

AUG 27 2009

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

NOT FOR PUBLICATION

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UNITED STATES BANKRUPTCY APPELLATE PANEL  
OF THE NINTH CIRCUIT

In re:	)	BAP No. CC-09-1016 PaRMo
	)	
MARK NELSON and KIMBERLY NELSON,	)	Bk. No. SV-06-11455-MT
	)	
Debtors.	)	Adv. No. SV-07-01014-MT
	)	
MARK NELSON and KIMBERLY NELSON,	)	
	)	
Appellants,	)	
	)	
v.	)	<b>M E M O R A N D U M</b> <sup>1</sup>
	)	
UNION BANK OF CALIFORNIA,	)	
	)	
Appellee.	)	

Argued and Submitted on July 31, 2009  
at Pasadena, California

Filed - August 27, 2009

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

Hon. Maureen T. Tighe, United States Bankruptcy Judge, Presiding.

Before: PAPPAS, RIEGLE<sup>2</sup> and MONTALI, 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.

<sup>2</sup> The Honorable Linda B. Rieggle, United States Bankruptcy Judge for the District of Nevada, sitting by designation.

1 Chapter 7<sup>3</sup> debtors Mark Nelson ("Nelson") and Kimberly Nelson  
2 ("Mrs. Nelson" and, collectively, "Nelsons") appeal the judgment  
3 of the bankruptcy court determining that the debt they owe to  
4 Union Bank of California ("UBOC") is excepted from discharge under  
5 § 523(a)(4). We AFFIRM.

6  
7 **FACTS**

8 Nelsons are the sole shareholders, officers and directors of  
9 Imperial Chair Components, Inc. ("Imperial"). Imperial, a  
10 California corporation, engaged in importing and distributing  
11 engineered furniture components. Nelson alleges that, at its  
12 height, Imperial serviced 80 percent of the United States arm  
13 chair market, equivalent to 40,000 chairs a week in production.

14 On June 24, 2004, Imperial executed a Trade Finance Agreement  
15 and Trade Promissory Note in favor of UBOC (the "Agreement").  
16 Under the Agreement, UBOC agreed to extend a Trade Finance Credit  
17 Facility to Imperial in the principal amount of \$2 million (the  
18 "Loan"). At the time of executing the Loan, Imperial used  
19 approximately \$1.85 million to pay off its prior lender, Bank of  
20 the West.

21 The Agreement provided that UBOC would advance sums to  
22 Imperial to purchase inventory from overseas vendors. The  
23 advances would be paid directly to vendors upon confirmation of  
24 clearance from U.S. customs. Within 120 days of each advance,  
25 Imperial was required to repay the advanced funds to UBOC from the  
26 receipt of accounts receivable from the sale of the inventory for

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27 <sup>3</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.

1 which the advance was made. Imperial agreed to repay the entire  
2 principal amount plus interest upon the maturity of the Loan.  
3 UBOC was Imperial's only term creditor, and the amounts owed to  
4 UBOC accounted for essentially all of Imperial's debts.

5 Imperial executed a Security Agreement on June 24, 2004, to  
6 secure the Loan with all of Imperial's personal property. The  
7 same day Nelsons executed unconditional guarantees of Imperial's  
8 obligations under the Loan. Nelsons also executed Subordination  
9 Agreements, agreeing that any debt owed by Imperial to Nelsons  
10 would be subordinated to, and be paid after, the debt owed by  
11 Imperial to UBOC under the terms of the Loan.

12 From June 24, 2004, through November 28, 2005, Nelsons allege  
13 that they infused \$1,269,818.35 of their personal funds into  
14 Imperial, and that they paid \$396,127.19 of Imperial's business  
15 expenses from their personal accounts, for a total contribution of  
16 \$1,665,945.54. There are no loan or other agreements in the  
17 record supporting these contributions, and Nelson admitted in his  
18 response to interrogatories that he had no such documents.

19 Beginning in September 2004, UBOC issued several trade  
20 advances totaling approximately \$250,000 to an Asian vendor on  
21 behalf of Imperial for its purchase of certain chair pads (the  
22 "New Inventory"). The New Inventory was needed by Imperial to  
23 fulfill an order for chairs from one of its customer, Steelcase,  
24 Inc., a major office products supplier. The advances were set to  
25 mature starting on January 27, 2005.

26 On January 18, 2005, Nelson contacted Mark Brutto ("Brutto"),  
27 the loan officer responsible for Imperial's accounts at UBOC.  
28 Nelson informed Brutto that Steelcase had reported there were

1 latent defects in the New Inventory in that the chair pads  
2 secreted an offensive odor, and that Steelcase would not pay for  
3 the New Inventory. Given this development, Nelson told Brutto  
4 Imperial would be forced to take a writeoff of approximately  
5 \$180,000. In addition to discussing the New Inventory problem at  
6 this meeting, Nelson and Brutto also spoke about Imperial's  
7 insufficient cash flow to pay the advances. Nelson proposed  
8 reducing the Loan from \$2 million to \$1.8 million, and sought an  
9 additional term loan from UBOC of \$350,000 for two years to pay  
10 off the New Inventory advances and for other projects.

11 UBOC rejected Imperial's request for the additional term  
12 loan, but extended the time to repay the advances on the New  
13 Inventory to February 20, 2005. And, on or about February 5,  
14 2005, UBOC downgraded its risk grade on the Loan and reassigned  
15 the Imperial account to Salvador Lopez ("Lopez") of UBOC's special  
16 assets division ("SAD").

17 Imperial failed to repay the advances on the New Inventory on  
18 the maturity date of February 20, 2005, or at any time thereafter.  
19 Consequently, as of that date, Imperial was in default on the  
20 Loan, and, under the terms of the loan agreement, the full amount  
21 of the loan, \$1,994,928, plus interest and costs, was due and  
22 payable in full.

23 As of April 20, 2005, Nelsons had not been able to refinance  
24 their property and infuse cash into Imperial because the loan-to-  
25 value ratio on their property was too high and Nelsons had poor  
26 credit scores. Nelsons requested that UBOC forebear from  
27 exercising their remedies under the Loan agreement until May 31,  
28 2005, to allow Nelsons additional time to infuse cash into

1 Imperial. UBOC continued to forebear by allowing Imperial to use  
2 its limited cash flow to pay down some old advances and permitting  
3 additional advances on the credit line, provided that the total  
4 indebtedness did not exceed the \$2 million line.

5 As of May 31, 2005, Imperial and Nelsons had been unable to  
6 pay the advances or pay down the loan. On June 6, 2005, UBOC  
7 charged off the majority of the Loan, based on Imperial's "weak  
8 cash flow, insufficient collateral coverage and losses from the  
9 write-downs of defective inventory resulting in serious liquidity  
10 issues."

11 During this time, Nelson was in negotiation with various  
12 asset-based lenders. Lopez testified that he spoke with Richard  
13 Gilbert of BFI Business Finance, an asset-based lender that was  
14 considering a possible line of credit of \$1 million for Imperial.  
15 Gilbert sent Lopez a copy of an unsigned proposal addressed to  
16 Imperial on December 8, 2005. The negotiations between BFI and  
17 Imperial were unsuccessful.

18 On January 23, 2006, and for the next several months, Lopez  
19 and Nelson discussed Nelsons' continuing efforts to pay down the  
20 Loan and their joint efforts at a workout agreement. However, on  
21 April 28, 2006, Lopez informed Nelson that there had been too many  
22 delays. Nelson allegedly told Lopez that he would "do his best"  
23 to close with an asset-based lender by May 31, 2006, but Imperial  
24 did not pay down the Loan by the May 31, 2006 deadline.

25 On June 22, 2006, UBOC filed a complaint in Los Angeles  
26 County Superior Court, Union Bank of Cal. v. Imperial Chair  
27 Components, Inc., et al., Case no. LC075032 (the "State Court  
28 Action"). The complaint alleged causes of action for breach of

1 contract against Imperial and breach of the guarantees against  
2 Nelsons.

3 On August 29, 2006, Nelsons filed a petition for relief under  
4 chapter 7 of the Bankruptcy Code. On their Schedule F, Nelsons  
5 list a contingent, disputed, unsecured nonpriority claim of  
6 \$1,999,974.94 to UBOC.

7 On January 22, 2007, UBOC commenced an adversary proceeding  
8 against Nelsons seeking to determine that its claim should be  
9 excepted from dischargeable under § 523(a)(4). The complaint  
10 alleges that on or about February 20, 2005, Imperial's debt  
11 obligation to UBOC became due and payable; that as of that date,  
12 and thereafter, Imperial was insolvent; that Nelsons, as the sole  
13 directors and officers of Imperial during the period of  
14 insolvency, had a fiduciary duty to Imperial's creditors; and that  
15 Nelsons had violated that duty by making significant payments to  
16 themselves to the detriment of Imperial's creditors. Nelsons  
17 answered on March 15, 2007, generally denying the allegations.

18 On October 18, 2007, Nelsons moved for summary judgment.  
19 Nelsons argued they owed no fiduciary duty to UBOC, there was no  
20 express trust between UBOC and Nelsons, and there was no evidence  
21 that Nelsons misappropriated any of Imperial's assets. UBOC  
22 replied on November 14, 2007, asserting that California's Trust  
23 Fund Doctrine imposed an express trust on Imperial's assets and a  
24 fiduciary duty on Nelsons, that the withdrawals of money by  
25 Nelsons from Imperial were defalcations, and that there remained  
26 material issues to be determined by the trier of fact. After  
27 taking the issues under submission at a hearing on December 5,  
28 2007, the bankruptcy court issued a memorandum of decision on the

1 summary judgment motion on April 18, 2008. In the decision, the  
2 court denied the motion, concluding that genuine issues of  
3 material fact existed as to the elements of UBOC's claim.

4 The bankruptcy court then conducted a five-day trial from  
5 June 2 through June 11, 2008. Nelsons, Lopez, and Brutto  
6 testified. On January 5, 2009, the court entered its judgment in  
7 favor of UBOC and against Nelsons, determining that the debt owed  
8 by Nelsons to UBOC was nondischargeable under § 523(a)(4). The  
9 following day, the court entered findings of fact and conclusions  
10 of law in support of the judgment. Among those findings and  
11 conclusions are the following:

12 - "Nelson was overly general in much of his direct testimony  
13 about many entries on the financial statements. When pressed to  
14 explain the financial statements on cross-examination, he was  
15 evasive." Nelson "just hoped to keep UBOC at bay while he  
16 provided insufficient financial statements, did not allow an  
17 audit, and kept failing to find financing from elsewhere."

18 - "[UBOC] did not ever agree to write-off, discount, release  
19 or waive any portion of the outstanding obligation owed by  
20 Imperial and [Nelsons] to [UBOC]. . . . Lopez' testimony was  
21 credible and persuasive[.]"

22 - Nelsons "committed defalcation under 11 U.S.C. § 523(a)(4)  
23 when they caused Imperial, as its officers and directors, to repay  
24 themselves for purported loans they made to the company, ahead of  
25 Imperial's other creditors, including [UBOC]."

26 - "As of February 20, 2005, Imperial was insolvent as it  
27 could not pay its debts as they matured. [Nelsons] admitted in  
28 their responses to [UBOC]'s Special Interrogatories that 'Imperial

1 was unlikely to meet its liabilities when due.'"

2 - "Upon Imperial's insolvency, an express trust was created  
3 whereby all the assets of Imperial became a trust fund for the  
4 benefit of all of its creditors, including [UBOC]."

5 - "[Nelsons] were fiduciaries to [UBOC] at the time the debt  
6 was created because at all relevant times [Nelsons] were  
7 Imperial's only officers and directors."

8 - "[UBOC] has proven the elements of Bankruptcy Code Section  
9 523(a)(4), and [Nelsons] are liable to [UBOC] thereunder for a  
10 total of \$772,361.32."

11 Nelsons filed a timely appeal of the bankruptcy court's  
12 judgment on January 12, 2009.

13

#### 14 **JURISDICTION**

15 The bankruptcy court had jurisdiction under 28 U.S.C. §§ 1334  
16 and 157(b)(2)(I). The Panel has jurisdiction under 28 U.S.C.  
17 § 158.

18

#### 19 **ISSUES**

20 Whether the Panel may review a denial of a motion for summary  
21 judgment where there has been an intervening trial and judgment on  
22 the merits.

23 Whether the bankruptcy court erred in determining that  
24 Imperial was insolvent by February 20, 2005.

25 Whether the bankruptcy court erred in finding Nelsons' debt  
26 to UBOC nondischargeable under § 523(a)(4).

27 Whether the bankruptcy court erred or abused its discretion  
28 in its rulings on evidentiary and equitable issues.





1 a trial court's grant or denial of equitable relief. Forest Grove  
2 School Dist. v. T.A., 523 F.3d 1078, 1084 (9th Cir. 2008). A  
3 bankruptcy court abuses its discretion if it bases its decision on  
4 an erroneous view of the law or clearly erroneous factual  
5 findings. Cooter & Gell v. Hartmarx Corp., 496 U.S. 384, 405  
6 (1990). Otherwise, to reverse for abuse of discretion we must have  
7 a definite and firm conviction that the bankruptcy court committed  
8 a clear error of judgment in the conclusion it reached. Stasz v.  
9 Gonzalez (In re Stasz), 387 B.R. 271, 274 (9th Cir. BAP 2008).

## 10 11 DISCUSSION

### 12 I.

13 The Panel will not review a denial of a motion for summary  
14 judgment where there has been a subsequent trial  
and judgment on the merits.

15 Nelsons ask us to review the bankruptcy court's denial of  
16 their motion for summary judgment. We decline.

17 A denial of a motion for summary judgment is not properly  
18 reviewable on an appeal when there has been a subsequent trial and  
19 judgment on the merits. Lakeside-Scott v. Multnomah County,  
20 556 F.3d 797, 801 n.4 (9th Cir. 2009) ("The denial of a motion for  
21 summary judgment is not reviewable on an appeal from a final  
22 judgment entered after a full trial on the merits." ) (quoting  
23 Locricchio v. Legal Servs. Corp., 833 F.2d 1352, 1359 (9th Cir.  
24 1987). This rule has not only been uniformly followed by  
25 appellate panels in this circuit, but is the rule in all other  
26 circuits that have considered the issue.<sup>4</sup>

27  
28 <sup>4</sup> See Pahuta v. Massey-Ferguson, 170 F.3d 125, 130 (2d Cir.  
(continued...)

1 There is but one exception to the Locricchio rule:

2 If a [trial] court denies a motion for summary judgment  
3 on the basis of a question of law that would have  
4 negated the need for a trial, this court should review  
5 that decision. If, however, a [trial] court denied a  
6 motion for summary judgment based on a disputed issue of  
7 fact, and that issue of fact was decided in a subsequent  
8 trial, this court will not engage in the pointless  
9 academic exercise of deciding whether a factual issue  
10 was disputed after it has been decided.

11 Banuelos v. Constr. Laborers' Trust Funds for S. Cal., 382 F.3d  
12 897, 903 (9th Cir. 2004).

13 In this action, the bankruptcy court, in a well reasoned  
14 memorandum decision, denied summary judgment because of the  
15 existence of three disputed issues: whether the funds transferred  
16 from Imperial to Nelsons were repayment of loans; whether, and  
17 when, any express trust arose as a result of insolvency; and  
18 whether Nelsons owed a fiduciary duty to UBOC. These are factual  
19 questions or, at least, mixed questions of fact and law. None are  
20 pure questions of law such that, if answered favorably to Nelsons,  
21 would bring this appeal within the exception to Locricchio.

22 Nelsons suggest that the bankruptcy court did decide an issue  
23 of law in its consideration of summary judgment. Nelsons complain  
24 that the bankruptcy court "gave every inference to [UBOC's]  
25 alleged evidence, rather than construing it narrowly and  
26 construing [Nelson's] evidence liberally. . . . Thus, [the]

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27 <sup>4</sup>(...continued)  
28 1999); Metropolitan Life Ins. Co. v. Golden Triangle, 121 F.3d  
351, 354 (8th Cir. 1997); Chesapeake Paper Prods. Co. v. Stone &  
Webster Eng'g Corp., 51 F.3d 1229, 1237 (4th Cir. 1995); Lama v.  
Borras, 16 F.3d 473, 476 n.5 (1st Cir. 1994); Black v. J.I. Case  
Co., 22 F.3d 568, 570-71 (5th Cir. 1994); Watson v. Amedco Steel,  
Inc., 29 F.3d 274, 277 (7th Cir. 1994); Whalen v. Unit Rig, Inc.,  
974 F.2d 1248, 1250-51 (10th Cir. 1992); Jarrett v. Epperly,  
896 F.2d 1013, 1016 (6th Cir. 1990); Glaros v. H.H. Robertson Co.,  
797 F.2d 1564, 1569 (Fed. Cir. 1986).

1 Court's ruling failed to take into consideration the fresh start  
2 evidentiary analysis required of In re Miller, 39 F.3d 301, 304  
3 (11th Cir. 1994), in ruling on the summary judgment." Nelsons'  
4 Br. at 7, 9. In short, Nelsons argue that because this is  
5 dischargeability litigation, in considering Nelsons' motion for  
6 summary judgment, the bankruptcy court must view the evidence in  
7 the light most favorable to the moving party, the Nelsons.

8 This argument misperceives the required analysis. In  
9 resolving a motion for summary judgment, the proper test is that  
10 "facts must be viewed in the light most favorable to the nonmoving  
11 party . . . [unless] the record taken as a whole could not lead a  
12 rational trier of fact to find for the nonmoving party." Scott v.  
13 Harris, 550 U.S. 372, 380 (2007) (emphasis added); accord Friedman  
14 v. Boucher, 568 F.3d 1119 (9th Cir. 2009). There is nothing in  
15 the record to suggest that the case presented by UBOC at the  
16 summary judgment "could not lead a rational trier of fact to find  
17 for the nonmoving party." Indeed, UBOC's positions ultimately  
18 prevailed, as shown in the thorough findings of fact and  
19 conclusions of law entered by the bankruptcy court in support of  
20 its judgment on nondischargeability.<sup>5</sup>

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24 <sup>5</sup> Nelsons' citation to In re Miller refers to the general  
25 bankruptcy policy that "exceptions to discharge be narrowly  
26 construed against the creditor and liberally against the debtor,  
27 thus effectuating the fresh start policy of the Code." 39 F.3d  
28 301, 304 (11th Cir. 1994). The Miller case and the fresh start  
rule, however, apply to the bankruptcy court's evaluation of the  
weight of evidence in considering entry of final judgment on  
nondischargeability, not to the sufficiency of evidence or  
existence of questions of material fact at the summary judgment  
stage of discharge litigation.



1 intentional or negligent, defaults in performing trust duties.  
2 Woodworking Enters. v. Baird (In re Baird), 114 B.R. 198, 204  
3 (9th Cir. BAP 1990) (cited with approval in In re Lewis, 97 F.3d  
4 at 1186).

5 Whether a relationship is a fiduciary one within the meaning  
6 of § 523(a)(4) is a question of federal law. Ragsdale v. Haller,  
7 780 F.2d 794, 795 (9th Cir. 1986). In the dischargeability  
8 context, the fiduciary relationship must arise from an express or  
9 technical trust that was imposed before and without reference to  
10 the wrongdoing that caused the debt. Id. at 796. Whether a  
11 fiduciary is a trustee chargeable under § 523(a)(4) is determined  
12 by reference to state law. Id.

13 The Panel has previously examined whether, under California  
14 law, an express trust arises in favor of creditors upon the  
15 insolvency of a corporation, and whether corporate officers are  
16 fiduciaries as to those creditors. We decided that, indeed, under  
17 the Trust Fund Doctrine as adopted in California, an express trust  
18 sufficient for purposes of the application of § 523(a)(4) exists  
19 under such circumstances. In re Jacks, 266 B.R. at 728; see also  
20 In re Kallmeyer, 242 B.R. at 492.

21 A. The Trust Fund Doctrine in California

22 "The theory of the trust fund doctrine is that all of the  
23 assets of a corporation, immediately on its becoming insolvent,  
24 become a trust fund for the benefit of all of its creditors." 15A  
25 William Meade Fletcher, FLETCHER CYCLOPEDIA OF THE LAW OF CORPORATIONS  
26 § 7369 (Thomson Reuters/West 2009). The Trust Fund Doctrine is a  
27 time-honored principle in our legal system. It replaced the  
28 earlier common law rule that, upon dissolution of a corporation,

1 its real estate reverted to the grantors and its personalty to the  
2 state. 19 AM. JUR. 2D CORPORATIONS § 2419 (2008).

3 The Panel recently reaffirmed the vitality of the Trust Fund  
4 Doctrine as the basis for an exception to discharge, albeit in a  
5 case from Arizona. See Oney v. Weinberg (In re Weinberg), \_\_\_  
6 B.R. \_\_\_, 2009 Bankr. LEXIS 2112, 2009 WL 2437044 (9th Cir. BAP,  
7 July 31, 2009).<sup>6</sup> Along with other states, California courts have  
8 also embraced the Trust Fund Doctrine. See Saracco Tank & Welding  
9 Co., Ltd. v. Platz, 65 Cal. App.2d 306, 315, 150 P.2d 918, 923  
10 (Cal Ct. App. 1944) ("All the assets of a corporation, immediately  
11 upon its becoming insolvent, become a trust fund for the benefit  
12 of all its creditors."); In re Jacks, 266 B.R. at 736; see also  
13 Lawrence T. Lasagna, Inc., v. Foster, 609 F.2d 392, 396 (9th Cir.  
14 1979) (holding that, under California law, director of an  
15 insolvent corporation is a fiduciary for purposes of § 34(a)(4),  
16 the predecessor of § 523(a)(4)).<sup>7</sup>

17 \_\_\_\_\_  
18 <sup>6</sup> Our opinion in In re Weinberg was issued but not yet  
19 published on the day of oral argument in this appeal. At that  
20 hearing, the parties were given copies of the Weinberg opinion and  
21 invited to submit supplementary briefs addressing the implications  
22 of our holdings in Weinberg, if any, in this appeal. Both parties  
23 filed supplemental briefs. In theirs, Nelsons argue that the  
24 Trust Fund Doctrine has been superseded in California by certain  
25 amendments to the California Corporations Code and decisions of  
26 the California Supreme Court. But Nelsons' arguments were  
27 addressed and rejected in our previous decision wherein the Panel  
28 noted that "California's corporate statutes, while modifying  
remedies, do not eliminate the trust comprised of corporate assets  
that arises upon a corporation's insolvency." In re Jacks, 266  
B.R. at 737.

<sup>7</sup> Section 34(a)(4) of the Bankruptcy Act, repealed upon  
enactment of the Code in 1978, provided: "A discharge in  
bankruptcy shall release a bankrupt from all of his provable debts  
. . . except such as . . . (4) were created by his fraud,  
embezzlement, misappropriation or defalcation while acting as an  
(continued...)

1 Other California law, although not specifically invoking the  
2 Trust Fund Doctrine, recognizes that a director of an insolvent  
3 corporation who is also a creditor owes a fiduciary duty to other  
4 creditors. Commons v. Schine, 35 Cal. App. 3d 141, 144 (Cal. Ct.  
5 App. 1973) ("One who dominates and controls an insolvent  
6 corporation may not . . . use his power to secure for himself an  
7 advantage over other creditors of the corporation. [Citations  
8 omitted.] [A] director of an insolvent corporation [] thus  
9 occupies a fiduciary relationship to its creditors.");  
10 1-6 BALLANTINE & STERLING CAL. CORP. LAWS § 102 n.31 (Matthew Bender  
11 2009) (citing Schine for the principle that a director who is a  
12 creditor of an insolvent corporation is a fiduciary to other  
13 creditors); see also Rankin v. Tilley, 47 Cal. App.3d 75, 89 (Cal.  
14 Ct. App. 1975 ("To be sure, directors of [an insolvent]  
15 corporation cannot secure to themselves any preference or  
16 advantage over the other creditors in the payment of their  
17 claims.")).

18 In short, under the Trust Fund Doctrine in California, a  
19 corporate officer owes fiduciary duties to creditors when the  
20 corporation is insolvent. An officer's violation of these duties  
21 may therefore give rise to a nondischargeable debt under  
22 § 523(a)(4).

23  
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26 <sup>7</sup>(...continued)  
27 officer or in any fiduciary capacity." Section 523(a)(4) of the  
28 Code provides: "A discharge under section 727, 1141, 1228(a),  
1228(b), or 1328(b) of this title does not discharge an individual  
debtor from any debt - . . . (4) for fraud or defalcation while  
acting in a fiduciary capacity, embezzlement or larceny."



1       B. The bankruptcy court did not err in determining that  
2 Imperial was insolvent on February 20, 2005, under the equity  
3 insolvency test.

4       Because a corporation's insolvency is a requisite for  
5 application of the Trust Fund Doctrine under California law,  
6 determining the date of insolvency of Imperial is at the heart of  
7 this appeal. We conclude that the bankruptcy court applied the  
8 correct insolvency test under California law, and did not err in  
9 fixing the date of Imperial's insolvency.

10       Under California law, a corporation is insolvent when it is  
11 "likely to be unable to meet its liabilities . . . as they  
12 mature." CAL. CORP. CODE § 501; In re Jacks, 266 B.R. at 736; see  
13 also CAL. CIV. CODE § 3439.2(c) ("A debtor who is not paying his or  
14 her debts as they become due is presumed to be insolvent.").  
15 Here, the bankruptcy court correctly applied Cal. Corp. Code § 501  
16 in determining that Imperial was insolvent as of February 20,  
17 2005:

18       Under California Corporate Code § 501, a corporation is  
19 insolvent when it is unlikely to be able to meet its  
20 liabilities as they mature.

20 Court's Conclusion of Law no. 4.

21       By February 20, 2005, Imperial failed to pay its trade  
22 advances to UBOC as they matured. Concurrently,  
23 Imperial's financial statements as of March 2005 showed  
24 a negative cash flow of nearly \$100,000, evidencing  
25 Imperial's inability to pay its debts as they matured.  
26 Thus, Imperial was insolvent no later than February 20,  
27 2005 pursuant to California Corporate Code § 501.

25 Court's Finding of Fact no. 25.

26       Whether a party is paying its debts as they come due is a  
27 question of fact reviewed for clear error. Liberty Tool v. Vortex  
28 Fishing Sys. (In re Vortex Fishing Sys.), 277 F.3d 1057, 1072

1 (9th Cir. 2002). Nelson admitted that Imperial was unable to pay  
2 the trade advances when they became due in February 2005. Nelsons  
3 conceded that UBOC was Imperial's largest single creditor and  
4 constituted almost all of its debt. The bankruptcy court may base  
5 an equity insolvency determination, in part, on the failure to pay  
6 a single creditor where, as here, that creditor constitutes a  
7 substantial percentage of the total debt. Concrete Pumping Serv.,  
8 Inc. v. King Constr. Co. (In re Concrete Pumping Serv.), 943 F.2d  
9 627 (6th Cir. 1991); In re Food Gallery of Valley Brook, 222 B.R.  
10 480, 488 (Bankr. W.D. Pa. 1998); In re Int'l Teldata Corp.,  
11 12 B.R. 879, 882-83 (Bankr. D. Nev. 1981). That Imperial was  
12 unable to pay its debts to UBOC as they became due on February 20,  
13 2005, is adequate evidence to support a finding by the bankruptcy  
14 court that Imperial was insolvent as of that date under the equity  
15 insolvency test.

16 Besides Imperial's admitted inability, and actual failure, to  
17 pay its principal creditor the advances due on February 20, 2005,  
18 the bankruptcy court also relied on other grounds, supported in  
19 the record, to conclude that Imperial was unable to pay its debts  
20 as they became due. One of the documentary exhibits admitted at  
21 trial was a chart, prepared with information taken from Imperial's  
22 own financial statements, showing that, as of March 2005, Imperial  
23 had a negative cash flow of almost \$100,000. Although Nelsons  
24 objected to the admission of this exhibit, they provided no  
25 persuasive argument disputing that figure. As shown by this  
26 chart, the bankruptcy court found that the "negative cash flow of  
27 \$100,000 evidence[d] Imperial's inability to pay its debts as they  
28 matured."

1           Although not cited by the bankruptcy court in its findings of  
2 fact and conclusions of law, there was other evidence in the  
3 record to support a finding of insolvency as of February 20, 2005.  
4 Beginning in March 2005, Lopez arranged a "hand to mouth" approach  
5 where the bank would allow Imperial to make a limited paydown of  
6 the credit line and then open up an equivalent amount for  
7 inventory purchases. However, Imperial was never able to catch up  
8 or pay down the trade advances that had been due on February 20,  
9 2005. By February 20, Imperial had lost its largest customer,  
10 Steelcase, which Nelson testified was particularly harmful in a  
11 relatively small market.

12           And, significantly, the bankruptcy court heard testimony from  
13 Nelson and Lopez regarding the financial relations between  
14 Imperial and UBOC. The court found Nelson evasive on financial  
15 questions and not credible. In contrast, the court found Lopez  
16 credible. We give special deference to the court's determinations  
17 of credibility in a trial. Rule 8013; Anderson, 470 U.S. at 573.

18           Given Nelson's admission that Imperial could not and did not  
19 pay its principal creditor the advances due on February 20, 2005,  
20 after it had been granted a one-month extension to obtain the  
21 funds, together with other evidence in the record that Imperial  
22 was experiencing a significant negative cash flow, and the court's  
23 findings that Nelson's testimony on financial matters was not  
24 credible and Lopez' testimony was, we conclude that the bankruptcy  
25 court did not clearly err in determining that Imperial was  
26 insolvent as of February 20, 2005.

27           Nelsons' principal arguments against insolvency on that date  
28 fall into two areas. First, Nelson asserts that, based on a

1 balance sheet standard, Imperial was solvent on February 20, 2005.  
2 This argument lacks merit.

3       There is evidence in the record that the preparation of  
4 Imperial's balance sheets was faulty. The balance sheet for  
5 September 2004 was a "CPA Draft," and was never signed off by  
6 Imperial's CPA. Imperial would not allow UBOC to perform an  
7 independent audit. Moreover, all Imperial balance sheets on or  
8 after December 2004 were prepared by Nelson, who is not an  
9 accountant. The balance sheets submitted to UBOC or the  
10 bankruptcy court did not provide any record of the shareholder  
11 loans that Nelsons admit to providing Imperial between 2004 and  
12 2006; even if they had adjusted the balance sheet, Nelsons admit  
13 that they had no documentation of the loans. The bankruptcy court  
14 found that these balance sheets were "incomplete and misleading."  
15 And, as mentioned above, the bankruptcy court found Nelson's  
16 testimony to be evasive and not credible when discussing the  
17 financial statements. Under these circumstances, the bankruptcy  
18 court was justified in rejecting Nelsons' balance sheet evidence,  
19 and relying on the equity test in determining Imperial's  
20 insolvency.

21       Nelsons were the sole directors, officers and shareholders of  
22 Imperial at all relevant times in this dispute. Because the  
23 bankruptcy court did not clearly err in determining that Imperial  
24 was insolvent on February 20, 2005, the Nelsons were fiduciaries  
25 to the creditors of Imperial, including UBOC, from and after that  
26 date under the Trust Fund Doctrine. As a result, repayments of  
27 any loans by Imperial to Nelsons while other creditors went unpaid

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1 constituted defalcations as that term is understood in  
2 § 523(a)(4).

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4 **III.**

5 The bankruptcy court did not abuse its discretion  
6 in its rulings on Nelsons' equitable defenses or  
evidentiary objections.

7 A. Equitable Arguments.

8 Nelsons offer equitable defenses to application of the Trust  
9 Fund Doctrine in this case. Nelsons' first equitable argument is  
10 that they infused money into Imperial at the demand of UBOC based  
11 upon UBOC's promise in return that it would restructure the Loan,  
12 or waive terms of the Agreement. As a result, according to  
13 Nelsons:

14 There could not have been misappropriation of funds out  
15 of Imperial such that it caused Imperial to be  
16 insolvent. Rather the evidence demonstrated that based  
upon the representations of Sal Lopez the NELSONS  
advanced to Imperial \$1,269,818.35.

17 Nelsons' Br. at 8 (emphasis added). Nelsons argue that UBOC  
18 should be estopped from denying that an agreement existed that  
19 would allow Nelsons to trace their personal funds, set off the  
20 funds, or claim damages for breach from UBOC. In tandem with  
21 their estoppel argument, Nelsons assert that the bankruptcy court  
22 "failed to recognize that . . . there could not have been  
23 misappropriation of funds [defalcation] as Nelson put more money  
24 into Imperial th[a]n was repaid to them." They assert that, in  
25 response to Lopez' "offer" to restructure the Loan and demand that  
26 Nelsons infuse more funds into Imperial, they contributed  
27 \$1,269,818.35 from personal funds and paid \$396,127.19 of  
28 Imperial's business expenses from personal funds, for a total

1 contribution of \$1,665,254.38. Since they also repaid themselves  
2 \$1,177,619.32 for these "loans" to Imperial, Nelsons suggest that  
3 Imperial owes them \$488,326.22. Nelsons' Br. at 8.

4 There are both credibility problems and mathematical flaws in  
5 Nelsons' argument.

6 The bankruptcy court made a credibility determination and  
7 found, contrary to Nelsons' insistence, that there never was a  
8 binding offer by UBOC to restructure the Loan in exchange for  
9 Nelsons' cash infusions:

10 [UBOC] did not ever agree to write-off, discount,  
11 release or waive any portion of the outstanding  
12 obligation owed by Imperial and [Nelsons] to [UBOC]. In  
13 his testimony, Nelson kept stressing that UBOC never  
14 modified the loan despite all he did to save his  
15 business, but he never provided any evidence that UBOC  
16 was ever under a duty to modify the loan. To the  
17 contrary, Lopez's testimony, all documentary evidence,  
18 and even Nelson's testimony showed that UBOC's  
19 instructions were clear that Nelson needed to bring in  
20 at least some outside financing for UBOC to consider  
21 releasing their liens. Lopez' testimony was credible  
22 and persuasive.

23 Court's Finding of Fact 30 (emphasis added). As mentioned before,  
24 we give deference to this credibility determination of the  
25 bankruptcy court. Anderson, 470 U.S. at 573.

26 But even if there had been a formal offer, the record shows  
27 that Nelsons did not contribute the amounts they state in their  
28 brief. Although there is evidence that Nelsons contributed  
29 \$1,269,818.35 to Imperial, \$1,064,771 of that amount was given to  
30 the company in 2004 and the first week of 2005, before Imperial  
31 defaulted on its obligations to UBOC, before UBOC had any  
32 discussions with Nelsons, and in fact before Lopez was even  
33 involved with their loan. Even viewing the evidence in a light  
34 most favorable to Nelsons, they at most contributed only \$205,047

1 after the loan default or in response to some hypothetical offer  
2 from UBOC, not \$1,269,818.35. They may have paid \$396,127.19 of  
3 Imperial business expenses from their personal funds for a total  
4 contribution of \$601,174.19 after default (and, for our purposes,  
5 while Imperial was insolvent). In contrast, there is evidence in  
6 the record that Nelsons took \$809,461.35 in repayments of these  
7 "loans" from Imperial after default.<sup>8</sup>

8 On this record, the bankruptcy court was not required to  
9 conclude that Nelsons made a net contribution of funds to Imperial  
10 after default on its obligation to UBOC and while it was  
11 insolvent. Indeed, it appears that Nelsons received a net  
12 \$207,186.16 from Imperial while it was insolvent. Thus, the  
13 bankruptcy court did not abuse its discretion in rejecting  
14 Nelsons' equitable argument that UBOC should be estopped from  
15 arguing defalcation, nor in refusing to offset the contribution.<sup>9</sup>

16 Nelsons' second equitable argument is based on the doctrine  
17 of unclean hands. However, while their brief generally discusses  
18 this equitable doctrine, they fail to explain how UBOC violated  
19 the principle of unclean hands. We decline to consider on appeal  
20 any argument that is not clearly and adequately addressed in the  
21 opening brief. Martinez-Serrano v. INS, 94 F.3d 1256, 1260

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23 <sup>8</sup> Just as we reduce the \$1,269,818.35 by the contribution of  
24 \$1,064,771 made in 2004 to get a net contribution after default of  
25 \$205,047, we also reduce the \$1,177,619.34 total repayments by the  
26 \$368,157.99 in repayments taken out of Imperial in 2004, leaving a  
net repayment from Imperial to Nelsons after default and while  
insolvent of \$809,461.35.

27 <sup>9</sup> At several points in their brief, Nelsons inflate their  
28 alleged contribution by an additional \$775,000 in "deferred  
salary." Obviously, deferring payment of an expense is not a cash  
infusion.

1 (9th Cir. 1996). Even so, we note that the bankruptcy court  
2 explicitly addressed this defense, ruling that UBOC "did not act  
3 in any way that would constitute unclean hands." Nelsons have  
4 provided no cogent reason why this ruling constituted an abuse of  
5 discretion.

6 B. Evidentiary Issues

7 Nelsons' objections to the evidentiary rulings by the  
8 bankruptcy court also lack merit.

9 In their brief, Nelsons begin their attack on the evidentiary  
10 rulings of the bankruptcy court by arguing that the court should  
11 not have allowed Brutto to testify at trial:

12 [Nelsons] made a motion to exclude Witness Mark Brutto,  
13 a UBOC employee. [Citing to Trial Tr. 44:16-45:2  
14 (June 3, 2008)]. This employee was not identified in  
15 UBOC's pre-Trial Order Witness List. . . . The court  
16 denied the motion stating the UBOC could call the  
17 witness for impeachment. [Citing to Trial Tr. 44:16-45:2  
18 (June 3, 2008)]. Witnesses not identified in the pre-  
19 trial order are barred from being called under Campbell  
20 [Indus.] v. M/V Gemini (9th Cir. 1980) 619 F.2d 24, 27-  
21 28. Thus, it was error for the court to allow Mark  
22 Brutto to testify.

23 Nelsons' Br. at 22.

24 We have carefully examined all of the trial transcripts in  
25 addition to the portion cited above. Nelsons never moved to  
26 exclude Brutto as a witness, and the bankruptcy court never ruled  
27 on such a motion. Nelsons' transcript citation above refers to a  
28 colloquy between Nelsons' attorney, Lozoya, and the court, in  
which the court agreed with counsel that only Nelsons could call  
Brutto as a witness in their case-in-chief. However, at no time  
did the bankruptcy court indicate that Brutto could not be called  
as an impeachment witness.



1 As it turned out, neither Nelsons nor UBOC called Brutto as a  
2 witness in their cases-in-chief. Brutto was called as a rebuttal  
3 witness by UBOC. Trial Tr. 182:4-5 (June 5, 2008), 117:21-147:20  
4 (June 11, 2008). Nelsons did not object to calling Brutto at that  
5 time nor did they move to strike any of Brutto's testimony.  
6 Nelsons' counsel cross-examined Brutto.

7 Nelsons never raised any objection to Brutto as a rebuttal  
8 witness in the bankruptcy court or specifically in the issues on  
9 appeal. Simply put, the facts do not support Nelsons' statement  
10 in their brief that they "made a motion to exclude Witness Mark  
11 Brutto" or that the court denied that motion.

12 Nor would the law support such a motion. Nelsons cite to  
13 Campbell Indus. for the principle that "witnesses not identified  
14 in the pre-trial order are barred from being called[.]" That is  
15 not the holding of Campbell Indus. Instead, in that decision the  
16 Ninth Circuit held that a trial judge did not abuse his discretion  
17 by declining to amend a pre-trial order allowing the addition of  
18 witnesses. Id. at 27. Neither Campbell Indus. nor other circuit  
19 case law restricts the calling of impeachment witnesses not  
20 identified in pre-trial orders. Indeed, the Local Bankruptcy  
21 Rules of the Central District of California provide that  
22 impeachment witnesses need not be identified in pre-trial orders.  
23 Bankr. C.D. Cal. LBR 7016-1(2)(E).

24 Nelsons' real objection to Brutto's testimony appears to  
25 relate to certain documents about which Brutto testified and that  
26 Nelsons allege were withheld from Nelsons during discovery.  
27 Nelsons filed three motions in limine to exclude the documents.

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The transcript shows the bankruptcy court and counsel discussed Nelsons' motions at length at the commencement of the trial. After hearing arguments of counsel, the court ruled that the declarations and evidence submitted by Nelsons to support the motions in limine were not credible or not supported by the facts. "The declarations and evidence submitted by [Nelsons] as to whether or not they received this document are very vague." Trial Tr. 37:5-7 (June 3, 2008). The bankruptcy court further noted that Nelsons' objections related to documents produced in discovery over a year before trial that had been discussed during the court's earlier hearing on Nelsons' summary judgment motion. During that earlier hearing, the court had indicated that Nelsons should bring a motion to exclude the documents. Having failed to bring that motion in a timely manner, the court noted that the objections should not have been raised one week before the beginning of trial. At least as to one document, the bank's charge-off file, the court admonished Nelsons that the objection was "too little, too late, and I really think it's an unfortunate last-minute attempt to delay a trial." Trial Tr. 40:5-7. The court also found that the information in the charge-off file was also contained in other documents that Nelsons agreed to having received in discovery. Trial Tr. 38:6-7.

Based upon our review of the entire record, we conclude that the bankruptcy court did not abuse its discretion. Home Indem. Co. v. Lane Powell Moss & Miller, 43 F.3d 1322, 1329 (9th Cir. 1995) ("Trial courts have broad discretion in making evidence rulings and handling late objections.").

1 Nelsons also object to the Lopez testimony regarding  
2 documents that he did not create, and was thus not competent to  
3 authenticate. However, these were apparently business records  
4 for which Lopez was the designated custodian by UBOC. He was  
5 therefore competent to authenticate them under Fed. R. Evid.  
6 901(b)(1) ("By way of illustration only, and not by way of  
7 limitation, the following are examples of authentication or  
8 identification conforming with the requirements of this rule:  
9 . . . (1) Testimony of a witness with knowledge. Testimony that a  
10 matter is what it is claimed to be.").<sup>10</sup>

11 Nelsons object to the bankruptcy court's failure to exclude  
12 Lopez' testimony because it allegedly contradicted his prior,  
13 deposition testimony wherein Lopez repeatedly used the term  
14 "offer" in his deposition to refer to a binding contractual offer.  
15 At trial, Lopez insisted that he never made a formal offer to  
16 change the contract terms, waive provisions or otherwise  
17 restructure the Loan.

18 The bankruptcy court heard considerable testimony on this  
19 topic and, as discussed above, did not clearly err in ruling that  
20 there was no formal offer by UBOC. The bankruptcy court's finding  
21 of fact no. 30 shows that it made this finding in light of "all  
22 documentary evidence," so we assume that the bankruptcy court was  
23 aware of Lopez' deposition.

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25 <sup>10</sup> To the extent that Nelsons appear to argue that Lopez  
26 could not testify regarding documents prepared by other officers  
27 of UBOC on the basis of hearsay, such documents authenticated by  
28 an officer charged with their custody are not excluded by the  
hearsay exception. FED. R. EVID. 803(6) (excluding from hearsay any  
memorandum, report, record, or data compilation made and kept in  
the regular course of business and authenticated by the business's  
custodian of those documents).

1           In sum, there was no abuse of discretion in the bankruptcy  
2 court's evidentiary determinations.

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**CONCLUSION**

The judgment of the bankruptcy court is AFFIRMED.