

AUG 24 2005

**HAROLD S. MARENUS, CLERK
U.S. BKCY. APP. PANEL
OF THE NINTH CIRCUIT**

NOT FOR PUBLICATION

**UNITED STATES BANKRUPTCY APPELLATE PANEL
OF THE NINTH CIRCUIT**

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In re:)	BAP Nos. ¹	EC-04-1263-SPMa
)		EC-04-1264-SPMa
AARON D. LOOS and ALICE M. LOOS,)		(Related Appeals)
)		
Debtors.)	Bk. No.	03-24832-C-7
)		
_____)	Adv. Nos.	03-02402
AARON D. LOOS; ALICE M. LOOS,)		03-02403
)		
Appellants,)		
)		
v.)	MEMORANDUM²	
)		
STANLEY AYERS; BRIAN BANIQUED,)		
)		
Appellees.)		
_____)		

Argued and Submitted on
May 20, 2005 at Sacramento, California

Filed - August 24, 2005

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

Honorable David E. Russell, Bankruptcy Judge, Presiding

Before: SMITH, PERRIS and MARLAR, Bankruptcy Judges.

¹ Two independently filed adversary proceedings were joined for the purposes of trial and are the subject of this appeal. This memorandum addresses both appeals.

² This disposition is not appropriate for publication and may not be cited except when relevant under the doctrines of law of the case, res judicata, or collateral estoppel. See 9th Cir. BAP Rule 8013-1.

1 The debtors, Aaron D. Loos ("Loos" or "Debtor") and Alice M.
2 Loos ("Mrs. Loos") (collectively, "Debtors"), appeal final
3 judgments of the bankruptcy court, entered on May 5, 2004, which
4 rendered the debts owed to Stanley Ayers ("Ayers") and Brian
5 Baniqued ("Baniqued") (collectively "Plaintiffs") non-
6 dischargeable.³ We VACATE and REMAND.

7
8 **FACTS**

9 Debtors filed a voluntary chapter 7⁴ petition on April 29,
10 2003. On July 25, 2003, Ayers and Baniqued initiated separate
11 adversary proceedings against Debtors objecting to discharge under
12 §§ 727(a) (3) and (a) (5).⁵ The complaints each alleged that Loos
13 was hired to manage Plaintiffs' respective apartment buildings and
14 that under the terms of the management agreements, Loos was to
15 "advertise and lease units, collect rents, pay bills
16 for services and supplies, and perform necessary repairs."
17 According to Plaintiffs, Loos failed to perform the duties as

18
19 _____
20 ³ The bankruptcy court made a finding as to Loos and not Mrs.
21 Loos and held that Plaintiffs "take nothing against" Mrs. Loos.
22 Nevertheless, both Debtors appealed.

23 ⁴ Unless otherwise indicated, all chapter, section and rule
24 references are to the Bankruptcy Code, 11 U.S.C. §§ 101-1330, and
25 to the Federal Rules of Bankruptcy Procedure, Rules 1001-9036.

26 ⁵ Prior to the bankruptcy filing, both Ayers and Baniqued had
27 commenced litigation against Loos. Ayers had filed a complaint in
28 state court for breach of contract, breach of implied covenant of
good faith and fair dealing, conversion, and breach of fiduciary
duty. However, the bankruptcy case was filed before the complaint
could be served. Baniqued had commenced an arbitration proceeding
asserting the same claims, as well as intentional
misrepresentation and fraud, and obtained an arbitration award in
the amount of \$20,530.32 prior to the bankruptcy. The arbitration
award, however, makes no findings regarding any of the specific
charges.

1 required. Specifically, Loos failed to "provide [Plaintiffs] with
2 invoices and other documentation sufficient to justify the amounts
3 of rent retained."

4 The trial in both adversary proceedings was set for February
5 5, 2004.⁶ On January 30, 2004, just six days prior to the trial
6 and without leave of the court, Plaintiffs filed a pleading which
7 apparently sought to amend the complaint to add exceptions to
8 discharge under § 523.⁷ At trial, Plaintiffs' attorneys orally
9 moved to amend the complaint and explained the basis for the
10 proposed amendment:

11 Bildhauer⁸: [Plaintiffs] had spoken with the
12 clerk who suggested that we file 523 to give -
13 anyway, we wanted to give you another option
14 in the event that you felt specific exception
15 was equitable, as to oppose - as opposed to a
16 total conclusion of discharge.

17 Transcript of Proceedings, February 5, 2004, p. 11.

18 Debtors opposed the motion for leave on the ground that they
19 did not receive adequate notice pursuant to Fed. R. Civ. P. 15 (as
20 incorporated by Fed. R. Bankr. P. 7015):

21 ⁶ The adversaries were consolidated for purposes of trial.
22 Though Debtor has raised an objection to the "conjoining" of the
23 proceedings on appeal, no objection was made prior to or during
24 the trial. In any event, the consolidation of the two actions
25 seeking the denial of discharge under identical subsections of
26 § 727 is not clearly erroneous.

27 ⁷ The docket reflects the filing of a document entitled
28 "Supplemental Filing/Support By Plaintiff Brian Baniqued To . . .
Complaint 727 Objection" on January 30, 2004. At trial,
Plaintiffs' counsel identified the supplemental pleading as one
purporting to add § 523 exceptions. However, as the document was
not submitted as part of the record on appeal, its content is
unknown.

⁸ Mathias Bildhauer ("Bildhauer") appeared at trial on behalf
of the Plaintiffs and Eric Farber ("Farber") served as co-counsel.
Transcript of Proceedings, February 5, 2004, p. 4.

1 Loos⁹: Under Rule 7015 it is okay to convert
2 it from a 727 to a 523, but thirty days needs
3 to be given advance notice, a motion needs to
4 be filed, summons to the court, an order needs
5 to be signed, and that was never accomplished.
6 The [P]laintiffs' attorney has said that he
7 filed [the amended complaint] two or three
8 weeks ago, but, again, the facts in the docket
9 show that it was filed on the mere eve of
10 trial attempting to convert it from everyone
11 being discharged on the 727 to only their
12 clients being discharged on the 727, so I
13 object to the conversion.

14 Id. at p. 10.

15 The court agreed with Loos and denied the oral motion for
16 leave to amend, as well as the admission of all evidence in
17 support of the § 523 claims:

18 The Court: Well, I'm definitely very troubled
19 by [the amended complaint]. I have not had
20 such a situation occur before. I am aware
21 that there is provision about changing or
22 amending a pleading, which would be the
23 complaint, I suppose, at the end of the trial
24 if the evidence that comes in is admitted and
25 the evidence shows that another cause of
26 action or another approach could be satisfied
27 by the evidence that was permitted. Here,
28 however, we have someone who is objecting from
29 the beginning of the proceeding about the
30 change in the complaint. Again, without
31 having - had this matter come before
32 previously, I still think I have to make a
33 decision on this morning in regard to it [sic]
34 because the matter has been set for trial, we
35 have proceeded this far to get to trial. And
36 I must - I think I agree with the debtor, I'm
37 going to deny the amendment of the complaint.

38 Id. at p. 17 (emphasis added).

39 The Court: . . . I have omitted or not taken
40 in or not permitted Plaintiff Baniqued's
41 objection to discharge supplemental filing
42 because that does refer almost entirely to
43 523, and I don't think it's applicable to 727,
44 that is going to be excluded

45 ⁹ Loos represented himself pro se at trial.

1 Id. at 20.

2 Thereupon, the trial proceeded as scheduled. The court heard
3 testimony and reviewed evidence in support of the objection to
4 discharge under § 727. At various points in the proceeding, Loos
5 objected to evidence directed to § 523 allegations and the court
6 seemed to take great pains to limit the evidence admitted to that
7 which supported denial of discharge under § 727.

8 At the close of trial, and after both parties had rested,
9 Plaintiffs once again moved to amend the complaint to assert
10 exceptions to discharge under § 523. At this point, the court and
11 Plaintiffs engaged in a curious round of negotiation:

12 Farber: At this time I would like to make a
13 motion to amend the pleadings to amend the
14 complaint to add 523. I believe that the
evidence has clearly shown in this that 523 is
applicable code and complaint to be added.

15 The Court: Are you going to waive the denial
16 of discharge?

17 Farber: Are you going to allow me to amend
18 523?

19 The Court: I may very well allow you to amend
20 your pleadings to show 523 if you will remove
21 your request for denial of discharge.

22 Farber: I do so.

23 The Court: All right. Very well. We will
24 remove the - your request is granted.

25 Id. at 175-176.

26 The bankruptcy court explained its rationale for reversing
27 its earlier decision:

28 The Court: . . . And I have a very specific
reason why I permitted the change at the last
minute, when previously I had ruled that it
would not be permitted, that is because I
think you were going to lose the other one,

1 and that is far more devastating to you than
2 523(a)(2), which I think has been proven here.

3 We know that - it's weird the way the facts
4 came into this case, I guess, because we
5 initially had started with a 727, there was a
6 request to change it to a 523, which I denied,
7 and then we moved in the evidence under 523 -
8 I mean, under 727(a)(3) and (5). What I think
9 the evidence clearly shows is that there was
10 an effort by you, Loos, to deceive these
11 parties. I think that the financial
12 statements that you gave them were wrong. I
13 think that you made up those statements
14 deliberately for the purpose of taking their
15 money and not giving them an honest accounting
16 of what happened to the money. I have no
17 doubt that you spent some monies on repairs, I
18 have no doubt that you did a lot of the repair
19 work yourself, but you had a duty to your
20 clients to present them with or provide to
21 them an appropriate accounting, which you
22 didn't do. And from that I can only conclude
23 that you had taken money that didn't belong to
24 you under this management - under these
25 management agreements.

26 I think that was - that you had the intent at
27 the time you took the money to misrepresent
28 what you were doing to Dr. Ayers and Baniqued
- pardon me, Baniqued. That because you had
the intent to take the money, that you made
material misrepresentations to them about what
happened during the time that you were
operating the management agreements with them.

19 Id. at 176-77.

20 The court thereafter ruled in favor of Plaintiffs pursuant to
21 §§ 523(a)(2)(A) and (a)(4) as follows:

22 1. Debtor Aaron Loos, in his dealings with
23 [Plaintiffs], through false accountings, false
24 representations and actual fraud, violated 11
U.S.C. Section 523(a)(2)(A).

25 2. Debtor Aaron Loos, as [Plaintiffs' Real
26 Property Manager], engaged in fraud, or
27 defalcation while acting in a fiduciary
28 capacity and embezzled rents and other funds
and therefore violated 11 U.S.C. Section
523(a)(4).

1 Debtors appeal.¹⁰

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3 **ISSUE**

4 Whether bankruptcy court abused its discretion in granting
5 the motion for leave to amend the § 727 complaint to add § 523
6 exceptions to discharge at the conclusion of trial.¹¹

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8 **JURISDICTION**

9 The bankruptcy court had jurisdiction under 28 U.S.C. § 1334
10 and § 157(b) (1) (and (b) (2). This Panel has jurisdiction under 28
11 U.S.C. § 158(b) (1).

12
13 **STANDARD OF REVIEW**

14 Leave to amend a complaint is generally within the discretion
15 of the bankruptcy court and is reviewed under the abuse of

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¹⁰ The bankruptcy court awarded Baniqued \$20,530.32, which was
18 the amount of the arbitration award, as being excepted from
19 discharge. As to Ayers, the proceeding was continued to February
20 8, 2005 for further findings on damages. On that date, the
bankruptcy court awarded a judgment in the amount of \$22,494.51.
Transcript of Proceedings, February 8, 2005, p. 41.

21 ¹¹ Debtors also assert on appeal: (1) the bankruptcy court
22 failed to hold the Plaintiffs responsible for late filings,
including the amended complaint, which handicapped their defense;
23 (2) impartiality and clarity were impaired by the consolidation of
the two adversary proceedings; (3) "[Baniqued] in his capacity as
24 an agent in contract with the plaintiff was authorized to do
repairs without holding a contractor's license;" and (4) the
25 "absence of testimony, expert witness, etc. to expound a perfect
affirmative defense gave sure and right precedent to the bench to
26 generally and specifically award a carte blanc [sic] judgment to
plaintiff."

27 The Panel does not address these issues primarily because, in
28 our view, the dispositive issue on appeal is whether the court
abused its discretion when it granted the motion for leave to
amend the complaint at the conclusion of the trial.

1 discretion standard. Mende v. Dun & Bradstreet, Inc., 670 F.2d
2 129 (9th Cir. 1982); Waters v. Weyerhaeuser Mortg. Co., 582 F.2d
3 503, 507 (9th Cir. 1978); Komie v. Buehler Corp., 449 F.2d 644,
4 648 (9th Cir. 1971). Even under the abuse of discretion standard,
5 the bankruptcy court's decision is reversible if it is based upon
6 an incorrect legal conclusion. In re Dominguez, 51 F.3d 1502,
7 1508 n.5 (9th Cir. 1995); Magno v. Rigsby (In re Magno), 216 B.R.
8 34, 38 (9th Cir. BAP 1997) (citation omitted). Whether an
9 amendment relates back to the date of the original pleading under
10 Fed. R. Civ. P. 15(c)(2) is a legal question which we review de
11 novo. Id.; Martell v. Trilogy, Ltd., 872 F.2d 322, 325 (9th Cir.
12 1989).

14 DISCUSSION

15 Leave to amend pleadings "shall be freely given when justice
16 so requires." Fed. R. Civ. P. 15.¹² The Ninth Circuit applies
17 this rule with "extreme liberality." Forsyth v. Humana, Inc., 114
18 F.3d 1467, 1482 (9th Cir. 1997) (citing Morongo Band of Mission

20 ¹² Fed. R. Civ. P. 15, made applicable in an adversary
21 proceedings by Rule 7015, provides in part:

22 (a) A party may amend the party's pleading once as a
23 matter of course at any time before a responsive
24 pleading is served or, if the pleading is one to which
25 no responsive pleading is permitted and the action has
26 not been placed upon the trial calendar, the party may
27 so amend it at any time within 20 days after it is
28 served. Otherwise a party may amend the party's
pleading only by leave of court or by written consent of
the adverse party; and leave shall be freely given when
justice so requires. A party shall plead in response to
an amended pleading within the time remaining for
response to the original pleading or within 10 days
after service of the amended pleading, whichever period
may be the longer, unless the court otherwise orders.

1 Indians v. Rose, 893 F.2d 1074, 1079 (9th Cir. 1990)).

2 In exercising its discretion, a bankruptcy court "must be
3 guided by the underlying purpose of Rule 15 to facilitate decision
4 on the merits, rather than on the pleadings or technicalities."
5 In re Magno, 216 B.R. at 38; United States v. Webb, 655 F.2d 977,
6 979 (9th Cir. 1981). A bankruptcy court considers the following
7 factors in determining whether a motion to amend should be
8 granted: "(1) undue delay; (2) bad faith; (3) futility of
9 amendment; and (4) prejudice to the opposing party." Hurn v. Ret.
10 Fund Trust of the Plumbing, Heating & Piping Indus., 648 F.2d
11 1252, 1254 (9th Cir. 1981); In re Magno, 216 B.R. at 38.

12 Here, the prejudice to Debtor is so overwhelming that it
13 alone is enough to prompt remand. However, for completeness, the
14 Panel will consider all four factors.

15 **1. Undue Delay**

16 Plaintiffs initiated this adversary proceeding on July 25,
17 2003. The request to amend the complaint was filed seven months
18 after the commencement of the adversary proceeding and just six
19 days before trial; the oral motions for leave were made at trial.
20 No explanation for the extraordinary delay in seeking the
21 amendment has ever been offered by Plaintiffs.

22 **2. Bad Faith**

23 Nothing in the record suggests that Plaintiffs acted in bad
24 faith.

25 **3. Futility of Amendment**

26 There is no question that the amendment to the complaint was
27 allowed after the June 10, 2003 deadline for the filing of a
28

1 complaint under § 523.¹³ Therefore, if the amendment did not
2 relate back to the original complaint it would have been a "futile
3 gesture for the bankruptcy court to grant leave to amend." In re
4 Magno, 216 B.R. at 38.

5 Under the Fed. R. Civ. P. 15(c)(2):

6 An amendment of a pleading relates back to the
7 date of the original pleading when the claim
8 or defense asserted in the amended pleading
9 arose out of the conduct, transaction, or
10 occurrence set forth or attempted to be set
11 forth in the original pleading.

12 Thus, the new claim should be capable of being proven by the
13 "same kind of evidence offered in support of the original
14 pleading." 216 B.R. at 39 (citation omitted). Indeed, the "focus
15 of the inquiry is on the factual allegations made in the two
16 complaints so as to give the opposing party fair notice of the
17 claims against him." Id. (citing In re Dean, 11 B.R. 542 (9th Cir.
18 BAP 1981), aff'd, 687 F.2d 307 (9th Cir. 1982)). In Dean, we
19 observed:

20 The basic test is whether the evidence with
21 respect to the second set of allegations could
22 have been introduced under the original

23 ¹³ Rule 4007(c) provides:

24 A complaint to determine the dischargeability of a debt
25 under § 523(c) shall be filed no later than 60 days
26 after the first date set for the meeting of creditors
27 under § 341(a). The court shall give all creditors no
28 less than 30 days' notice of the time so fixed in the
manner provided in Rule 2002. On motion of a party in
interest, after hearing on notice, the court may for
cause extend the time fixed under this subdivision. The
motion shall be filed before the time has expired.

29 Pursuant to the court's Notice of Filing Report of No
Distribution Combined with Order Fixing Deadline to Object
Thereeto, the deadline for filing a nondischargeability complaint
was June 10, 2003.

1 complaint, liberally construed; or, as a
2 corollary, that in terms of notice, one may
3 fairly perceive some identification or
relationship between what was pleaded in the
original and amended complaints.

4 11 B.R. at 545.

5 Though it is not clear from the record which specific
6 subsections of § 523 Plaintiffs sought to add to the complaint, it
7 is abundantly clear that the evidence required to support denial
8 of discharge under § 727(a)(3) and (a)(5)¹⁴ was not factually
9 similar to the bankruptcy court's ultimate findings under
10 §§ 523(a)(2)(A) and (a)(4)¹⁵.

11
12 ¹⁴ Section 727 provides, in relevant part:

13 (a) The court shall grant the debtor a discharge,
unless --

14

15 (3) the debtor has concealed, destroyed, mutilated,
16 falsified, or failed to keep or preserve any recorded
information, including books, documents, records, and
17 papers, from which the debtor's financial condition or
business transactions might be ascertained, unless such
18 act or failure to act was justified under all of the
circumstances of the case; [or]

19

20 (5) the debtor has failed to explain satisfactorily,
21 before determination of denial of discharge under this
paragraph, any loss of assets or deficiency of assets to
meet the debtor's liabilities[.]

22 ¹⁵ Sections 523(a)(2)(A) and (a)(4) provide:

23 (a) A discharge under section 727, 1141, 1228(a),
24 1228(b), or 1328(b) of this title does not discharge an
individual debtor from any debt -

25 (2)(A) for money, property, services, or an extension,
26 renewal or refinancing of credit, to the extent obtained
by false pretenses, or actual fraud, other than a
27 statement respecting the debtor's or an insider's
financial condition; [or]

28 (4) for fraud or defalcation while acting in a fiduciary
(continued...)

1 For example, the bankruptcy court found that Loos violated
2 § 523(a)(2)(A) in his dealings with Ayers through false
3 accountings, false representations, and actual fraud.
4 Significantly, the bankruptcy court made a finding of fraud where
5 no requirement of fraud exists under either § 727(a)(3) or
6 § 727(a)(5). Additionally, the bankruptcy court also found the
7 existence of a "fiduciary relationship" under § 523(a)(4) though
8 no such requirement exists under §§ 727(a)(3) or (a)(5). The
9 elements required to prove discharge exceptions under
10 §§ 523(a)(2)(A) and (a)(4) simply do not fit into the requirements
11 for establishing denial of discharge under §§ 727(a)(3) and
12 (a)(5). In Magno, we declined to affirm a court's decision to
13 allow an amended pleading which added a new claim under § 523 to a
14 § 727 complaint, reasoning that:

15 To prove a § 523(a)(6) claim, [plaintiff] must
16 show that there was an intentional act by
17 debtor which caused injury to [plaintiff] or
18 their property. On the other hand, under
19 § 727(a)(2)(A), there must be findings that
20 debtor concealed his property with the intent
21 to hinder, delay, or defraud a creditor.
22 Section 727(a)(4)(A) requires a finding that
23 Debtor knowingly and fraudulently made a false
24 oath or account in, or in connection with, the
25 case. ¶ The elements under § 523(a)(6) are
26 not included in those required for § 727 and
27 are clearly distinct from them. Even under a
28 liberal definition of lesser-included claim,
the 523(a)(6) claim does not fit the
definition.

24 In re Magno, 216 B.R. at 42 (citations omitted).

25 Here, it is clear that the evidence required to establish the
26 § 727 claims on the one hand, and the § 523 claims on the other,
27

28 ¹⁵(...continued)
capacity, embezzlement, or larceny[.]

1 are not identical, or even related.

2 **4. Prejudice to Debtor**

3 Notwithstanding the court's unequivocal denial of the motions
4 to add the discharge exceptions under § 523 at the outset of trial
5 and its limitation of the evidence to the § 727 allegations during
6 trial, the court nevertheless allowed the amendments at the close
7 of the trial.¹⁶

8 The bankruptcy court abused its discretion by allowing the
9 post-trial amendments. The prejudice to Debtors, who proceeded
10 throughout trial under the belief that the allegations and
11 evidence against them were solely rooted in § 727, was
12 substantial. Simply put, the bankruptcy court effectively
13 deprived Debtors of a defense. As the Fehrle court so eloquently
14 articulated:

15 The recitation of a specific cause of action,
16 and the selection of a particularized section
17 of the Bankruptcy Code under which to proceed,
18 both profoundly affect the nature of the
19 resulting defense. To construct a complaint
20 invoking a general denial of discharge
21 inspires an altogether different form of
22 defense from that which would be forthcoming
23 in the case of a complaint seeking to have a
24 particular debt excepted from discharge. The
25 whole theory of the defense and the elements
26 of its rebuttal proof are radically
27 distinguishable in the two types of cases.

22 In re Fehrle, 34 B.R. 974, 975 (Bankr. W.D. Ky. 1983).

23 As stated above, and as implicitly recognized by the court
24 itself, the proof requirements under §§ 727(a)(3) and (a)(5) do
25 not include fraud or the existence of a fiduciary relationship.
26 Thus, Debtors defended the § 727 claims without regard for, among

28 ¹⁶ At oral argument, Plaintiffs' counsel conceded that the
fraud evidence was introduced on rebuttal.

1 other things, presenting evidence relating to Loos' intent (or
2 lack thereof) to deceive Plaintiffs, Plaintiffs' reliance on
3 alleged misrepresentations, or the existence (or lack thereof) of
4 a fiduciary relationship between Loos and Plaintiffs. Allowing
5 Plaintiffs to completely abandon the original focus of the
6 complaint at the end of the trial, after the bankruptcy court
7 clearly denied the amendment at the outset, substantially
8 prejudiced Debtor.

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CONCLUSION

We VACATE and REMAND to the bankruptcy court with instructions to: (1) set aside the withdrawal of the § 727 complaints; and (2) enter findings and judgment as appropriate under §§ 727 (a) (3) and (a) (5).