

DEC 20 2012

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

NOT FOR PUBLICATION

UNITED STATES BANKRUPTCY APPELLATE PANEL
OF THE NINTH CIRCUIT

5	In re:)	BAP No. NC-11-1652-HPaMk
6	OSCAR TREJO,)	Bk. No. 10-58782
7	Debtor.)	Adv. No. 10-05392
8	_____)	
9	HERITAGE PACIFIC FINANCIAL,)	
10	LLC, d/b/a Heritage Pacific)	
11	Financial, a Texas Limited)	
12	Liability Company,)	
13	Appellant,)	
14	v.)	M E M O R A N D U M¹
15	OSCAR TREJO,)	
16	Appellee.)	
17	_____)	

Argued and Submitted on October 18, 2012
at San Francisco, California

Filed - December 20, 2012

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

Honorable Stephen L. Johnson, Bankruptcy Judge, Presiding

Appearances: Brad A. Mokri, Law Offices of Mokri & Associates,
argued for Appellant; Jennifer Bregante, Alexander
Community Law Center of Santa Clara University
School of Law, argued for Appellee.²

¹ 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.

² Ms. Bregante is a law student acting under the supervision
of attorney Gary Neustadter. On June 18, 2012, the BAP granted
the debtor's motion requesting permission to allow Ms. Bregante
to appear with Mr. Bregante and argue on behalf of Appellee.

1 Before: HOLLOWELL, PAPPAS, and MARKELL, Bankruptcy Judges.

2
3 Heritage Pacific Financial, LLC (Heritage) filed a complaint
4 alleging that the debtor's loan obligation was nondischargeable
5 under § 523(a)(2).³ After trial, the bankruptcy court entered
6 judgment in favor of the debtor. Heritage appeals. We AFFIRM.

7 **I. FACTS**

8 On March 6, 2006, Oscar Trejo (the Debtor) applied for a
9 loan from American Mortgage Express Financial dba Millennium
10 Funding Group (Millennium). Millennium was a subprime lender; it
11 lent to borrowers with lower credit scores who represented a
12 greater credit risk than more qualified borrowers. The Debtor
13 executed a promissory note in the amount of \$88,802 in favor of
14 Millennium (the Loan) on March 7, 2006. The Loan was secured by
15 a second mortgage on the Debtor's real property in Merced,
16 California (the Property). The Loan was subsequently assigned to
17 Heritage.⁴

18 In order to obtain the Loan, the Debtor completed and
19 executed a Uniform Residential Loan Application form (Loan
20 Application). On the Loan Application, Trejo stated his monthly
21 income was \$9,500. The Debtor stated that he was employed by
22 Trejo Networks, a "consulting business" that operated from the

23
24 ³ Unless otherwise indicated, all chapter and section
25 references are to the Bankruptcy Code, 11 U.S.C. §§ 101-1532.
26 "Rule" references are to the Federal Rules of Bankruptcy
Procedure, Rules 1001-9037.

27 ⁴ At some point after Heritage was assigned the Loan, the
28 Property was foreclosed by the first deed of trust holder.
Heritage did not receive any funds from the foreclosure sale.

1 Debtor's home. It was later revealed that this information about
2 the Debtor's income and employment was not true even though the
3 Debtor signed the Loan Application under penalty of perjury.

4 The Debtor provided the information about his income and
5 employment in an interview in conjunction with completing the
6 Loan Application. In addition, the Debtor executed a Borrower's
7 Certification and Authorization form on March 8, 2006, which
8 certified that the information the Debtor provided in the Loan
9 Application was true and complete (Certification Form).

10 The Loan Application provided that: "Self Employed
11 Borrower(s) may be required to provide additional documentation
12 such as tax returns and financial statements." The Certification
13 Form also authorized Millennium to review the Debtor's financial
14 information with lenders and other third parties. However,
15 Millennium did not request any additional documentation from the
16 Debtor, such as tax returns, earnings statements, or bank
17 records.

18 On August 24, 2010, the Debtor filed a voluntary chapter 7
19 petition. He was not represented by an attorney.

20 On November 23, 2010, Heritage filed a complaint (Complaint)
21 against the Debtor alleging that the Debtor made
22 misrepresentations in the Loan Application, which constituted
23 fraud, making the Loan nondischargeable under both § 523(a)(2)(A)
24 and (B).

25 Heritage served Requests for Admission on the Debtor in
26 April 2011, which requested the Debtor to admit, among other
27 things, that he misstated his monthly income and employer on the
28 Loan Application, and obtained the Loan through false pretenses,

1 false representations, and actual fraud. The Debtor did not
2 respond to the Requests for Admission.

3 On May 27, 2011, Heritage filed a motion for summary
4 judgment (MSJ). A hearing on the MSJ was held on August 25,
5 2011. The bankruptcy court subsequently denied the MSJ on
6 September 8, 2011. According to the bankruptcy court, based on
7 Boyajian v. New Falls Corp. (In re Boyajian), 564 F.3d 1088 (9th
8 Cir. 2009), the original lender's reliance was the key issue in
9 the case and there was a genuine issue of fact as to whether
10 Millennium appropriately relied on the representations made by
11 the Debtor in the Loan Application.⁵

12 A trial on the Complaint was held on September 21, 2011.
13 In a written order entered on November 2, 2011 (Order After
14 Trial), the bankruptcy court found that Heritage failed to
15 establish that Millennium justifiably or reasonably relied on the
16 representations made by the Debtor in the Loan Application.
17 Therefore, the bankruptcy court determined that Heritage failed
18

19 ⁵ In re Boyajian held that an assignee's reliance was not
20 necessary to satisfy § 523(a)(2)(B)'s reliance element, when the
21 assignee had already established the original lender's reasonable
22 reliance. See id. at 1090. It did not address the question of
23 whether, and under what circumstances, an assignee's reliance
24 might be sufficient by itself under § 523(a)(2)(B).

25 The Bankruptcy Appellate Panel has indicated that an
26 assignee's reliance, under certain circumstances and when not
27 contested, may support a finding of reliance under
28 § 523(a)(2)(B)(iii). See Tustin Thrift & Loan Ass'n v. Maldonado
(In re Maldonado), 228 B.R. 735, 737-740 (9th Cir. BAP 1999).
However, this case does not present the unaddressed issue of
whether an assignee's alleged but contested reliance is
sufficient to satisfy § 523(a)(2)(B)(iii). Cf. id. at 737 (such
reliance conceded and not contested).

1 to prove its claims under § 523(a)(2)(A) and (B). It entered
2 judgment in favor of the Debtor and discharged the Loan on
3 November 3, 2011. Heritage timely appealed.

4 **II. JURISDICTION**

5 The bankruptcy court had jurisdiction pursuant to 28 U.S.C.
6 §§ 1334 and 157(b)(2)(I). We have jurisdiction under 28 U.S.C.
7 § 158.

8 **III. ISSUES**

9 Did the bankruptcy court err in determining that Heritage
10 failed to prove that the Loan should be excepted from the
11 Debtor's discharge under § 523(a)(2)?

12 **IV. STANDARDS OF REVIEW**

13 In reviewing a bankruptcy court's discharge determination,
14 we review its findings of fact for clear error and conclusions of
15 law de novo. Oney v. Weinberg (In re Weinberg), 410 B.R. 19, 28
16 (9th Cir. BAP 2009). Reliance is a factual matter reviewed for
17 clear error. Tallant v. Kaufman (In re Tallant), 218 B.R. 58, 63
18 (9th Cir. BAP 1998); see also Eugene Parks Law Corp. Defined
19 Benefit Pension Plan v. Kirsh (In re Kirsh), 973 F.2d 1454, 1456
20 (9th Cir. 1992). A factual finding is clearly erroneous if it is
21 illogical, implausible, or without support in the record. Retz
22 v. Samson (In re Retz), 606 F.3d 1189, 1196 (9th Cir. 2010)
23 (citing United States v. Hinkson, 585 F.3d 1247, 1261-62 & n.21
24 (9th Cir. 2009)(en banc)).

25 We note that if the bankruptcy court's "account of the
26 evidence is plausible in light of the record viewed in its
27 entirety," we may not reverse even though we may be convinced
28 that "had [we] been sitting as the trier of fact, [we] would have

1 weighed the evidence differently." Anderson v. City of Bessemer
2 City, N.C., 470 U.S. 564, 574 (1985). "Where there are two
3 permissible views of the evidence, the factfinder's choice
4 between them cannot be clearly erroneous." Id.

5 The bankruptcy court's evidentiary rulings are reviewed for
6 abuse of discretion. Int'l Ass'n of Firefighters v. City of
7 Vallejo (In re City of Vallejo), 408 B.R. 280, 291-92 (9th Cir.
8 BAP 2009). A bankruptcy court abuses its discretion if it bases
9 a decision on an incorrect legal rule, or if its application of
10 the law was illogical, implausible, or without support in
11 inferences that may be drawn from the facts in the record.
12 Hinkson, 585 F.3d at 1261-62 & n.21; Ellsworth v. Lifescape Med.
13 Assocs., P.C. (In re Ellsworth), 455 B.R. 904, 914 (9th Cir. BAP
14 2011).

15 V. DISCUSSION

16 Heritage argues that the Debtor committed fraud when he
17 applied for and obtained the Loan, and that this fraud gave rise
18 to a nondischargeable debt under § 523(a)(2). Section 523(a)(2)
19 provides that a debtor is not entitled to a discharge of a debt
20 to the extent that the debt was obtained by:

21 (A) false pretenses, a false representation, or actual
22 fraud, other than a statement respecting the debtor's
or an insider's financial condition; or

23 (B) use of a statement in writing –

24 (I) that is materially false;

25 (ii) respecting the debtor's or an insider's
26 financial condition;

27 (iii) on which the creditor to whom the debtor is
28 liable for such money, property, services, or
credit reasonably relied; and

1 (iv) that the debtor caused to be made or
2 published with intent to deceive. . . .

3 In order to prevail, Heritage was required to prove: (1) the
4 Debtor made material representations; (2) that he knew at the
5 time were false; (3) with the intention of deceiving the
6 creditor; (4) who justifiably or reasonably relied on the
7 representations; (5) which caused damage as a result. See In re
8 Weinberg, 410 B.R. at 35 (citing Turtle Rock Meadows Homeowners
9 Ass'n v. Slyman (In re Slyman), 234 F.3d 1081, 1085 (9th Cir.
10 2000)); Hopper v. Everett (In re Everett), 364 B.R. 711, 720 n.28
11 (Bankr. D. Ariz. 2007) (citing Siriani v. Nw. Nat'l Ins. Co. of
12 Milwaukee, WI (In re Siriani), 967 F.2d 302, 304 (9th Cir. 1992)
13 (holding that due to substantial similarity of § 523(a)(2)(A) and
14 (B), adoption of § 523(a)(2)(A) elements for use in
15 § 523(a)(2)(B) cases is appropriate)). "The creditor bears the
16 burden of proof to establish all five of these elements by a
17 preponderance of the evidence." Id. (citing Slyman, 234 F.3d at
18 1085).

19 Heritage argues that it established all the necessary
20 elements because, when the Debtor failed to answer the Requests
21 for Admission, the Debtor admitted that he: (1) "obtained the
22 loan through false pretenses"; (2) "obtained the loan through
23 false representations"; and (3) "obtained the loan through actual
24 fraud."

25 Federal Rule of Civil Procedure 36(a)(3) provides that if a
26 party does not answer a request for admission within thirty days
27 of being served, it is deemed admitted. Fed. R. Civ. P. 36(a)(3)
28 (incorporated by Rule 7036); Conlon v. United States, 474 F.3d

1 616, 621 (9th Cir. 2007). Consequently, the result of the
2 Debtor's failure to answer the Requests for Admission was that
3 the facts set forth in the request became admitted facts.

4 However, the bankruptcy court determined that the Requests
5 for Admission sought an impermissible admission of a conclusion
6 of law, which exceeded the scope of Fed. R. Civ. P. 36(a)(1)(A).

7 We agree. Heritage's § 523(a)(2) claim requires that the
8 bankruptcy court make the ultimate determination that the Debtor
9 obtained the Loan fraudulently. That determination necessarily
10 requires the bankruptcy court to find that there are sufficient
11 facts to prove each element of § 523(a)(2)(A) or (B). While
12 "requests for admission may relate to the application of law to
13 fact," "opinions of law" are not contemplated by Fed. R. Civ.

14 P. 36(a)(3). 8B CHARLES ALAN WRIGHT & ARTHUR R. MILLER, FEDERAL PRACTICE
15 AND PROCEDURE § 2255 (3d ed. 2012); Disability Rights Council v.

16 Wash. Metro. Area Transit Auth., 234 F.R.D. 1, 3 (D.D.C. 2006) (a
17 party cannot demand that the other party admit the truth of a
18 legal conclusion); Playboy Enters., Inc. v. Welles, 60 F. Supp.
19 2d 1050, 1057 (S.D. Cal. 1999) (requests for admissions cannot be
20 used to compel an admission of a conclusion of law).

21 Even to the extent the admissions were not conclusions of
22 law, the admissions did not cover all of the elements that
23 Heritage had to prove by a preponderance of the evidence in order
24 to prevail on the Complaint. The "admitted" facts, at most,
25 established that Heritage proved the first three elements of
26 § 523(a)(2). Although the Loan was funded, Heritage did not
27 establish through the "admitted" facts that Millennium

1 justifiably or reasonably relied on the misrepresentations before
2 disbursing the funds under the Loan.

3 The bankruptcy court ultimately held that Heritage failed to
4 prove the reliance element of its § 523(a)(2) claim for relief.⁶
5 Accordingly, the focus of our analysis is whether the bankruptcy
6 court erred in finding that the element of reliance was not
7 satisfied.

8 Justifiable Reliance

9 Section 523(a)(2)(A) requires a finding that a creditor
10 justifiably rely on a debtor's false statements or
11 misrepresentations, whereas § 523(a)(2)(B) requires that the
12 reliance is reasonable. Field v. Mans, 516 U.S. 59, 74-75
13 (1995). Justifiable reliance is a subjective standard, which
14 turns on a person's knowledge under the particular circumstances.
15 Citibank (South Dakota), N.A. v. Eashai (In re Eashai), 87 F.3d
16 1082, 1090 (9th Cir. 1996). "Justification is a matter of the
17 qualities and characteristics of the particular plaintiff, and
18 the circumstances of the particular case, rather than of the
19 application of a community standard of conduct to all cases."
20 Id. (quoting Field, 516 U.S. at 70.).

21 Therefore, the inquiry regarding the justifiable standard
22 focuses on "whether the falsity of the representation was or
23 should have been readily apparent to the individual to whom it
24 was made." Beneficial Cal., Inc. v. Brown (In re Brown),
25 217 B.R. 857, 863 (Bankr. S.D. Cal. 1998) (citations omitted).

26
27 ⁶ Because it is the reliance determination that is at issue
28 on appeal, Heritage's argument that the bankruptcy court erred in
not giving the admissions proper effect is largely irrelevant.

1 The justifiable reliance standard generally does not entail
2 a duty to investigate and a person may be justified in relying on
3 a representation of fact even if he might have ascertained the
4 falsity of the representation had he made an investigation. See
5 Field, 516 U.S. at 70. However, a duty to investigate is imposed
6 on a creditor by virtue of suspicious circumstances. Id. at 71;
7 see also, Wheels Unlimited, Inc. v. Sharp (In re Sharp), 2009 WL
8 511640, *8 (Bankr. D. Idaho Jan. 14, 2009). Thus, "justifiable
9 reliance does not exist where a creditor ignores red flags."
10 Mandalay Resort Grp. v. Miller (In re Miller), 310 B.R. 185, 198
11 (Bankr. C.D. Cal. 2004) (citing Anastas v. Am. Sav. Bank (In re
12 Anastas), 94 F.3d 1280, 1286 (9th Cir. 1996)). "[A] person
13 cannot purport to rely on preposterous representations or close
14 his eyes to avoid discovery of the truth." In re Eashai, 87 F.3d
15 at 1090-91.

16 At the trial, a representative for Millennium (Judith
17 Dunham) testified that Millennium routinely relied on borrowers'
18 information provided in their loan applications. Ms. Dunham
19 testified that although she had no recollection of the Debtor's
20 Loan, there were general underwriting standards for subprime
21 loans on the secondary market. She testified that pursuant to
22 those standards, Millennium did not independently verify a
23 borrower's stated income unless it "didn't make sense," for
24 example, if an otherwise low earning professional stated a high
25 monthly income, or if "something look[ed] unusual." Under such
26 circumstances, Ms. Dunham testified that Millennium would
27 undertake further investigation to verify the information
28 provided in the loan application.

1 Ms. Dunham testified that with respect to self-employed
2 borrowers, Millennium typically verified employment. Indeed, the
3 Loan Application and the Certification Form permitted Millennium
4 to request further information to document the representations
5 made in the Loan Application, particularly when borrowers were
6 self-employed. Ms. Dunham testified, however, that there was no
7 additional documentation in the Loan records, and that it did not
8 appear that Millennium verified any of the information provided
9 by the Debtor on the Loan Application.

10 As a result, the bankruptcy court found that "[a]s a
11 business experienced in subprime lending, Millennium should have
12 known" that the Debtor's claim that he earned a "\$9,500 monthly
13 salary as the owner of an ambiguous 'consulting' company" did not
14 make sense and warranted further documentation. Order After
15 Trial at 8. Accordingly, it found that Millennium did not
16 justifiably rely on the Debtor's income and employment
17 information as provided in the Loan Application.

18 Heritage argues on appeal that the bankruptcy court's
19 assumption that a home business should have triggered further
20 investigation of the Debtor's financial information was erroneous
21 because "the converse is also true that home-based businesses are
22 no less credible than ones conducted in a more traditional
23 business setting." Appellant's Opening Br. at 15. However,
24 Ms. Dunham testified that with respect to borrowers who were
25 self-employed, Millennium's practice was typically to verify
26 employment. We also reiterate that a factfinder's choice between
27 two permissible views of the evidence cannot be clearly
28 erroneous. Anderson, 470 U.S. at 574.

1 Given Ms. Dunham's testimony that Millennium's practice was
2 to require further investigation or documentation when an
3 application contained unusual financial information or
4 self-employment, the bankruptcy court did not make an erroneous
5 finding that Millennium should have conducted further
6 investigation into the representations made by the Debtor on the
7 Loan Application, and without doing so, it could not have
8 justifiably relied on the Debtor's representations.

9 Reasonable Reliance

10 Reasonable reliance under § 523(a)(2)(B) focuses on whether
11 reliance would have been reasonable to the hypothetical average
12 person. In re Brown, 217 B.R. at 863; see also, First Mut. Sales
13 Fin. v. Cacciatori (In re Cacciatori), 465 B.R. 545, 555 (Bankr.
14 C.D. Cal. 2012). Reasonable reliance is analyzed under a
15 "prudent person" test. Cashco Fin. Servs., Inc. v. McGee (In re
16 McGee), 359 B.R. 764, 774 (9th Cir. BAP 2006); In re Cacciatori,
17 465 B.R. at 555 (court must objectively assess the circumstances
18 to determine if creditor exercised degree of care expected from a
19 reasonably cautious person in the same business transaction under
20 similar circumstances). Reasonable reliance is judged in light
21 of the totality of the circumstances on a case-by-case basis.

22 Id.

23 Again, a creditor is under no duty to investigate in order
24 for its reliance to be reasonable. Furthermore, a creditor's
25 reliance may be reasonable if it adhered to its normal business
26 practices. Nat'l City Bank v. Hill (In re Hill), 2008 WL
27 2227359, *3 (Bankr. N.D. Cal. May 23, 2008). However, in
28 determining the reasonableness of reliance, the bankruptcy court

1 may consider if the lender's normal practices align with industry
2 standards, or if there were any red flags that would have alerted
3 an ordinarily prudent creditor under similar circumstances to the
4 possibility that the representations relied on were not accurate,
5 and whether even minimal investigation would have revealed the
6 inaccuracy. Id.; see also, Highline Capital Corp. v. Register
7 (In re Register), 2010 WL 605314, *6 (Bankr. W.D. Wash. Feb. 19,
8 2010); In re McGee, 359 B.R. at 775.

9 The bankruptcy court found that there were red flags that
10 objectively warranted, even under a community standard, some
11 minor investigation into the representations made by the Debtor
12 on the Loan Application. Order After Trial at 8. It found that
13 "Millennium should reasonably have understood that [the Debtor]
14 was a greater risk for default than a better qualified borrower,"
15 and therefore should have required additional information to
16 verify the Debtor's income and employment. Consequently, the
17 bankruptcy court found that Millennium did not reasonably rely on
18 the Debtor's representations in the Loan Application. After
19 reviewing the evidence in the record, we conclude that the
20 bankruptcy court's findings were not clearly erroneous.

21 Two separate representatives from Heritage (Ben Ganter and
22 Mark Scheurman⁷) testified that, as part of the business of
23 making subprime loans in the secondary mortgage market, the
24 established custom and practice is to rely on the information
25 provided in loan applications, particularly the borrower's
26

27 ⁷ Mr. Schuerman's testimony was submitted in declaration
28 form. See Order After Trial at 3.

1 income, before funding loans. Mr. Scheurman testified that
2 because the "secondary market is highly negotiable and any
3 fraudulent misrepresentations of material facts contained in a
4 [loan application] would have a greater adverse effect on a
5 second trust deed holder . . . , the second deed of trust holder
6 . . . heavily relies on the stated income [and] employment . . .
7 in the [loan application]" to ensure continued payment on the
8 note in the event of foreclosure by the senior lender. See
9 Declaration of Mark Schuerman at 4-5.

10 Ms. Dunham also testified that there were general
11 underwriting standards for subprime loans, which include
12 verifying income if something appears "unusual," and, for
13 self-employed applicants, verifying employment. These standards
14 do not appear to have been applied with respect to the Debtor's
15 Loan.

16 We reject Heritage's assertion that the industry practice is
17 to rely solely on the representations in a loan application. The
18 generalized forms that were used indicate there is an industry
19 standard that requires borrowers to verify self-employment or
20 other representations made in connection with a loan. Thus, the
21 language used in the general forms signals that an ordinary
22 prudent creditor does not, in every instance, rely solely on the
23 information that the borrower provides on his application without
24 ever conducting further investigation into the veracity of those
25 representations.

26 As discussed above, the bankruptcy court found that red
27 flags existed, which required an ordinary creditor to conduct
28 further investigation. We perceive no error in that finding and

1 accordingly, we also perceive no error in the bankruptcy court's
2 finding that Heritage failed to prove the reasonable reliance
3 element of § 523(a)(2)(B).

4 The Debtor made other arguments in his appellate brief:
5 (1) the representations were not material; (2) Heritage's claims
6 are barred by the California anti-deficiency statute, Cal. Code
7 Civ. Proc. § 580(b);⁸ and (3) Heritage is not the real party in
8 interest, and therefore did not have standing to file the
9 Complaint. None of these arguments were made to the bankruptcy
10 court. Consequently, they are waived on appeal. Campbell v.
11 Verizon Wireless S-CA (In re Campbell), 336 B.R. 430, 434 n.6
12 (9th Cir. BAP 2005) (citing O'Rourke v. Seaboard Sur. Co.
13 (In re E.R. Fegert, Inc.), 887 F.2d 955, 957 (9th Cir. 1989)
14 ("The rule in this circuit is that appellate courts will not
15 consider arguments that are not 'properly raise[d] in the trial
16 courts.'").

17 Although standing is usually a jurisdictional issue that may
18 not be waived, the Debtor's argument here regarding standing
19 relates only to issues of prudential standing. Prudential
20 standing requires the plaintiff to assert its own claims rather
21 than the claims of another. Dunmore v. United States, 358 F.3d
22 1107, 1112 (9th Cir. 2004). Unlike constitutional standing,
23 prudential standing does not derive from the Constitution and may
24 be waived by a defendant if not properly or timely raised.
25 Pershing Park Villas Homeowners Ass'n v. United Pac. Ins. Co.,

26
27 ⁸ Because we do not consider the merits of the Debtor's
28 anti-deficiency argument, we DENY the Debtor's request that we
take judicial notice of facts to support that argument.

1 219 F.3d 895, 899 (9th Cir. 2000).

2 **VI. CONCLUSION**

3 Because we conclude that the bankruptcy court did not err
4 when it determined that Heritage failed to prove the Loan should
5 be excepted from discharge under § 523(a)(2)(A) or (B), we
6 AFFIRM.

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