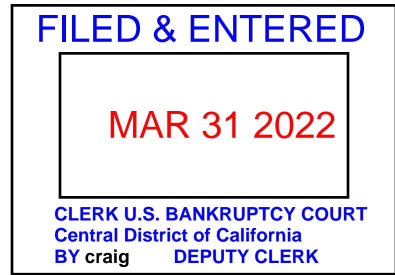

UNITED STATES BANKRUPTCY COURT

CENTRAL DISTRICT OF CALIFORNIA

RIVERSIDE DIVISION

In re: VANCE ZACHARY JOHNSON Debtor	Case No.: 6:18-bk-10939-MH Chapter: 7 Adv. No.: 6:18-ap-01106-MH
BANKERS HEALTHCARE GROUP, LLC, Plaintiff v. VANCE ZACHARY JOHNSON, Defendant	**MEMORANDUM DECISION AFTER TRIAL ON COMPLAINT FOR NONDISCHARGEABILITY OF DEBT PURSUANT TO 11 U.S.C. §§ 523(a)(2)(A), 523(a)(2)(B), 523(a)(4), and 523(a)(6)** Hearing Date: October 25, 2021 Time: 9:30 a.m. Courtroom: 301

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I. PROCEDURAL BACKGROUND

On February 7, 2018, Vance Zachary Johnson (“Defendant”) filed a Chapter 11 voluntary petition (“Bankruptcy Case”). [Case No. 6:18-bk-10939-MH]. In his petition, Defendant listed $762,306 in unsecured debt owing to Bankers Healthcare Group, LLC (“Plaintiff”). On April 3, 2018, Plaintiff filed a proof of claim in the amount of $504,945.65.

On May 7, 2018, Plaintiff commenced an adversary proceeding by filing a nondischargeability complaint against Defendant pursuant to 11 U.S.C. § 523(a)(2)(B), 523(a)(4), and 523(a)(6) (“Adversary Case”). [Adv. No. 6:18-ap-01106-MH]. Defendant filed an answer on June 7, 2018. On July 3, 2018, the Bankruptcy Case was converted to Chapter 7.

Prior to the trial on June 24, 2019, Plaintiff filed a motion for summary judgment on causes of action pursuant to §§ 523(a)(2)(B) and 523(a)(6) and amended the motion four days later. On July 31, 2019, Defendant filed an opposition, and on August 7, 2019, Plaintiff filed a reply. On August 26, 2019, the Court issued a tentative ruling that stated the Court was inclined to deny Plaintiff’s motion for summary judgement without prejudice because Plaintiff had not met its burden in demonstrating either that: (1) Defendant had no intention to use the funds for practice expansion under § 523(a)(2)(B); or (2) Defendant’s deviation from a statement of intended purpose constitutes tortious conduct under California law under § 523(a)(6). On August 4, 2020, Plaintiff filed an amended complaint, adding a cause of action pursuant to § 523(a)(2)(A).

On November 18, 2020, the parties filed the First Amended Joint Pretrial Stipulation (“Pretrial Stip.”). On October 8, 2021, the parties filed pre-trial briefs. Plaintiff and Defendant also filed

trial exhibits ("Plaintiff's Tr. Ex." or "Defendant's Tr. Ex."). On October 25, 2021, the Court held a one-day trial, where Defendant and Daniel Johnston ("Mr. Johnston"), who is Plaintiff's portfolio servicing manager, testified, and the trial date was subsequently continued from time to time as a holding date for the Court to consider the post-trial briefs and issue its memorandum decision. On October 27, 2021, the transcript of the trial was docketed ("Tr. of Trial"). On November 22, 2021, the parties filed post-trial briefs.

II. FACTUAL BACKGROUND

Defendant is a physician and 100% owner of Temecula Valley Pain Medical Group, Inc ("TVPMG"), a medical facility incorporated in California. TVPMG began operating on June 4, 2003. On July 19, 2017, Defendant and Plaintiff entered a Financing Agreement (Corporation) Promissory Note/Security Agreement/Personal Guaranty ("Loan Documents"). By the Loan Documents, Plaintiff agreed to make a loan ("Loan") to TVPMG in the original principal amount of $514,245 ("Loan Proceeds"), with $762,306.72 to be repaid over seven years.

Defendant submitted a loan application[1] ("Loan Application") to Plaintiff, including a Statement of Intended Primary Purpose of the Loan ("Statement of Intended Purpose"), dated July 19, 2017, which stated the Loan was a "commercial loan" to be used "primarily for other than personal, family, or household purposes" and for "practice expansion." During the Loan process, Plaintiff discovered that Defendant had unpaid personal IRS tax liability of $151,891 and directed payment of that liability from the Loan Proceeds.

[1] Parties only stipulated the existence of the Loan Application and did not submit the Loan Application itself.

In the Loan Application, Defendant represented that TVPMG had no liabilities at the time of the Loan. Defendant also provided a signed personal financial statement of his assets and income, dated July 10, 2017 ("Personal Financial Statement"). As part of the Loan Documents, Debtor signed and executed "an absolute and unconditional personal Guaranty" of TVPMG's obligations to Plaintiff on July 19, 2017. Defendant did not sign the loan summary ("Loan Summary") or applicant summary ("Applicant Summary").[2]

The Applicant Summary shows Defendant's annual income of $1,571,175.17 for 2017. Defendant's Personal Financial Statement shows annual income of $250,000. The Personal Financial Statement also shows (1) Defendant's total liabilities of $468,614, comprised of $5,020 in credit cards liability and $463,594 as mortgage liability, and (2) Defendant answered "No" to questions of "Do you pay alimony" and "Do you pay any child support." Defendant's Schedules E/F filed in the Bankruptcy Case reflects debts to the Franchise Tax Board ("FTB") of $62,888 for 2015 and $14,563 for 2016, and to Pacific Premier Bank of $218,060 for 2016 and 2017.

Plaintiff disbursed the Loan Proceeds to a newly created personal bank account of Defendant on July 20, 2017, and July 24, 2017. No other deposits were made into that bank account besides the Loan Proceeds.

About forty-three days after the Loan Documents were signed, or approximately five weeks after receiving the Loan Proceeds, on August 31, 2017, TVPMG ceased operations and focused on

[2] During the trial, the Loan Summary and Applicant Summary were admitted into evidence.

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collection of past accounts receivables.[3] TVPMG made a total of five loan payments to Plaintiff totaling $45,375.40, with the last payment on December 25, 2017.

III. Legal Analysis

A. Judicial Notice of Proofs of Claims

As a preliminary matter, the parties disagree on the judicial notice of the proofs of claims in this case. A court may judicially notice a fact that is not subject to reasonable dispute because it can be accurately and readily determined from sources whose accuracy cannot be reasonably questioned. FED. R. EVID. 201(b)(2); *see also In re Mortg., Store, Inc.*, Case No. 10-03454, Chapter 7, 2013 Bankr. LEXIS 5778, at *7-8 (Bankr. D. Haw. Nov. 26, 2013) ("The court can take judicial notice of the claims register for the purpose of establishing that parties have filed proofs of claims . . . [and] establishing that claims have been filed, even if it may not be appropriate to take judicial notice of the contents of the proofs of claim.").

Thus, the Court finds that it can take judicial notice of the proofs of claims[4] in this case for the purpose of establishing that claims have been filed, but not of the truth of the numbers in these proofs of claims for child support arrearages, IRS taxes, and Zamucen and Currren, LLB for CPA fees, because the numbers in these proofs of claims are the contents of these proofs of claims, and their accuracy is being questioned in this case. Moreover, it is unclear in this Chapter 7 case what incentive Defendant would have, if any, to object to allowance of those claims.

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[3] Transcript of 341 Hearing on Nov. 13, 2018 ("Tr. of 341 Hearing"), 15:10-13.

[4] The Court took judicial notice of the proofs of claims, which show claims for child support arrearages of at least $825,997.36 prior to 2017, IRS taxes of at least $149,585.85 prior to July 2017, and Zamucen and Curren, LLP debt for CPA fees for $52,005.05. [Tr. of Trial, 37:10-12 and Claim Nos. 1-1, 2-2, and 8].

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B. Plaintiff Has Met Its Burden to Show the Debt Is Nondischargeable Pursuant to 11 U.S.C. § 523(a)(2)(A)

11 U.S.C. § 523(a)(2)(A) provides that "a discharge . . . does not discharge an individual debtor from any debt . . . for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained, by . . . false pretenses, a false representation, or actual fraud." 11 U.S.C. § 523(a)(2)(A). Section 523(a)(2)(A) specifically excludes "a statement respecting the debtor's or an insider's financial condition." 11 U.S.C. § 523(a)(2)(A); *see also In re Howell*, 623 B.R. 565, 576 (Bankr. C.D. Cal. 2020). A false representation is an express misrepresentation, while a false pretense refers to an implied misrepresentation or conduct intended to create and foster a false impression. *In re Reingold*, BAP Nos. CC-12-1112-PaDKi, 2013 Bankr. LEXIS 1660, at *8-10 n. 4 (B.A.P. 9th Cir. Mar. 19, 2013). The elements of "actual fraud" under "§ 523(a)(2)(A) match the elements of common law fraud and actual fraud under California Law." *In re Jung Sup Lee*, 335 B.R. 130, 136 (B.A.P. 9th Cir. 2005) (citations omitted); *see also In re Tallant*, 218 B.R. 58, 64-65 (B.A.P. 9th Cir. 1998) ("The Supreme Court looked at the common law understanding of 'actual fraud' at the time § 523(a)(2)(A) was added to the Code and turned to the Restatement (Second) of Torts for the applicable standard.") (citations omitted).

To prevail on a claim under § 523(a)(2)(A), a creditor must show five elements: (1) the debtor made representations; (2) at the time the debtor knew the representations were false; (3) the debtor made representations intending to deceive the creditor; (4) the creditor relied on such representations; and (5) the creditor sustained the alleged loss as the proximate result of the

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misrepresentations. *See, e.g., In re Sabban*, 600 F.3d 1219, 1222 (9th Cir. 2010); *see also In re Reingold*, 2013 Bankr. LEXIS 1660, at *7-8.

1. The Statements regarding the Personal Debt and Annual Income Are Not Representations Under 11 U.S.C. § 523(a)(2)(A)

Section 523(a)(2)(A) specifically excludes "a statement respecting the debtor's or an insider's financial condition." 11 U.S.C. § 523(a)(2)(A). The representations that the debtor's company or the debtor had any undisclosed debts owed to others are representations about the debtor's and an insider's financial condition. *In re Pho*, Case No. 07-52664-ASW, Chapter 7, 2015 Bankr. LEXIS 3498, at *35 (N.D. Cal. Oct. 15, 2015) ("[T]he [c]ourt finds that the representations that neither [the defendant's company] nor [the d]efendant had any undisclosed debts owed to others [before the dates of loan agreements with the plaintiff] . . . were representations about the [d]efendant's and an insider's financial condition. Therefore, such representations cannot support a claim under § 523(a)(2)(A)."); *see also In re Howell*, 623 B.R. at 576-77 ("It is correct that statements regarding financial condition must be brought under § 523(a)(2)(B)."); *Lamar, Archer & Cofrin, LLP v. Appling*, 138 S.Ct. 1752, 1761 (2018) ("We also agree that a statement is 'respecting' a debtor's financial condition if it has a direct relation to or impact on the debtor's overall financial status. . . . Naturally, then, a statement about a single asset can be a 'statement respecting the debtor's financial condition.'") (citations omitted).

Here, the Court finds that Defendant's representations of his personal debt and annual income do not fall under § 523(a)(2)(A) because they are about his financial condition, specifically excluded under § 523(a)(2)(A). Defendant's personal debt and annual income have a direct relation to or impact on Defendant's overall financial status. *See id.* at 1761. Thus, the Court

finds that Defendant's representations of his personal debt and annual income cannot be representations under § 523(a)(2)(A).

2. The Statement Regarding the Use of the Loan Proceeds for Business Purposes Fails to Satisfy 11 U.S.C. § 523(a)(2)(A)

As to the representation that Defendant was going to use the Loan Proceeds for commercial purposes, there are somewhat inconsistent references in the Loan Documents, some reflecting that all of the Loan Proceeds were to be used presumably entirely for commercial purposes (such as the Verification of Funding), and at least one, the Statement of Intended Purpose, stating that the Loan Proceeds are to be used "primarily for other than personal, family or household purposes." Given the inconsistency between "exclusively" and "primarily", and Plaintiff's implicit acquiescence to some portion of the funds being used for personal expenses (as reflected by the amounts directed to be paid to the IRS on account of personal liability), the Court finds the evidence presented logically establishes that no more than 49% of the Loan Proceeds could be used for non-commercial uses (i.e., less than half) before this would constitute an actionable representation. Plaintiff has not met this burden.

The evidence establishes that the following amounts were paid by Defendant from the Loan Proceeds on account of personal expenses: (1) $151,229.08 to the IRS; (2) $72,468 for child support; and (3) $9,935 for jewelry, for a total of $233,632.08 (not $265,202.08 as asserted by Plaintiff in its post-trial brief). This amount is less than half of the Loan Proceeds, so it is plausible that the majority of the Loan Proceeds were in fact used for commercial purposes. The problem with Plaintiff's argument is that while concededly Defendant has not volunteered what the remaining funds were used for, Plaintiff has not presented any evidence of how the remaining

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funds were spent, including no admissible testimony from Defendant. While from the surrounding circumstances the Court suspects that the Loan Proceeds deposited into Defendant's personal bank account were ultimately used primarily or entirely for personal expenses, the record is simply insufficient to reach that conclusion. The fact that Plaintiff does not know what the unaccounted-for funds were used for does not mean that those funds were not primarily used for business purposes. As such, Plaintiff has failed to establish liability under Section 523(a)(2)(A) based on the representation as to the intended use of the Loan Proceeds.

3. The Statement Regarding the Purpose of the Loan Proceeds for Practice Expansion Satisfies 11 U.S.C. § 523(a)(2)(A)

a. Representation

A stated purpose of a loan can be a representation for the purposes of § 523(a)(2)(A). *See In re Reingold*, 2013 Bankr. LEXIS 1660, at *19-21 (holding that the debtor made a misrepresentation concerning "his intended use of the loan proceeds," which was "purchasing and rehabilitating the property," in the loan agreement when the debtor used the loan proceeds for other purposes) (citing *United States v. Gibson*, 690 F.2d 697, 701 (9th Cir. 1982)); *see also In re Yoon*, 627 B.R. 905 (Bankr. C.D. Cal. 2021) (holding that the plaintiff satisfied a § 523(a)(2)(A) claim, specifically a promissory fraud claim, when the debtor represented that he would use the loan proceeds with "the stated purpose of purchasing plum extract," but actually used the loan proceeds as "cash deposits") (citations omitted). A promise to do something "necessarily implies the intention to perform; hence, where a promise is made without such intention, there is an implied misrepresentation of fact that may be actionable fraud." *In re Larsen*, No. 2:16-bk-18600-RK, Chapter 7, 2019 Bankr. LEXIS 2935, at *125-26 (Bankr. C.D. Cal. Sep. 23, 2019) (citations omitted); *see also In re Pho*, 2015 Bankr. LEXIS 3498, at *35 ("[T]he representation

that the loan proceeds were to be used for expanding [the defendant's company's] business was not a representation regarding an insider's financial condition; therefore, this is . . . misrepresentation which could support a clam under § 523(a)(2)(A)."). Here, the Court finds that Defendant's representation that the Loan Proceeds would be used for practice expansion is a representation that can support a claim under § 523(a)(2)(A).

b. Knowledge of Falsity and Intent to Deceive

The intent to deceive requirement may be established by showing "either actual knowledge of the falsity of a statement, or reckless disregard for its truth . . . " *In re Gertsch*, 237 B.R. 160, 167 (B.A.P. 9th Cir. 1999) (quoting *In re Houtman*, 568 F.2d 651, 656 (9th Cir. 1978). "Because direct evidence of intent to deceive is rarely available, 'intent to deceive can be inferred from the totality of the circumstances, including reckless disregard for truth.'" *In re Kraemer*, BAP Nos. WW-10-1156-HJuMk, 2011 Bankr. LEXIS 1783, at *12 (B.A.P. 9th Cir. Apr. 21, 2011) (quoting *In re Gertsch*, 237 B.R. at 167-68). Intent to deceive can also be inferred from surrounding circumstances or inferences from a course of conduct. *See In re Kennedy*, 108 F.3d 1015, 1018 (9th Cir. 1997) ("Intent to deceive can be inferred from surrounding circumstances."); *In re Barrack*, 217 B.R. 598, 607 (B.A.P. 9th Cir. 1998) ("Fraudulent intent may be established by circumstantial evidence, or by inferences drawn from a course of conduct."); *In re Yoon*, 627 B.R. at 905 (same).

"[A] court may infer the existence of the debtor's intent not to pay if the facts and circumstances of a particular case present a picture of deceptive conduct by the debtor." *In re Hachemi*, 104 F.3d 1122, 1125 (9th Cir. 1996), *cert. denied*, 520 U.S. 1230 (1997) (quoting *In re Eashai*, 87 F.3d 1082, 1087 (9th Cir. 1996)). "[T]he focus must be on the totality of the circumstances and

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whether they create the overall impression of a deceitful debtor." *In re Kraemer*, 2011 Bankr. LEXIS 1783, at *12 (citations omitted).

Proof of intent for the purposes of § 523(a)(2)(A) must be measured by a debtor's subjective intention at the time of the transaction in which the debtor obtained the money, property or services. *In re Miller*, ED CV 14-2329 DMG, 2015 U.S. Dist. LEXIS 200007, at *9 (C.D. Cal. Sep. 28, 2015) (citations and quotations omitted). Courts can consider a course of conduct **and subsequent conduct** in determining fraudulent intent as long as that conduct provides an indication of the debtor's state of mind at the time of the false representations. *In re Reingold*, 2013 Bankr. LEXIS 1660, *19-23 ("The nature of a scheme to defraud by false representations can be shown by accumulated evidence . . . and subsequent conduct."); *In re Barrack*, 217 B.R. at 607; *see also Williamson v. Busconi*, 87 F.3d 602, 603 (1st Cir. 1996) (explaining that "subsequent conduct may reflect back to the promisor's state of mind and thus may be considered in ascertaining whether there was fraudulent intent at the time the promise was made").

A debtor's promise of future conduct or using a loan for a specific purpose without a present intent to perform or to use is actionable as fraud under § 523(a)(2)(A). *In re Wettstein*, No. 9:11-bk-15294-PC, 2015 WL 1246052, at *5 (Bankr. C.D. Cal. Mar. 13, 2015) ("A promise of future conduct is actionable as fraud only if made without a present intention to perform. . . ") (citations and quotations omitted); *In re Pho*, 2015 Bankr. LEXIS 3498, at *35-36 ("Ordinarily, a promise of the borrower that the funds borrowed will be used for a specific purpose would not be material

unless the debtor never intended to use the funds for the purpose stated.") (citations and quotations omitted).

With respect to Defendant's representation that his intended primary purpose of the Loan was for "practice expansion," the Court finds that, based on the totality of the evidence, that statement was false when made, and otherwise with respect to that representation, Plaintiff has satisfied Section 523(a)(2)(a). Defendant's arguments are that the purpose of the Loan was to enable his practice to expand by hiring two neurosurgeons, but that the plans failed because (1) Loma Linda University Medical Center ("LLUMC") reneged on its agreement to backstop the neurosurgeons' agreement to stay with Defendant's practice, (2) the Patient Protection and Affordable Care Act ("ACA") had provisions that "at the same time" [presumably when Defendant was seeking his expansion] dramatically affected reimbursements Defendant's practice could receive, so as to reduce its anticipated earnings, and (3) workers compensation changes also reduced anticipated earnings. As pointed out by Plaintiff, however, the ACA was passed in 2010, more than seven years before the subject loan, and Defendant has not presented any clarification as to how these provisions were unknown or unanticipated in 2017.

Much more importantly, however, Defendant's testimony regarding the facts surrounding LLUMC's "reneging" on its alleged agreement with Defendant's practice is completely lacking in credibility. His testimony is vague and evasive, lacks detail and support, is contradictory as to what practice expansion meant and when those efforts ended, and among other things Defendant could not remember the date the agreement was reneged on, even given the presumably enormous importance of the agreement and the practice expansion to the viability of his

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business, which closed shortly after the Loan funded. In a similar vein, in Defendant's 341(a) examination testimony, Defendant indicated that his recruiting efforts were done in the "preceding year, roughly, maybe a little more" to September 2017 when his practice was reduced to simply collecting on accounts receivables.

Coupled with the lack of credibility of Defendant's testimony, the surrounding circumstances support the finding that Defendant did not intend to use the Loan Proceeds to expand his practice when he applied for the Loan, and otherwise that the expansion efforts had ceased by that point. As noted above, Defendant closed his business five weeks after the Loan was funded, and Defendant made only five loan payments prior to filing his bankruptcy case. Further, the fact that Defendant did not intend to use the funds for a practice expansion is further supported by his immediately using almost half of the funds from the Loan Proceeds to pay, among other things, IRS debt, child support and jewelry expenses (with the disposition of the remaining funds not explained in any respect by Defendant). In addition, on questioning at his 341(a) examination, Defendant could provide no coherent, detailed explanation whatsoever as to how and when Plaintiff's loan proceeds were used to pay expenses for expansion, other than that they were used "mostly to operate TVPMG, I think". Stated otherwise, if the Loan Proceeds were needed for practice expansion, why was such a significant amount spent on personal debts immediately after the Loan closed, why could Defendant not clarify any specific expansion expense paid with the Loan Proceeds, why did his practice close 5 weeks after the Loan funded, and why could Defendant not recall any specific details regarding the timing as to when expansion efforts ceased.

The Court also disagrees with Defendant's argument that *In re Pho* applies here because the holding in *In re Pho* was based on (1) the Defendant's testimony that "the business was in fact expanding following the loan and that [the d]efendant did not personally benefit from the loan proceeds" and (2) the Plaintiff's non-rebuttal of this testimony. *See In re Pho*, 2015 Bankr. LEXIS 3498, at *35-37. However, here, unlike *In re Pho*, (1) Defendant stated that his recruitment effort for TVPMG's practice expansion was ended before obtaining the Loan Proceeds, (2) the testimony and documentary evidence shows Defendant used the Loan Proceeds for personal benefits, and (3) TVPMG's practice closed shortly after obtaining the Loan Proceeds. Thus, the Court finds that *In re Pho* is not persuasive in this case.

Therefore, these facts support the Court's finding that at the time of Defendant's representation on July 19, 2017, that the Loan was needed for practice expansion, and that representation was false.

Moreover, the Court finds that Defendant knew of falsity of his representation when he represented that he would not use the Loan Proceeds "to expand the business, particularly to add two neurosurgeons to" TVPMG, because, in addition to the findings above, Defendant's testimony and personal bank accounts show that Defendant ceased recruitment effort for two neurosurgeons about a year before obtaining the Loan Proceeds. At the time Defendant signed the Loan Documents on August 21, 2017, TVPMG ceased recruitment effort at least a year before September of 2017. Moreover, TVPMG closed after five weeks after receiving the Loan Proceeds. Thus, the Court infers that Defendant did not intend to use the Loan Proceeds "to expand the business, particularly to add two neurosurgeons to" TVPMG.

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2 Under the totality of the circumstances, the Court finds that the elements of knowledge of falsity
3 of representation and an intent to deceive are satisfied as to Defendant's representation of the
4 purpose of the Loan Proceeds under § 523(a)(2)(A).
5 *c. Justifiable Reliance by Plaintiff on Defendant's Representation*
6 The creditor must have justifiably relied on the debtor's representation. *Field v. Mans*, 516 U.S.
7 59, 54-55 (1995) ("[W]e hold that § 523(a)(2)(A) requires justifiable, but not reasonable
8 reliance."). This is a subjective standard. *Id.* "A creditor claiming nondischargeability under §
9 523(a)(2)(A) must also show it was justified in relying on the debtor's fraudulent conduct in
10 obtaining the money, property or services." *Id.* at 73-76. "[A] person may justifiably rely on a
11 misrepresentation even if the falsity of the representation[s] could have been ascertained upon
12 investigation." *In re Eashai*, 87 F.3d at 1090. "Although a person ordinarily has no duty to
13 investigate the truth of a representation, a person cannot purport to rely on preposterous
14 representations or close his eyes to avoid discovery of truth." *Id.* at 1090-91. A creditor can
15 justifiably rely on a representation of intent to repay if a borrower's account is not in default and
16 any initial investigations do not raise red flags that would make reliance unjustifiable. *See In re*
17 *Nguyen*, 235 B.R. 76, 86 (Bankr. N.D. Cal. 1999) ("[T]he credit card issuer justifiably relies on a
18 representation of intent to repay as long as the account is not in default and any initial
19 investigations into a credit report do not raise red flags that would make reliance unjustifiable.")
20 (citing *In re Eashai*, 87 F.3d at 1091 and *In re Anastas*, 94 F.3d 1280, 1286 (9th Cir. 1996)).
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23 The Ninth Circuit has stated that a bankruptcy court must consider "knowledge and relationship
24 of the parties themselves." *In re Tallant*, 218 B.R. at 67. Although this standard protects "the
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ignorant, gullible, and the dimwitted, for no rogue should enjoy his ill-gotten plunder for the simple reason that his victim is by chance a fool, if a person does have special knowledge, experience and competence he may not be permitted to rely on representations that an ordinary person would properly accept." *Id* (citing *In re Kirsh*, 973 F.2d 1454, 1458 (9th Cir. 1992)) (quotations omitted).

Here, testimony by Plaintiff's witness sufficiently establishes reliance on the financial representations made by Defendant. In addition, Defendant represented to Plaintiff that the Loan Proceeds are for "expand[ing] the business" for "primarily" for "the benefit of TVPMG," and Defendant never indicated that expansion efforts were failing or that Defendant's practice was in financial hardship. *See In re Yoon*, 627 B.R. at 913 (finding that the plaintiff justifiably relied on the misrepresentations of the debtor when "[the debtor's] products were still being sold at retail locations, and [the d]ebtor never indicated that his business was suffering"). Further, as noted above, the Court finds Defendant's testimony to be completely lacking in credibility.

Also, the fact that there are multiple pieces of financial information Plaintiff obtained during its due diligence, including, for example, Defendant's credit score, does not diminish the importance of each individual piece of information. Defendant's representation as to the intended purpose of the Loan does not have to be the only reason for Plaintiff's reliance, and Plaintiff does not have to demonstrate that it was motivated solely by Defendant's representation. *See In re Coughlin*, 27 B.R. 632, 637 (B.A.P. 1st Cir. 1983) ("Once reliance on the financial statement is established, most courts have held that a showing of partial reliance is sufficient: the creditor need not demonstrate that it was motivated solely by the false financial information."); *In re*

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Seaborne, 106 B.R. 711, 714-15 (Bankr. M.D. Fla., 1989) ("[C]reditor's partial reliance on certain documents when deciding to extend a loan will satisfy the element of reliance and support non-discharge . . . . under § 523(a)(2)(A)); *In re Ebbin*, 32 B.R. 936 (Bankr. S.D.N.Y. 1983) (only partial reliance needs be shown).

In fact, Plaintiff had no duty to investigate the truth of Defendant's representations. *In re Eashai*, 87 F.3d at 1090 ("[A] person may justifiably rely on a misrepresentation even if the falsity of the representation[s] could have been ascertained upon investigation."); *In re Nguyen*, 235 B.R. at 86 ("[T]he credit card issuer justifiably relies on a representation of intent to repay as long as the account is not in default and any initial investigations into a credit report do not raise red flags that would make reliance unjustifiable.") (citing *In re Anastas*, 94 F.3d at 1286).

Thus, based on the foregoing, Plaintiff justifiably relied on Defendant's representation that it would use the Loan Proceeds to expand his practice. Therefore, the Court finds that Plaintiff has met the elements of reliance under § 523(a)(2)(A).

d. Loss to Plaintiff Proximately Caused by Reliance on Defendant's Representation

The final element of § 523(a)(2)(A) is that "the creditor sustained a loss or injury as a proximate result of the misrepresentations having been made." *In re Vidov*, BAP Nos. CC-13-1421-KuBlPa, 2014 Bankr. Lexis 3268, at *23-24 (B.A.P. 9th Cir. July 31, 2014); *see also In re Malyzsek*, Case No.: 6;13-bk-10486-MH, 2017 Bankr. LEXIS 192, at *13-14 (Bankr. C.D. Cal. Jan. 12, 2017) ("[T]his [c]ourt can determine . . . that the damages awarded . . . were proximately caused by fraud, since the fraud itself induced the [p]laintiff to enter into the contract that was

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breached.”). “Proximate cause is sometimes said to depend on whether the conduct has been so significant and important a cause that the defendant should be legally responsible.” *In re Britton*, 950 F.2d 602, 604 (9th Cir. 1991).

The Court finds that Plaintiff was damaged in the amount of $514,245 because Defendant’s representation of the purpose of the Loan Proceeds proximately caused the damage that Plaintiff suffered. *In re Reingold*, 2013 Bankr. LEXIS 1660, at *28-29 (determining that the plaintiff was proximately damaged in the amount of $76,000, which was the original loan proceeds amount). Therefore, the Court finds that Plaintiff has met the elements of damages under § 523(a)(2)(A), and thus, the Court finds that Plaintiff has met its burden to show the Loan is nondischargeable under 11 U.S.C. § 523(a)(2)(A).

C. Plaintiff Has Met Its Burden to Show the Debt Is Nondischargeable Pursuant to 11 U.S.C. § 523(a)(2)(B)

11 U.S.C. § 523(a)(2)(B) provides that “a discharge under § 727 . . . does not discharge an individual debtor from any debt . . . for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by use of a statement in writing (i) that is materially false; (ii) respecting the debtor’s or an insider’s financial condition; (iii) on which the creditor to whom the debtor is liable for such money, property, services or credit reasonably relied; and (iv) that the debtor caused to be made or published with intent to deceive. 11 U.S.C. § 523(a)(2)(B).

The elements of a claim under § 523(a)(2)(B) are: (1) a representation of fact by the debtor; (2) that was material; (3) that the debtor knew at the time to be false; (4) that the debtor made with the intention of deceiving the creditor; (5) upon which the creditor relief; (6) that the creditor’s

reliance was reasonable; (7) that damage proximately resulted from the representation. *In re Candland*, 90 F.3d 1466, 1469 (9th Cir. 1996).

Statements regarding financial conditions are actionable and are required to be in writing under § 523(a)(2)(B). *In re Howell*, 623 B.R. at 576-77. Under § 523(a)(2)(B), a statement "must either have been written by the debtor, signed by the debtor, or written by someone else but adopted and used by the debtor." *In re Tallant*, 218 B.R. at 69 (citing 4 Collier on Bankruptcy at ¶ 53.08[2][a] (Lawrence P. King, 15th ed. Rev. 1997)). Financial condition concerns a debtor's "overall financial status." *See Lamar, Archer & Cofrin, LLP*, 138 S.Ct. at 1761.

1. The Statement as to the Annual Income Is Not Actionable Under 11 U.S.C. § 523(a)(2)(B)

Regarding Defendant's representation regarding his income, the Court finds Plaintiff has not established liability under § 523(a)(2)(B). First, there does not appear to be a writing made by Defendant listing the asserted $1,571,175.17 income referenced by Plaintiff. Applicant Summary was instead prepared by Plaintiff. Thus, the alleged representation fails to serve as a basis for liability under § 523(a)(2)(B). *See In re Tallant*, 218 B.R. at 69.

In addition, it is unclear how Plaintiff came to have that number and what the number was based on. This uncertainty is important, because at the same time Plaintiff had a $1,571,175.17 annual income amount for Defendant in its records, it also had a $250,000 annual income number in its records included in Defendant's Personal Financial Statement. Given the conflict between these two numbers, and the lack of any evidence supporting Plaintiff's knowledge or belief as to which one was correct and why, Plaintiff cannot establish that it reasonably relied on only the larger

number. For that reason, also, Plaintiff's request for relief under § 523(a)(2)(B) as to Defendant's representation regarding his income fails.

2. The Statement as to the Personal Debt Satisfies 11 U.S.C. § 523(a)(2)(B)

a. Materially False Representation

A statement is materially false if it paints a substantially untruthful picture of a financial condition by misrepresenting information of the type which would normally affect the decision to grant credit. *In re Greene*, 96 B.R. 279, 283 (9th Cir. 1989). Additionally, "'material falsity' in a financial statement can be premised upon the inclusion of false information or upon the omission of information about a debtor's financial condition." *Id.* at 283 (citations omitted).

As to the representation regarding the amount of debt Defendant had at the time he applied for the Loan, the Court finds Plaintiff has established liability under § 523(a)(2)(B). In the Personal Financial Statement, Defendant indicated that his total debt was $468,618, comprised of $463,594 in mortgage liability, and $5,020 in credit cards liability (in addition, Plaintiff subsequently, but prior to Loan closing, discovered that Defendant owed $151,229.08 to the IRS for tax liability, which Plaintiff required be paid immediately from the Loan Proceeds). However, the amount of debt listed in the Personal Financial Statement was incorrect. Instead, as listed on Defendant's Schedules E/F filed in his Bankruptcy Case in February 2018, Debtor had liability for the FTB liability of $62,888 for 2015, FTB liability of $14,563 for 2016, and $218,000 owing to Pacific Premier Bank reflected as incurred in 2016-2017, all of which were incurred in whole or in part prior to the time of the Loan. Based on the evidence presented and the credibility of witness testimony, the Court finds Defendant knew or should have known of this additional debt at the time he made the representation regarding his debt.

These facts alone would suffice to establish undisclosed debt owing at the time of the loan in July 2017 under § 523(a)(2)(B), but in addition, on July 27, 2017, seven days after Plaintiff deposited the initial $449,098.64 into Defendant's bank account, Defendant made a payment of $49,468 for child support. Given the proximity to the Loan funding and the nature of the child support debt, the Court finds that Defendant also knew of this debt at the time of the Loan. Importantly, the Court also finds Defendant's testimony in response to extensive questioning by Plaintiff in this regard, pertaining to what Defendant's debts were in July 2017, to be completely lacking in credibility whatsoever. Specifically, Defendant was very vague, inconsistent, and evasive as to what he owed at the time, including denying debts owing to Pacific Premier Bank (refuted by inclusion in his subsequent bankruptcy Schedules E/F) and that he was not behind on his child support (which obligation was not disclosed as either past due or an ongoing monthly obligation, and which was refuted by his $49,468 payment for child support seven days after the Loan funded), all without any explanation or detail. Instead, the picture painted by the totality of the evidence, including Defendant's medical practice ceasing operations five weeks after the $449,098.64 Loan funded, and a bankruptcy filing seven months later, is that of Loan Proceeds borrowed under materially false pretenses used as a desperate lifeline in significant part to pay past due personal debts. For the foregoing reasons, the Court finds that Plaintiff has satisfied § 523(a)(2)(B) with respect to Defendant's representation as to his debt at the time of the Loan.

b. Knowledge of Falsity and Intent to Deceive

Incorporating herein the analysis and findings immediately above, the Court finds that Defendant knew he made a false representation regarding the amount of his debt when he represented that he only had $5,020 in credit cards liability and $463,594 as mortgage liability and no child

support. The evidence shows that Defendant (1) paid $49,468 as child support on July 27, 2017, (2) had undisclosed debt to Pacific Premier Bank of $218,060 owing for 2016 and 2017, and (3) had undisclosed debt owing to the FTB for tax years 2015 and 2016. Coupled with the surrounding facts discussed above, the Court infers that Defendant intended to deceive Plaintiff. *See In re Reingold*, 2013 Bankr. LEXIS 1660, at *22.

Under the totality of the circumstances, the Court finds that the elements of knowledge of falsity of representation and an intent to deceive are satisfied under § 523(a)(2)(B).

c. Reasonable Reliance by Plaintiff on Defendant's Representation

A creditor's reliance must be both actual and reasonable. *See In re Montano*, 501 B.R. 96, 115 (B.A.P. 9th Cir. 2013). As to the first prong, the creditor must show reliance in fact—that the creditor actually relied on the written statement. *See id*. As to the second prong, courts consider the totality of the circumstances. *See id.* The degree of reliance required — reasonable rather than justifiable — is intended to create a heightened bar to a discharge exception under §523(a)(2)(B). *See Lamar, Archer & Cofrin, LLP*, 138 S.Ct. at 1763.

The Court finds that Plaintiff actually and reasonably relied on Debtor's representation of his personal debts. In addition to testimony from Plaintiff's witness, here, Plaintiff knew that (1) Defendant owed personal IRS tax of $151,891 and had monthly alimony obligations, after Defendant indicated to Plaintiff that Defendant has no liabilities, and (2) Plaintiff allowed Defendant to pay these taxes to the IRS using the Loan Proceeds weighs against Plaintiff. Importantly, as to the question of Plaintiff's reliance on Defendant's amount of debt, when Plaintiff determined Defendant had additional IRS debt, it required Defendant to immediately

1 pay off that debt from the Loan Proceeds, underlining the importance of Defendant's debt profile
2 to Plaintiff. Supporting this importance, Plaintiff's witness testified that Plaintiff would not have
3 made the Loan if additional debt was discovered because the "DTI [debt to income] would have
4 been much higher than the original 30 percent," and the evidence otherwise supports the
5 importance of an accurate knowledge of a borrower's debt as part of Plaintiff's lending practices.
6 Therefore, the Court finds that Plaintiff has met the elements of reliance under § 523(a)(2)(B).

7 *d. Loss to Plaintiff Proximately Caused by Reliance on Defendant's*
8 *Representation*

9 The Court finds that Plaintiff has suffered damages as a result of Defendant's representation of
10 his personal debts. This misrepresentation was a substantial factor in Plaintiff's decision to make
11 the Loan Proceeds to Defendant because (1) Plaintiff would not have made the Loan Proceeds if
12 Defendant had not made this misrepresentation; and (2) Defendant's failure to repay the Loan
13 Proceeds to Plaintiff is a reasonably foreseeable consequence of that misrepresentation. *See In re*
14 *Malyzsek*, 2017 Bankr. LEXIS 192, at *13-15. The Court finds that Plaintiff was damaged in the
15 amount of $514,245 because Defendant's false representation of his personal debts proximately
16 caused the damage that Plaintiff suffered. Therefore, the Court finds that Plaintiff has met the
17 elements of damages under § 523(a)(2)(B).

18 Thus, the Court finds that Plaintiff has met its burden to show the Loan is nondischargeable
19 under 11 U.S.C. § 523(a)(2)(B) because Defendant's false representation of his personal debt
20 falls under § 523(a)(2)(B).

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D. Plaintiff Has Not Met Its Burden to Show the Debt Is Nondischargeable Pursuant to 11 U.S.C. § 523(a)(4)

11 U.S.C. § 523(a)(4) provides that "a discharge under §727 . . . does not discharge an individual debtor from any debt . . . for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny." 11 U.S.C. § 523(a)(4).

1. Fraud or Defalcation While Acting in a Fiduciary Capacity

The creditor must show three elements for nondischargeability under this provision: (1) an express trust; (2) that the debt was caused by fraud or defalcation; and (3) the debtor was a fiduciary to the creditor at the time the debt was created. *See In re Niles*, 106 F.3d 1456, 1459 (9th Cir. 1997); *see also In re Jacks*, 266 B.R. 728, 735 (B.A.P. 9th Cir. 2001). To establish an express trust, a debtor must act as a fiduciary of a creditor, and the fiduciary relationship must predate the fraud or defalcation. *See In re Hemmeter*, 242 F.3d 1186, 1190 (9th Cir. 2001). A corporation's officer, director, or controlling shareholder has been held to lack fiduciary status towards the corporation for purposes of § 523(a)(4). *In re Dakota Steel, Inc.*, 284 B.R. 711, 724 (Bankr. N.D. Cal. 2002) (citing *In re Cantrell*, 269 B.R. 413 (B.A.P. 9th Cir. 2001)).

In re Cantrell states a possible exception to the general rule, when a fiduciary duty is claimed by a creditor of an insolvent corporation:

> Although not cited by either side, we recently held in *In re Jacks* . . . that "California's Corporation Code provides a remedy for an insolvent corporation's director's violations of fiduciary duties to creditors," which could be actionable under § 523(a)(4). *Id.* at 737. We also noted: "Because a director's fiduciary duties to creditors do not arise until the corporation is insolvent, the timing of the insolvency is critical." *Id.* at 738. Since the issue of insolvency was not raised by the [Plaintiffs], and because they are not creditors, *Jacks* is not relevant to the case before us.

In re Cantrell, 269 B.R. at 422 n. 10.

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2 *In re Jacks* points out that "the timing of the insolvency is critical because it is the insolvency
3 that creates the duty in the first place." *See In re Dakota Steel, Inc.*, 284 B.R. at 725 (quotations
4 omitted); *see also In re Pedrazzini*, 644 F.2d 756 (9th Cir. 1981) (holding that a trust relationship
5 must exist before the wrong and not arise as a result of it).
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8 Here, the Court rejects Plaintiff's argument that *In re Jacks* exception applies here because the
9 important point in *Cantrell* is that "California law treats the relationship between a corporation
10 and its principals as one of agency, not treating the principals as the trustees of an express trust."
11 *See In re Dakota Steel, Inc.*, 284 B.R. at 724 ("[T]he salient point about both *Cantrell* and
12 *Bainbridge* is that California law treats the relationship between a corporation and its principals
13 as one of agency, rather than viewing the principals as the trustees of an express trust with a
14 res.") (citations omitted). Here, Plaintiff has not shown that TVPMG was insolvent at the time
15 the Loan Proceeds were disbursed to Defendant. In fact, Plaintiff provides no evidence as to the
16 timing of the insolvency of TVPMG nor the existence of an express trust, but simply makes the
17 conclusory statement that it "believes the record provides ample support to except the debtor
18 from discharge under Section[] . . . 523(a)(4) . . . " Although Defendant owns 100% of TVPMG,
19 Defendant lacks fiduciary status toward TVPMG or fiduciary duties to Plaintiff for the purposes
20 of § 523(a)(4). Thus, the possible *In re Jacks* exception to the rule stated by *In re Cantrell* does
21 not apply in this case. Therefore, Plaintiff has not established fraud or defalcation while acting in
22 a fiduciary capacity.
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2. Embezzlement and Larceny

The elements of a claim based on embezzlement are: (1) property rightfully in the possession of the debtor; (2) the debtor's appropriation of the property to a use other than which the property was entrusted to the debtor; and (3) circumstances indicating fraud. *See In re Dakota Steel, Inc.*, 284 B.R. at 725. The elements of a claim based on larceny differ from those of a claim based on embezzlement only in that the original taking was wrongful. *Id.*

The Court finds that there was no embezzlement or larceny in connection with the Loan Proceeds where Defendant was entitled to use a portion of the funds for personal expenses, and where Plaintiff has not established what the majority of the Loan Proceeds were used for. Thus, Plaintiff has not met its burden to show the debt is nondischargeable under § 523(a)(4).

E. Plaintiff Has Not Met Its Burden to Show the Debt Is Nondischargeable Pursuant to 11 U.S.C. § 523(a)(6)

11 U.S.C. § 523(a)(6) provides that "a discharge under §727 . . . does not discharge an individual debtor from any debt . . . for willful and malicious injury by the debtor to another entity or to the property of another entity." 11 U.S.C. § 523(a)(6). To prevail on a claim under § 523(a)(6), a creditor must show three elements: (1) willful conduct; (2) malice; and (3) causation. *See In re Butcher*, 200 B.R. 675, 680 (Bankr. C.D. Cal. 1996) (quoting *In re Apte*, 180 B.R. 223, 230 (B.A.P. 9th Cir. 1995); *see also In re Barboza*, 545 F.3d 702, 206 (9th Cir. 2008) (holding that the malicious injury requirement is separate from the willful injury requirement); *Ormsby v. First American Title Company of Nevada*, 591 F.3d 1199, 1206 (9th Cir. 2010) (holding that "willful" and "malicious" are both required elements to establish nondischargeability under § 523(a)(6)). A willful and malicious injury under this provision requires proof of a "deliberate or intentional

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injury, not merely a deliberate or intentional act that leads to injury." *Kawaauhau v. Geiger*, 523 U.S. 57, 61 (1998).

An injury is willful when "the debtor subjectively intended to cause injury to the creditor, or the debtor subjectively believed that the injury was substantially certain to occur to the creditor as a result of her actions." *In re Chunchai Yu*, BAP No. CC–16–1045–KuFD, 2016 WL 4261655, at *3 (B.A.P. 9th Cir. Aug. 11, 2016); *see also In re Ormsby*, 591 F.3d 1199, 1207 (9th Cir. 2010) ("The [d]ebtor is charged with the knowledge of the natural consequences of his actions."); *Bankers Healthcare Grp., LLC v. Moss (In re Moss)*, 598 B.R. 508, 518 (Bankr. N.D. Ga. 2019) ("For a failure to pay loans, the debtor must have 'acted with a specific intent to cause economic injury, or knew injury was substantially certain to result, from his failing to remit payment on the subject loans,' for § 523(a)(6) to be indicated.") (citations omitted). If the act was intentional and the debtor knew that it would necessarily cause injury, "willful" intent does not require that the debtor has had the specific intent to injure the creditor. *In re Jercich*, 238 F.3d, 1202 1207 (9th Cir. 2001). "Willful" means "voluntary" or "intentional." *Kawaauhau*, 523 U.S. at 61-62 (citations omitted).

An injury is malicious when it involves: (1) a wrongful act; (2) done intentionally; (3) which necessarily causes injury; and (4) is done without just cause or excuse. *In re Barboza*, 545 F.3d at 706 (quoting *In re Jercich*, 238 F.3d at 1209). This definition "does not require a showing of biblical malice, i.e., personal hatred, spite, or ill will." *In re Bammer*, 131 F.3d 788, 791 (9th Cir. 1997). The Supreme Court narrowly held that "nondischargeability takes a deliberate or

intentional injury, not merely a deliberate or intentional act that leads to injury." *Kawaauhau*, 523 U.S. at 61 (citations omitted).

The Ninth Circuit held "an intentional breach of contract cannot give rise to nondischargeability under § 523(a)(6) unless it is accompanied by conduct that constitutes a tort under state law." *Lockerby v. Sierra*, 535 F.3d 1038, 1040 (9th Cir. 2008). The Bankruptcy Appellate Panel provided a helpful expansion of this principle:

> There are at least two relevant ways a creditor may take a judgment consisting of damages for breach of contract and prove that it is nondischargeable under § 523(a)(6). The first would be to establish that the breach of contract also constituted a tort such as conversion that the debtor undertook willfully and maliciously within the meaning of § 523(a)(6). . . .
>
> Alternatively, the creditor could prove a tortious breach of contract. But to do so, the creditor would need to show not only tortious conduct, but also that the debtor's conduct violated a fundamental public policy of the state.

In re Zeeb, BAP No. CC-19-1019-SKuTa, 2019 WL 3778306, at *6 (B.A.P. 9th Cir. Aug. 9, 2019) (citations and quotations omitted).

The Court finds that Plaintiff has not shown that Defendant's conduct violated a fundamental policy or Defendant's breach was accompanied by a conversion undertaken willfully and maliciously. *See id.* at *6 (citations and quotations omitted); *see also In re Yoon*, 627 B.R. at 914 (holding that the plaintiff has not meet her burden for her §523(a)(6) claim when she established fraud but has not shown that the debtor's conduct violated a fundamental public policy nor the debtor's breach was accompanied by a conversion undertaken willfully and maliciously). Plaintiff provides does not discuss why any of Defendant's conduct constitutes a breach of fundamental public policy of California. Instead, Plaintiff argues that Defendant's conduct

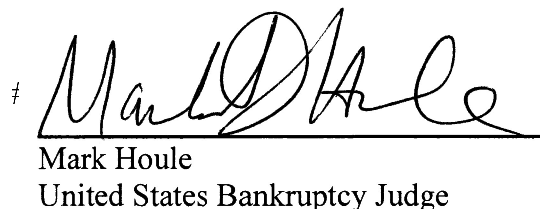
constitutes a tort because Defendant "willfully and maliciously lied about the state of TVPMG's business, that the Loan Proceeds would be used for business purpose, that the Loan would not be used for his own personal benefit . . . [Defendant] injured [Plaintiff] by scheming to have these Loan Proceeds to fund him with cash to pay his personal debts and did not use the Loan Proceeds for TVPMG's benefit." However, the Court finds that Plaintiff failed to prove that Defendant acted with the "actual intent to cause injury" because Plaintiff has not established what the majority of the Loan Proceeds were used for. *See Kawaauhau*, 523 U.S. at 61 (holding that § 523(a)(6) covers "a deliberate or intentional injury, not merely a deliberate or intentional act that leads to injury") (citations omitted).

Therefore, the Court concludes that Plaintiff failed to establish the required elements under 11 U.S.C. § 523(a)(6) because Plaintiff has not shown that Defendant's conduct violated a fundamental public policy nor Defendant's breach was accompanied by a conversion undertaken willfully and maliciously.

IV. CONCLUSION

For the reasons set forth above, and for the reasons set forth on the record, the Court determines that Plaintiff has established by a preponderance of the evidence the elements required for a finding of nondischargeability under 11 U.S.C. §§ 523(a)(2)(A) and 523(a)(2)(B), but not under 11 U.S.C. §§ 523(a)(4) and 523(a)(6).

Date: March 31, 2022



Mark Houle
United States Bankruptcy Judge