the PK
10 Distribution and that these sums are identifiable to Lara's 4½% interest in PK Holdings.

11 Therefore, the court finds that Wilson intentionally converted Lara's share of the
12 PK Distribution without justification or excuse. As a matter of law, Wilson's conversion of
13 Lara's share of the PK Distribution constitutes a "willful" and "malicious" injury to Lara
14 within the meaning of § 523(a)(6). *See Del Pino v. Bailey (In re Bailey)*, 197 F.3d 997,
15 1000 (9th Cir. 1999) ("The conversion of another's property without his knowledge or
16 consent, done intentionally and without justification and excuse, to the other's injury,
17 constitutes a willful and malicious injury within the meaning of § 523(a)(6).") (*quoting*,
18 *Transamerica Commercial Finance Corp. v. Littleton*, 942 F.2d 551, 554 (9th Cir.1991)).

19 The court further finds that Wilson's conversion of the PK Distribution was "willful"
20 because Wilson, who is charged with the natural consequences of his actions, had a
21 *subjective* belief that his conversion of the PK Distribution was substantially certain to
22 harm Lara. The court also finds that Wilson's conversion of the PK and MT Distributions
23 were also "malicious" because they were wrongful acts, done intentionally, which
24 necessarily causes injury, and which were done without just cause or excuse. Thus, Lara
25 has proven by a preponderance of the evidence that Wilson's conversion of Lara's share
26 of the PK Distribution was "willful" and "malicious" for purposes of § 523(a)(6).

27 Therefore, Lara has proven by a preponderance of the evidence the elements for
28 a § 523(a)(6) claim with respect to his damages from the PK Distribution. But Lara has

1 not proven by a preponderance of the evidence the elements of § 523(a)(6) claim with
2 respect to his damages from the MT Distributions for the same reasons discussed above
3 relating to § 523(a)(2)(A). The debt based on the portion of the Judgment attributable to
4 Lara's damages from the PK Distribution should be excepted from discharge pursuant to
5 § 523(a)(6), while the debt based on the portion of the Judgment attributable to Lara's
6 damages from the MT Distributions should not be excepted from discharge pursuant to §
7 523(a)(6).

8 CONCLUSION

9 For the foregoing reasons, the court determines that the debt owed by Wilson to
10 Lara based on portion of the Judgment attributable to Lara's damages from the PK
11 Distribution is excepted from discharge pursuant to 11 U.S.C. § 523(a)(2)(A) and (6), but
12 **not** excepted from discharge pursuant to 11 U.S.C. § 523(a)(4). The court further
13 determines that the debt owed by Wilson to Lara based on the portion of the Judgment
14 attributable to Lara's damages from the MT Distributions is **not** excepted from discharge
15 pursuant to 11 U.S.C. § 523(a)(2)(A), (4) or (6).

16 Lara is ordered to submit a proposed judgment within 30 days of the entry of this
17 memorandum decision consistent with this decision.

18 IT IS SO ORDERED.

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24 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 TO DETERMINE DISCHARGEABILITY OF DEBT** 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:

- J Scott Bovitz boviz@bovitz-spitzer.com
- Beth Gaschen bgaschen@wglp.com, msciesinski@wglp.com
- Dale F. Hardeman hardeman1@cox.net
- Weneta M Kosmala (TR) Weneta.Kosmala@7trustee.net,
ca15@ecfbis.com;wkosmala@kosmalalaw.com;dfitzger@kosmalalaw.com;kgeorge@kosmalalaw.com
- Robert S Marticello Rmarticello@wglp.com, msciesinski@wglp.com
- Evan D Smiley esmiley@wglp.com, msciesinski@wglp.com
- Autumn D Spaeth aspaeth@wglp.com, tjones@wglp.com
- United States Trustee (SA) ustpreion16.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

Benjamin L Meeker
Law Offices of Benjamin L. Meeker APC
34921 Calle del Sol
Capistrano Beach, CA 92624

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: