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NOT FOR PUBLICATION

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U.S. BKCY. APP. PANEL  
OF THE NINTH CIRCUIT

UNITED STATES BANKRUPTCY APPELLATE PANEL  
OF THE NINTH CIRCUIT

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In re:	)	BAP No.	CC-10-1307-PaDKi
	)		
JAMES CASTRO and JESSICA	)	Bk. No.	LA 08-16504 SB
CASTRO,	)		
	)	Adv. No.	LA 08-01660 SB
Debtors.	)		
<hr/>			
BRIAN DONLINGER; WEST COAST	)		
BUDDY, LLC; MILO, LLC,	)		
	)		
Appellants,	)		
	)	<b>MEMORANDUM<sup>1</sup></b>	
v.	)		
	)		
JAMES A. CASTRO,	)		
	)		
Appellee.	)		
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Argued and submitted on March 16, 2011  
at Pasadena, California

Filed - April 4, 2011

Appeal from the United States Bankruptcy Court  
for the Central District of California

Hon. Samuel L. Bufford, Bankruptcy Judge, Presiding.

Appearances: David N. Tarlow appeared for Appellants.  
Raymond H. Aver appeared for Appellee.

Before: PAPPAS, DUNN and KIRSCHER, Bankruptcy Judges.

<sup>1</sup> This disposition is not appropriate for publication.  
Although it may be cited for whatever persuasive value it may have  
(see Fed. R. App. P. 32.1), it has no precedential value. See 9th  
Cir. BAP Rule 8013-1.

1 This is an appeal from the bankruptcy court's order granting  
2 summary judgment in favor of chapter 7<sup>2</sup> debtor James A. Castro  
3 ("Castro"), dismissing the § 523(a) exception to discharge claims  
4 asserted by creditors Brian Donlinger ("Donlinger"), West Coast  
5 Buddy, LLC ("WCB"), and Milo, LLC ("Milo") (collectively,  
6 "Appellants"). We VACATE and REMAND the dismissal under  
7 § 523(a)(2)(A), and AFFIRM the dismissal under § 523(a)(4).

8  
9 **FACTS**

10 Sunset Beach

11 Castro was an investment banker. In June 2004, he learned  
12 that a local business, Dublin's Irish Whiskey Pub ("Dublins"),  
13 intended to sell its lease rights to a commercial property on West  
14 Sunset Boulevard, West Hollywood, California. As he later  
15 recounted in his declaration, Castro was "very optimistic and  
16 excited about the possibility of opening a new venture, consisting  
17 of a restaurant and a bar, there." Because Castro had no  
18 experience in operating such a business, he invited Steve Marlton  
19 ("Marlton"), an experienced restaurateur, to join him in making a  
20 proposal to acquire the lease. Castro was the managing member of  
21 Gardner Restaurants, LLC; Marlton was president of California  
22 Restaurant Authority, Inc. Together, they formed Sunset  
23 Restaurants Limited Partnership ("SRLP"), in which their two  
24 entities were the general partners. SRLP acquired the lease  
25 rights to the commercial property on July 1, 2004.

26  
27 <sup>2</sup> Unless otherwise indicated, all chapter, section and rule  
28 references are to the Bankruptcy Code, 11 U.S.C. §§ 101-1532, and  
to the Federal Rules of Bankruptcy Procedure, Rules 1001-9037. The  
Federal Rules of Civil Procedure are referred to as "Civil Rules."

1 Capital was needed to develop the property into an operating  
2 business. To assist them in attracting investors to their  
3 project, Castro and Marlton created a document called a  
4 Confidential Investment Summary (the "PPM"), which outlined the  
5 business plans and objectives of SRLP and contained information on  
6 the proposed business venture. For example, in describing what it  
7 termed "The Concept," the PPM states "Sunset Beach Restaurant and  
8 Ultra Lounge [will be] set in a casual beach inspired setting, in  
9 the same vein as the world renowned Nikki Beach [a well-known,  
10 successful restaurant and bar in Florida], that promotes mingling  
11 among its guests. . . . The bar area, located away from the main  
12 dining room, will create a focal point for guest interaction."  
13 Describing the venture's business strategy, the PPM noted in  
14 particular that, "[t]he sophisticated, full-service bar will offer  
15 a broad selection of domestic and imported bottled and draft  
16 beers, premium wines, and speciality drinks, along with top shelf  
17 liquor. . . . The Venue anticipates to be open seven days a week  
18 generally from 11:00 a.m. to 2:00 a.m. to serve its guests lunch,  
19 happy hour, dinner and late supper."

20 Castro and Donlinger agree that they met at a birthday party  
21 in September 2004, and that, for the first time, they discussed  
22 Donlinger's possible investment in SRLP.

23 On November 16, 2004, SRLP filed an application with local  
24 authorities for a Minor Conditional Use Permit ("MCUP"). Among  
25 the statements submitted to the Planning Commission of the City of  
26 West Hollywood, and contrary to the statements in the PPM, the  
27 MCUP indicated that "Sunset Beach intends to be open for Lunch  
28 during week days from 11:30 a.m. to 2:30 p.m. and for Dinner from

1 5:30 p.m. to 12:30 a.m. Sunday through Thursday and until 1:30  
2 a.m. on Fridays and Saturdays." In addition, this application  
3 made no request for authority to operate a "full-service bar" at  
4 Sunset Beach to service customers independent of food services.  
5 Moreover, the proposed floor plans for the project accompanying  
6 the application show space allotted for an "espresso bar" on the  
7 first floor of the business premises, and for a "sushi bar" on the  
8 second floor.

9 In mid-December 2004, Castro and Donlinger met again at the  
10 El Guapo Restaurant to talk more about Sunset Beach. At that  
11 meeting Castro gave Donlinger a copy of the PPM, a form  
12 Subscription Agreement to the partnership, and an Equity Bonus  
13 Plan. The parties significantly diverge, however, in their  
14 characterization and recollection of the oral discussions at that  
15 meeting.

16 Donlinger alleges that Castro made numerous oral  
17 representations to him at the El Guapo meeting that the "Sunset  
18 Beach Restaurant and Ultra Lounge" would be a "restaurant, full  
19 service bar and nightclub." In particular, he alleges in the  
20 Second Amended Complaint that:

21 Castro told Donlinger [] that he and his partner planned  
22 to open an ultra lounge at the property called Sunset  
23 Beach, which would be a restaurant, full service bar and  
24 nightclub, which would promote an interactive experience  
25 among the customers. Castro stated that the model for  
26 Sunset Beach was a nightclub in Miami, Florida called  
27 Nikki Beach, which was an "ultra lounge" which contained  
28 a restaurant and nightclub. Castro explained that  
Sunset Beach would have multiple dining areas and a full  
service bar for alcohol service and consumption. He  
said the bar would be the focal point of guest  
interaction. He also told Donlinger that Sunset would  
have a disk jockey booth and a dance floor, so that its  
patrons could dance until 2:00 a.m. each night. Castro  
also told Donlinger that he was so confident in the

1 success of Sunset that he had invested \$150,000.00 of  
2 his own money in the company.

3 Donlinger's declaration submitted in opposition to Castro's  
4 summary judgment motion restates these allegations:

5 Castro explained to me [at the El Guapo meeting that]  
6 SRLP proposed to open a restaurant and bar at the  
7 property, which would be an "ultra lounge." He  
8 explained to me that it was to be a hip venue on the  
9 Sunset Strip which would have two full-service bars,  
10 meal service, music, a disc jockey, happy hours,  
11 dancing, promotions and special events, among other  
12 things. He also told me that Sunset Beach would be  
13 operating under the exact same guidelines as Dublin's  
14 had operated previously. . . . Castro further explained  
15 to me that Sunset Beach would be open until 2:00 a.m.  
16 each night, and that it was intended to compete with  
17 other such venues on the Sunset Strip as Saddle Ranch  
18 Chop House and Miyagi's. . . . The real attraction of  
19 these venues is the bar/nightlife scene. They both have  
20 large bars which are their main attractions, and are  
21 frequently doing business at their bars until 2:00 a.m.

22 Except for the alleged representation that he had invested  
23 his own money, in his declaration in support of summary judgment,  
24 Castro does not deny that he made any of these statements to  
25 Donlinger at the El Guapo. As Castro summarizes what was said, "I  
26 explained [to Donlinger] our concept of what Sunset Beach would  
27 be, and how we expected to fund construction without any debt  
28 financing (such as a construction loan from a bank)."

29 Castro makes no comment in his declaration regarding  
30 Donlinger's allegation that, by describing the proposed business  
31 as "an ultra lounge," he thereby implied it would include a full-  
32 service bar that would serve alcohol to customers who were not  
33 also dining at the restaurant. He was later asked in his  
34 deposition to explain his concept of an ultra lounge:

35 Question: Back in 2004 and 2005, did you have an  
36 understanding of what an ultra lounge was?

1 Castro: Yes.

2 . . . .

3 Question: Back in 2004 and 2005, your understanding of  
4 [ultra lounge], did it include a place where someone  
could go and get a drink without having to order food?

5 Castro: Yes.

6 Question: Did it include a place where someone could go  
7 and actually walk up to a bar, sit at the bar, and have  
8 a drink there, without having to worry about being put  
at a restaurant table to eat?

9 Castro: Yes.

10 Castro Dep. 33:13-15, 34:3-11 (December 2, 2009).

11 Between December 2004 and May 2005, Castro and Donlinger had  
12 several more meetings, telephone conversations and email exchanges  
13 regarding Donlinger's possible investment in SRLP. Donlinger  
14 alleges that in those communications Castro repeated his  
15 statements that Sunset Beach would stay open until 2:00 a.m. every  
16 day of the week, with music and dancing.

17 In one email communication on February 25, 2005, Donlinger  
18 requested that Castro send him the floor plans for the restaurant  
19 so that he could show them to other potential investors. In  
20 response, Castro sent the floor plans, which showed an espresso  
21 bar on the first floor and a sushi bar on the second. At that  
22 time, Castro also wrote, "Keep in mind, terms such as espresso  
23 bars and sushi bars are simply ways to get around the permitting  
24 process. They will simply be alcohol bars."

25 On March 25, 2005, in a telephone conversation, Castro  
26 informed Donlinger that he was about to "close the fund to new  
27 investors." Donlinger told Castro that he planned on becoming an  
28 investor. Castro then joined Marlton in the call, who

1 congratulated Donlinger on his involvement in "the next hottest  
2 club in L.A."

3 On April 21, 2005, Castro attended a hearing before the City  
4 of West Hollywood Planning Commission where SRLP was granted its  
5 MCUP. However, the MCUP contained several important conditions,  
6 including:

7 - Condition 10.12. Hours of operation: Lunch (weekdays only)  
8 11:30 a.m. to 2:30 p.m. Dinner Sunday-Thursday 5:30 p.m. to  
9 12:30 a.m., with alcohol consumption and service ending at  
10 11:30 p.m. Dinner Friday and Saturday 5:30 p.m. to 1:30  
11 a.m., with alcohol consumption and service ending at 12:30  
12 a.m.

13 - Condition 10.14. Sale, service and consumption of alcohol  
14 only permitted when accompanied by meal service, or to  
15 patrons waiting for a table for meal service.

16 - Condition 10.15. Patrons not permitted to be served  
17 alcohol at the espresso bar unless they are seated at the bar  
18 for meal service.

19 - Condition 10.23. No happy hour or alcohol related  
20 promotions permitted.

21 - Condition 11.12. Restaurant may not limit the entry of  
22 minors into the establishment.

23 On May 17, 2005, apparently unaware of the conditions in the  
24 MCUP, Donlinger signed a Subscription Agreement and invested  
25 \$150,000 of his own funds in SRLP in exchange for three limited  
26 partnership units. Among the provisions in the Subscription  
27 Agreement relevant to the current appeal are the following:

28 - That a copy of the PPM was provided to Subscriber (i.e.,  
Donlinger); and that Subscriber represented that he had  
"received, read and is familiar with the" PPM.

- That Subscriber represented that he is a sophisticated  
investor, knowledgeable and experienced in financial and  
business matters and is capable of evaluating the merits and  
risks of an investment. That Subscriber is aware of the  
highly speculative nature of any investment in the  
partnership.

1 - That the imposition of non-standard restrictions on the  
2 liquor license could materially adversely affect the proposed  
3 business of the partnership. However, the Subscription  
4 Agreement also provides that there are numerous licenses and  
5 permits, including the liquor license and "no assurances can  
6 be made that they will be obtained and, if so, that there  
7 will not be any additional conditions imposed on the  
8 Partnership that are not currently anticipated."

9 Of paramount concern in this appeal is what the bankruptcy  
10 court and parties refer to as a "disclaimer clause" in the  
11 Subscription Agreement. There are actually two "disclaimer" or  
12 waiver clauses.<sup>3</sup> The first appears at ¶ 5(x), and provides that:  
13 "Subscriber has not received any representations or warranties  
14 from the General Partners, the Partnership or any of their  
15 employees or agents, other than those expressly set forth in this  
16 Agreement and the Investment Summary." Then, at ¶ 7(iv), the  
17 Subscription Agreement provides: "Entire Agreement. This  
18 Agreement contains the entire agreement of the parties with  
19 respect to the subject matter of this Agreement, and the parties  
20 shall not rely upon any representations, covenants or other  
21 agreements that are not set forth in this Agreement."

22 As early as the El Guapo meeting in December 2004 where he  
23 offered Donlinger the Equity Bonus Plan, Castro had encouraged  
24 Donlinger to recruit additional investors in SRLP. Donlinger did  
25 just that. From December 2004 through July 2005, Donlinger passed  
26 information he had received from Castro to his former boss, Joel  
27 Leonard, to solicit Leonard's company, WCB, to invest in SRLP.  
28 The declarations of both Donlinger and Leonard submitted in  
opposition to Castro's summary judgment motion state that

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<sup>3</sup> The parties and the court used the terms disclaimer and waiver interchangeably.



1 Donlinger specifically passed on Castro's representations that  
2 Sunset Beach would have two full service bars, meal service,  
3 music, disc jockeys, dancing, promotions and special events.

4 Castro acknowledged during his deposition that he was aware  
5 and expected that Donlinger would convey the information Castro  
6 gave him to Leonard. And although Castro had only one brief  
7 telephone conversation with Leonard, he did provide copies of the  
8 PPM and Subscription Agreement to Leonard. As Leonard would later  
9 summarize, from the PPM and oral representations conveyed to him  
10 by Donlinger, he was led to believe that his company, WCB, would  
11 be "buying into a bar and nightclub in the nightlife hospitality  
12 industry, and not merely a restaurant." Leonard caused WCB to  
13 invest \$150,000 in SRLP on August 2, 2005; Leonard signed the  
14 Subscription Agreement.

15 In late Summer 2005, construction commenced on Sunset Beach.  
16 At the same time, Marlton left his management duties at Sunset  
17 Beach to work on a movie project in Southeast Asia. In December  
18 2005, Castro hired Barnaby Holm to replace Marlton.

19 By April 2006, Castro contacted Donlinger, telling him that  
20 construction costs had exceeded expectations and offered Donlinger  
21 the opportunity to invest an additional \$200,000 in the  
22 partnership in return for 24.49% of cash distributions received by  
23 Gardner [general partner of SRLP controlled by Castro] from Sunset  
24 Beach. A Consulting Agreement indicates that Donlinger, through  
25 his controlled limited liability company, Milo, invested \$200,000  
26 in SRLP on April 19, 2006. Donlinger would later testify in his  
27 declaration opposing summary judgment that he invested the  
28 additional \$200,000 on behalf of Milo based on the oral



1 Happy Hours at the restaurant; (5) Sunset Beach's limited partners  
2 would be paid on a "first money out to limited partners" basis;  
3 (6) Castro invested his own moneys in Sunset Beach; (7) Castro  
4 misstated Holm's qualifications to be manager of a restaurant; and  
5 (8) Castro withheld information on the serious financial  
6 difficulties of the restaurant which resulted in its borrowing  
7 approximately \$1 million from another party, Jerry Nelson. The  
8 Second Amended Complaint alleged that Castro knew these  
9 representations were false when he made them and, specifically,  
10 that Castro made the representations when he had already caused  
11 SRLP to apply for an MCUP that was materially inconsistent with  
12 the representations.

13 As to the (a)(4) claim, Appellants alleged that Castro had  
14 breached his fiduciary duty to his partners by embezzling funds of  
15 the partnership, and that they were damaged by Castro's acts of  
16 defalcation resulting in their loss of their investments of  
17 \$500,000.

18 For the two claims, Appellants sought compensatory and  
19 punitive damages, and a judgment declaring the damage awards  
20 excepted from discharge under §§ 523(a)(2)(A) and (a)(4).

21 Castro filed a motion for summary judgment on February 15,  
22 2010, arguing that there were no genuine issues of material fact  
23 regarding any of the claims in the Second Amended Complaint.  
24 Castro argued that the record showed that he either never made the  
25 misrepresentations as alleged in the complaint, or that the  
26 representations were in fact true. As to embezzlement or  
27 defalcation, Castro asserted that the specific acts cited by  
28 Appellants did not constitute embezzlement or defalcation, or that

1 Castro was not in financial control of SRLP and did not  
2 participate in any of the challenged transactions. The motion was  
3 supported by declarations from Castro and Marlton, and excerpts  
4 from the depositions of Castro and his attorney.

5 Appellants filed a brief in opposition to the motion on March  
6 19, 2010. Appellants supported their position with declarations  
7 from Donlinger and Appellants' attorney, and with excerpts from  
8 Donlinger's deposition. In the brief, Appellants argued that  
9 Castro knew that Sunset Beach was to be a restaurant, not a full  
10 service bar and nightclub, even before he solicited Donlinger's  
11 investment. In particular, Appellants noted that the MCUP  
12 application Castro filed with the City of West Hollywood was  
13 inconsistent with critical elements in the PPM. Moreover,  
14 Appellants argued, at the El Guapo meeting, Castro knowingly made  
15 written and oral misrepresentations regarding Sunset Beach, and  
16 that Castro continued to make material misrepresentations  
17 throughout the period when Appellants were considering making  
18 their investments, and never informed Appellants that the approved  
19 MCUP was inconsistent with those representations. In Appellants'  
20 view, genuine issues of fact remained for trial regarding the  
21 § 523(a)(2)(A) claim. As to the (a)(4) claim, Appellants repeated  
22 their assertions from the Second Amended Complaint.

23 Castro responded to Appellants' brief on April 6, 2010. He  
24 argued that Appellants could not prove that he had made any  
25 misrepresentations prior to their investment. As to the  
26 embezzlement claims, Castro argued that he had no control over the  
27 finances of SRLP at the times alleged and therefore Appellants  
28 could not prove embezzlement. Regarding defalcation, Castro

1 argued that Appellants could not prove that Castro failed to  
2 account for any of Sunset Beach's money.

3 The hearing on Castro's motion for summary judgment took  
4 place on May 11, 2010. From the beginning of the hearing, the  
5 bankruptcy judge made it clear that, in assessing the (a)(2)(A)  
6 claims, he would not consider any alleged misrepresentations by  
7 Castro that were not in the PPM or Subscription Agreement:

8 THE COURT: Let me make sure I understand what  
9 representations are properly before the Court. This was  
10 a case where there was an offering circular and  
11 subscription agreement?

12 TARLOW (Appellants' attorney): Yes, your Honor.

13 THE COURT: And those documents said that they embody the  
14 entire agreement between the parties and there are no  
15 representations or warranties given apart from that?

16 TARLOW: That's what the papers said, but there were  
17 other representations made.

18 THE COURT: And they were disclaimed in the agreement,  
19 were they not?

20 TARLOW: There was a disclaimer in the agreement, yes.

21 THE COURT: So under California law, they disappear.

22 Hr'g Tr. 1:20-2:9 (May 11, 2010).

23 In its ruling at the end of the hearing, the bankruptcy court  
24 repeated its decision to effectively decline to consider any oral  
25 representations: "With respect to the fraud claims, apart from  
26 the two documents, the subscription agreement and the [PPM],  
27 [Appellants] have disclaimed any other representations and  
28 warranties. So I can't give weight to any others." Hr'g Tr.  
31:21-25.

The bankruptcy court next examined the PPM, and noted that  
the evidence before the court showed that the PPM was a "concept"

1 document. The court then explained that, in its view, Castro's  
2 written statements about his business concepts and strategies  
3 could not support a fraud claim:

4 The evidence before the Court is that there was a  
5 concept document, set forth a concept. Concepts are  
6 never realized exactly the way they're originally put  
7 forth, at least not in this kind of context. That there  
8 should be a variation is not surprising. It's expected  
9 and does not give rise to a claim for fraud.

10 There is also business strategy. Business strategy  
11 is different from specific representations also.  
12 Business strategy is not always realized. That does not  
13 – and if the business strategy is not realized . . .  
14 that alone is not a basis for a claim of fraud.

15 In this adversary proceeding, the claims of fraud  
16 are based on particular details, not on the overall  
17 business strategy or the overall concept. And so on  
18 these grounds, then I find there's no triable issue of  
19 fact, and summary judgment has to be granted to the  
20 Defendant.

21 Hr'g Tr. 32:5-23 (May 11, 2010).

22 As to the § 523(a)(4) claim, the bankruptcy court determined  
23 that Appellants had not presented adequate evidence to support the  
24 claims of embezzlement or defalcation. The court noted that a  
25 defalcation requires the existence of a trust relationship between  
26 the parties, which Appellants had not shown. Instead, the court  
27 observed that Appellants had raised conclusory arguments about  
28 Castro's alleged failure to explain various financial  
29 transactions, and the court was satisfied with Castro's  
30 explanations. The court concluded that Appellants had not shown a  
31 material question of fact remained regarding the defalcation or  
32 embezzlement claims to justify nondischargeability under  
33 § 523(a)(4).

34 The bankruptcy court entered its order granting summary  
35 judgment to Castro on July 28, 2010. Appellants filed a timely  
36 appeal on August 11, 2010.

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**JURISDICTION**

The bankruptcy court had jurisdiction under 28 U.S.C. §§ 1334 and 157(b) (2) (B) and (I). We have jurisdiction under 28 U.S.C. § 158.

**ISSUE**

Whether the bankruptcy court erred in granting summary judgment to Castro dismissing Appellants' complaint for exceptions to discharge under §§ 523(a) (2) (A) and (a) (4).

**STANDARD OF REVIEW**

We review de novo a bankruptcy court's decision to grant summary judgment. Wood v. Stratos Prod. Dev. (In re Ahaza Sys., Inc.), 482 F.3d 1118, 1123 (9th Cir. 2007) (stating that both the Court of Appeals and the BAP apply de novo review to a bankruptcy court's decision to grant summary judgment).

**DISCUSSION**

Summary judgment may be granted "if the pleadings, the discovery and disclosure materials on file, and any affidavits show that there is no genuine issue as to any material fact and that the movant is entitled to judgment as a matter of law." Civil Rule 56(c) (2), incorporated by Rule 7056. Barboza v. New Form, Inc. (In re Barboza), 545 F.3d 702, 707 (9th Cir. 2008). The court does not weigh evidence in resolving a motion for summary judgment, but rather determines only whether any material factual dispute remains for trial. Covey v. Hollydale Mobilehome Estates, 116 F.3d 830, 834 (9th Cir. 1997).

The party seeking summary judgment bears the initial burden

1 of establishing the absence of a genuine issue of material fact.  
2 Margolis v. Ryan, 140 F.3d 850, 852 (9th Cir. 1998). A dispute is  
3 genuine if there is sufficient evidence for a reasonable fact  
4 finder to hold in favor of the non-moving party, and a fact is  
5 "material" if it might affect the outcome of the case. Far Out  
6 Prods., Inc. v. Oskar, 247 F.3d 986, 992 (9th Cir. 2001) (citing  
7 Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 248-49 (1986)).  
8 When the movant has carried its burden under Civil Rule 56(c), the  
9 non-moving party must come forward with "specific facts showing  
10 that there is a genuine issue for trial." Id. at 1035 (quoting  
11 Civil Rule 56(e)); Hayes v. Palm Seedlings Partners (In re Agric.  
12 Research), 916 F.2d 528, 533 (9th Cir. 1990).

13 The standard of proof for discharge exceptions is a  
14 preponderance of the evidence. Grogan v. Garner, 498 U.S. 279  
15 (1991); Melton v. Moore, 964 F.2d 880 (9th Cir. 1992).

16 In this appeal, we conclude that the bankruptcy court erred  
17 when it determined that, because of the disclaimer clause in the  
18 Subscription Agreement, it should not consider any other alleged  
19 representations made by Castro to Appellants. In doing so, the  
20 bankruptcy court effectively refused to consider what we deem were  
21 "specific facts showing that there is a genuine issue for trial."  
22 When those facts are considered, it is clear that genuine issues  
23 of material fact remained for trial. The bankruptcy court also  
24 erred when it concluded that the statements in the PPM were  
25 "concept" or "business strategy" only and, as a result, could not  
26 constitute the basis for a fraud claim. Consequently, we will  
27 vacate the bankruptcy court's grant of summary judgment to Castro  
28 on Appellants' claims under § 523(a)(2)(A).





1 Appellants argued that disputed issues of material fact  
2 existed concerning whether Castro had committed fraud in inducing  
3 Appellants to invest in Sunset Beach. In particular, Appellants  
4 attempted to show the bankruptcy court that Castro made  
5 misrepresentations of material facts via both the written  
6 documents given to them, and through his oral statements. Among  
7 the false statements allegedly made were that Sunset Beach was  
8 going to be a full service bar and "ultra lounge" that would serve  
9 alcohol without requiring patrons to eat meals there; that Sunset  
10 Beach would remain open until 2:00 a.m. seven days a week as a  
11 nightlife center competing with neighboring facilities, by using  
12 disc jockeys, promotions, dancing, and "Happy Hours"; that Sunset  
13 Beach's limited partners would be paid on a "first money out to  
14 limited partners" basis; that Castro had invested his own moneys  
15 in Sunset Beach; that Castro misstated Holm's qualifications to be  
16 manager of a restaurant; and that Castro withheld information on  
17 the serious financial difficulties of the restaurant which  
18 resulted in its borrowing approximately \$1 million from another  
19 party, Jerry Nelson. Although Appellants argued that their  
20 position was supported in many respects by the contents of the  
21 PPM, each of the claims rested, at least in part, on the oral  
22 representations made by Castro at the El Guapo meeting with  
23 Donlinger, and in his continuing communications with Donlinger  
24 that he knew would be passed on to Leonard during the period  
25 before Appellants made their investments in Sunset Beach.

26 The bankruptcy court ruled that, under California law,  
27 because of the disclaimer provision in the contract documents the  
28 court was prevented from considering external, or parol evidence

1 of other representations allegedly made by Castro. This legal  
2 conclusion was incorrect.

3 A claim for nondischargeability of a debt under 523(a)(2)(A),  
4 alleging fraudulent concealment, fraud and misrepresentation to  
5 obtain funds may be analyzed as a claim for fraud in the  
6 inducement under California law. Franklin v. Commonwealth Fin.  
7 Corp. (In re Franklin), 922 F.2d 536, 539 (9th Cir. 1991); In re  
8 Nga Tuy Pham, 2009 WL 3367046 (Bankr. N.D. Cal. 2009) ("A debt is  
9 excepted from discharge if it results from fraud in the  
10 inducement. 11 U.S.C. § 523(a)(2)[A]."); see also O'Neil v. Goode  
11 (In re Goode), 2011 Bankr. LEXIS 607, at \*12 (Bankr. E.D. Tenn  
12 2011) (applying Tennessee law); Gonzalez v. Cantu (In re Cantu),  
13 2009 Bankr. LEXIS 4447, at \*12 (Bankr. S.D. Tex. 2009) (applying  
14 Texas law); Gamble v. Overton (In re Overton), 2009 Bankr. LEXIS  
15 478, at \*17 (Bankr. D. Idaho 2009) (applying Wyoming law). Where  
16 a creditor is induced to enter into an agreement by fraudulent  
17 misrepresentations, not only does California's law of fraud in the  
18 inducement apply, but any disclaimer in the agreement cannot be  
19 used to prevent the court from considering oral representations.  
20 As a leading treatise on California law opines, a party that is  
21 charged with fraudulently inducing another party to enter an  
22 agreement

23 cannot absolve himself from the effects of his fraud by  
24 any stipulation in the contract, either that no  
25 representations have been made, or that any right which  
26 might be grounded upon them is waived. Such a  
27 stipulation or waiver will be ignored, and parol  
evidence of misrepresentations will be admitted, for the  
reason that fraud renders the whole agreement voidable,  
including the waiver provision.

28 B.E. Witkin, SUMMARY OF CALIFORNIA LAW CONTRACTS § 304(1) (10th ed.

1 2010). California courts have consistently recognized as well-  
2 settled law that parol or extrinsic evidence is admissible to  
3 prove fraud in the inducement of a contract "even though the  
4 contract recites that all conditions and representations are  
5 embodied therein." Ron Greenspan Volkswagen, Inc. v. Ford Motor  
6 Land Dev. Corp., 32 Cal. App. 4th 985, 990 (Cal. Ct. App. 1995)  
7 (quoting Ferguson v. Koch, 268 P. 342, 347 (Cal. 1928)); Morris v.  
8 Harbor Boat Building Co., 247 P.2d 589, 596 (Cal. Ct. App. 1952)  
9 ("[I]t was never intended that the parol evidence rule should be  
10 used as a shield to prevent the proof of fraud . . . even though  
11 the contract recites that all conditions and representations are  
12 embodied therein."); Oak Industries, Inc. v. Foxboro Co., 596 F.  
13 Supp. 601, 607 (S.D. Cal. 1984) (holding that under California  
14 law, extrinsic evidence is admissible to prove fraud in the  
15 inducement notwithstanding a contract provision that no  
16 representations have been made other than those stated in the  
17 agreement); Applications Inc. v. Hewlett Packard Co., 501 F. Supp.  
18 129, 134 (S.D.N.Y. 1980) (applying California law, holding that  
19 parol evidence is admissible to prove fraud despite contract  
20 provision waiving representations not stated in the agreement).  
21 Therefore, under the controlling law, the disclaimer clause in the  
22 Subscription Agreement did not insulate Castro from Appellants'  
23 claims that he defrauded them through oral misrepresentations,  
24 thereby inducing them to invest in Sunset Beach.

25       After incorrectly declining to consider the alleged oral  
26 misrepresentations made by Castro to induce Appellants to invest,  
27 the bankruptcy court next examined the effect of the  
28 representations made in the written PPM. The court ruled that

1 statements concerning the nature of the proposed Sunset Beach  
2 operation were "concepts" or "business strategy," or that those  
3 statements were in fact true representations. The bankruptcy  
4 court then concluded, without citing anything in the record to  
5 support its factual conclusion, that business concepts and  
6 strategies always vary from the final results. As a result, the  
7 bankruptcy court concluded that Appellants could not justifiably  
8 rely upon such statements to support a claim for fraud.

9 We disagree with the bankruptcy court's approach in this  
10 procedural context, and its conclusion. For example, the PPM  
11 states, "The sophisticated, full-service bar will offer a broad  
12 selection of domestic and imported bottled and draft beers,  
13 premium wines, and specialty drinks, along with top-shelf liquor."  
14 Appellants argue that this statement supports their position in  
15 that a "sophisticated, full service bar" implies a bar available  
16 for drinks without food. The bankruptcy court found that those  
17 types of liquor were, indeed, actually served at Sunset Beach, and  
18 that the PPM did not indicate that the full-service was to be a  
19 bar to accommodate late-night, non-diners. However, when viewed  
20 in the context of the numerous oral representations made by Castro  
21 that Sunset Beach would have a "full-service bar" and that the  
22 restaurant was also intended as a nightlife spot, and especially  
23 in view of the exchange of emails that the espresso and sushi bars  
24 shown on proposed floor plans were actually to be, in Castro's own  
25 words, "alcohol bars," a reasonable trier of fact could conclude  
26 that Sunset Beach was not merely to be a restaurant but also a  
27 club catering to a nightlife crowd. In the context of a summary  
28 judgment proceeding, the bankruptcy court was not empowered to

1 determine whether Sunset Beach was in fact intended or represented  
2 by Castro to be a nightclub, but only with whether there was a  
3 triable issue of fact in that regard. And a fair view of the  
4 evidence submitted to the bankruptcy court could lead a trier of  
5 fact to find that, when the written documents are viewed together  
6 with the oral representations, several triable issues of fact  
7 emerged. It was therefore error for the bankruptcy court to  
8 conclude, as a matter of fact, that any "concept" or "business  
9 strategy" representations were not reliable, or that the other  
10 statements in the PPM were true and exclusive to a restaurant-only  
11 interpretation.

12 Appellants' submissions to the bankruptcy court addressed  
13 each of the elements under the case law to establish an exception  
14 to discharge under § 523(a)(2)(A). Appellants submitted proof  
15 that Castro made a variety of representations to Donlinger that  
16 Sunset Beach would be an ultra lounge and full-service bar.  
17 Because such representations were seemingly inconsistent with the  
18 MCUP previously issued by the local authorities to Castro,  
19 Appellants have shown the existence of at least an issue of fact  
20 whether Castro knew these statements to Donlinger were false when  
21 he made them. The record also shows some evidence that Castro  
22 intended Appellants to rely on his representations so they would  
23 invest in the business by withholding other information from them,  
24 such as the true terms of the MCUP. While it is true that  
25 Appellants signed a Subscription Agreement containing a provision  
26 disclaiming that they relied upon other information in investing,  
27 when the record as a whole is considered, issues of fact exist as  
28 to whether they justifiably relied on Castro's representations,

1 and whether, without those representations, they would have  
2 invested in Sunset Beach. Finally, it is undisputed that  
3 Appellants lost their investments, and arguably suffered damages  
4 as a result of Castro's alleged fraud. Clearly, then, there are  
5 triable issues of fact on Appellants' fraud claims.

6 In sum, the bankruptcy court erred when it ruled that it  
7 could not consider representations made by Castro other than in  
8 the PPM because of the disclaimer provision in the Subscription  
9 Agreement. It also erred in concluding that the statements in the  
10 PPM about Sunset Beach were concepts and business strategy that  
11 could not serve as a basis for a fraud claim by Appellants.  
12 Because the record demonstrates that there were genuine issues of  
13 fact as to Appellants' fraud claims, a trial was required. We  
14 must therefore vacate the bankruptcy court's grant of summary  
15 judgment to Castro on the § 523(a)(2)(A) issues, and remand this  
16 action for trial.

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**II.**  
**The bankruptcy court did not err in granting**  
**summary judgment to Castro under § 523(a)(4).**

19

20 Section 523(a)(4) provides that a " discharge under section  
21 727 . . . does not discharge an individual debtor from any debt--  
22 . . . (4) for fraud or defalcation while acting in a fiduciary  
23 capacity, embezzlement, or larceny." In an action to except a  
24 debt from discharge under § 523(a)(4), a creditor must establish:  
25 (1) that an express trust existed between the debtor and creditor;  
26 (2) that the debt was caused by the debtor's fraud or defalcation;  
27 and (3) that the debtor was a fiduciary to the creditor at the  
28 time the debt was created. Otto v. Niles, (In re Niles), 106 F.3d

1 1456, 1459 (9th Cir. 1997); Nahman v. Jacks (In re Jacks), 266  
2 B.R. 728, 735 (9th Cir. BAP 2001).

3       The bankruptcy court properly found that there was no express  
4 trust between Castro and Appellants. An express trust in  
5 California requires three elements: 1) sufficient words to create  
6 a trust; 2) a definite subject; and 3) a certain and ascertained  
7 object or res." Schlecht v. Thornton (In re Thornton), 544 F.2d  
8 1005, 1007 (9th Cir. 1976); Destfino v. Bockting (In re Destfino),  
9 2010 Dist. LEXIS 107749, at \*7 (E.D. Cal. 2010). There is simply  
10 no evidence that the parties intended to create a trust.

11       As to Appellants' more specific arguments that Castro  
12 embezzled funds entrusted to him, Appellants failed to provide  
13 sufficient facts to support their argument. Under federal law,  
14 embezzlement in the context of § 523(a)(4) is "the fraudulent  
15 appropriation of property by a person to whom such property has  
16 been entrusted or into whose hands it has lawfully come."  
17 Transamerica Comm. Fin. Corp. v. Littleton (In re Littleton), 942  
18 F.2d 551, 555 (9th Cir. 1991) (quoting Moore v. United States, 160  
19 U.S. 268, 269 (1885)). The bankruptcy court found, and we agree,  
20 that Appellants submitted no evidence to support a claim of  
21 embezzlement. Instead, Appellants made numerous conclusory  
22 statements that SRLP funds had been used for improper purposes,  
23 but provided no evidence that Castro was in control of the  
24 finances of SRLP or that funds had been used for an improper  
25 purpose. On the contrary, the court found that the only evidence  
26 before the court was that Castro had properly accounted for each  
27 of the alleged misuses.

28       Because there was no triable issue of fact regarding whether



1 Castro and Appellants' relationship was a trust for purposes of  
2 § 523(a)(4) or that Appellants had submitted evidence in support  
3 of their claims of embezzlement, the bankruptcy court correctly  
4 granted summary judgment to Castro.

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6

**CONCLUSION**

7 We VACATE the bankruptcy court's order granting summary  
8 judgment to Castro on Appellants' § 523(a)(2)(A) claim, and REMAND  
9 this matter to the bankruptcy court for further proceedings  
10 consistent with this decision. We AFFIRM the bankruptcy court's  
11 order granting summary judgment to Castro on the § 523(a)(4)  
12 claim.

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