NOT FOR PUBLICATION

**UNITED STATES BANKRUPTCY APPELLATE PANEL**

**OF THE NINTH CIRCUIT**

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| In re: | BAP Nos. WW-10-1156-HJuMk<br>WW-10-1175-HJuMk |
| ERWIN M. KRAEMER and CHRISTINE M. KRAEMER, | (Cross Appeals) |
| Debtors. | Bk. No. 08-40066 |
| | Adv. Pro. No. 08-04047 |
| NWAS OKLAHOMA, INC.; WATER LOCATORS, LLC; TOBIAS TAYLOR; REGINA TAYLOR; LORRIE GRUBBS; TORREY GRUBBS; DAN HOLT; SHANNON HOLT; JANE SCOTT; DALE SCOTT; JESSE PIKE; RICHARD KEATING; RICHARD KEATING, JR.; ERIC KEATING, | |
| Appellants/Cross-Appellees, | |
| v. | **M E M O R A N D U M**[1] |
| ERWIN M. KRAEMER; CHRISTINE M. KRAEMER, aka Christine Wolliscroft-Kraemer, | |
| Appellees/Cross-Appellants. | |

Argued and Submitted on January 21, 2011
at Seattle, Washington

Filed - April 21, 2011

Appeal from the United States Bankruptcy Court
for the Western District of Washington

Philip H. Brandt, Bankruptcy Judge, Presiding

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[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.

Appearances: Laurin S. Schweet of Schweet, Ricke & Linde, PLLC for Appellants/Cross-Appellees; Deirdre P. Glynn Levin for Appellees/Cross-Appellants.

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Before: HOLLOWELL, JURY and MARKELL, Bankruptcy Judges.

This is an appeal by judgment creditors of an order entered by the bankruptcy court dismissing their § 523(a)(2)(A)[2] nondischargeability complaint. The bankruptcy court found that the debtors did not intend to deceive the creditors, who bought a groundwater surveying franchise, by misrepresenting the surveying equipment's accuracy. The debtors have cross-appealed the bankruptcy court's admission of deposition testimony that supported the creditors' case. We AFFIRM and decline to address the issues raised by the cross-appeal because the debtors were not prejudiced by the bankruptcy court's ruling.

## I. FACTS

A. Background

Ervin and Christine Kraemer (the Debtors) owned Northwest Aquifer Surveying, Inc. (NWAS), a groundwater surveying business. The Debtors' business utilized Electro-Kinetic System (EKS) technology to locate ground water and areas where wells could be drilled at the least possible depth and with the greatest yield. EKS was created in England and marketed by a company named Ground Flow. The Debtors became involved with EKS in late 1999, and thereafter became certified by Ground Flow to use the technology

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[2] Unless otherwise indicated, all chapter and section references are to the Bankruptcy Code, 11 U.S.C. §§ 101-1532. All Rule references are to the Federal Rules of Bankruptcy Procedure, Rules 1001-9037.

and equipment (the EKS System). In 2001, NWAS was the exclusive distributor of the EKS System in the United States. In 2002, NWAS began selling the EKS System as franchises. In the course of doing so, they created written marketing materials,[3] which advertised the EKS System as having the:

> Proven Ability to Accurately Estimate Well Yield Within a 25% Margin and The Ability to Estimate Well Depth Within a 10%-20% Margin!

Richard Keating Sr., Richard Keating Jr., Eric Keating, and Jessie Pike (the Appellants) are among fourteen corporate and individual parties who purchased EKS System franchises from the Debtors but later became dissatisfied with the EKS System (the Franchisees). In 2006, the Franchisees brought an American Arbitration Association (AAA) action against the Debtors for false representations in the sale of a franchise under Washington's Franchise Investment Protection Act (FIPA), RCW 19.100 et. seq., which provides a civil cause of action for franchisees harmed by false statements or omissions in the sale of a franchise. As part of the AAA proceedings, the Debtors' depositions were taken (the Depositions).

The Franchisees obtained a summary judgment ruling by the AAA panel. The AAA panel determined that the Debtors violated RCW 19.100.170(2), under which it is:

> unlawful for any person in connection with the offer, sale, or purchase of any franchise . . .
> (2) To sell or offer to sell by means of any written or

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[3] There are ostensibly other written marketing materials; however, they are not contained in the record.

> oral communication which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements made in light of the circumstances under which they were made not misleading.

The AAA panel granted the Franchisees damages and rescission under RCW 19.100.190(2):

> Any person who sells or offers to sell a franchise in violation of this chapter shall be liable . . . for damages . . . . In the case of a violation of RCW 19.100.170 rescission is not available to the plaintiff if the defendant proves that the plaintiff knew the facts concerning the untruth or omission or that the defendant exercised reasonable care and did not know or if he had exercised reasonable care would not have known of the untruth or omission.

The final AAA award was issued on November 26, 2006, and reduced to judgment in the District Court for the Western District of Washington (the District Court) on July 24, 2007 (the AAA Judgment).

On January 9, 2008, the Debtors filed a chapter 7 petition. The Franchisees, originally split into two separate groups of plaintiffs, filed complaints against the Debtors, which were consolidated into one adversary proceeding (Adv. Proc. No. 08-4047), alleging that the AAA Judgment was nondischargeable under § 523(a)(2)(A) (the Complaint).

On February 6, 2009, the Appellants filed a motion for summary judgment (MSJ) asserting that under the principles of issue preclusion the AAA Judgment established that their claims were nondischargeable. The bankruptcy court held a hearing on

the MSJ on March 25, 2009.[4] At the hearing, the bankruptcy court asked the parties to provide additional briefing on whether the recission remedy of RCW 19.100.190(2) was available if there had been only a negligent misrepresentation by a franchisor. The hearing was continued to April 22, 2009.

At the continued hearing on the MSJ, the bankruptcy court stated, "It seems to me pretty obvious that we've got issue preclusion on all of the elements except the intent-related ones." The bankruptcy court considered the parties' arguments regarding whether the issue of intent was actually litigated and resolved when the AAA panel granted the recission remedy of RCW 19.100.190(2). It concluded that an award of recission under RCW 19.100.190(2) was only available for intentional violations of the FIPA, and therefore, the requisite intent to defraud under § 523(a)(2)(A) was established. The bankruptcy court entered an order granting the MSJ on June 3, 2009, and a judgment of nondischargeability in favor of the Appellants in the amount of $175,260.65 on June 9, 2009.

The Debtors appealed.[5] On September 1, 2009, the District Court entered an order that reversed and remanded the matter to the bankruptcy court. The District Court held that the

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[4] We have taken judicial notice of the pleadings and transcripts filed in the underlying bankruptcy case by accessing the electronic docketing system. See O'Rourke v. Seaboard Sur. Co. (In re E.R. Fegert, Inc.), 887 F.2d 955, 957-58 (9th Cir. 1989) (noting that the appellate court may take judicial notice of items of record).

[5] The Appellants filed an election to the District Court pursuant to Rule 8001(e)(1) and 28 U.S.C. § 158(c)(1).

bankruptcy court erred in deciding that the AAA Judgment had preclusive effect on the issue of intent when it was not clear from the limited arbitration record that it had been actually litigated. The District Court specifically made "no other findings in regard to the motion for summary judgment."

B. Renewed Motion For Summary Judgment And Trial On Complaint

On October 28, 2009, the Appellants filed a renewed motion for summary judgment (Renewed MSJ) contending that the issue of intent to deceive had been factually established through the Depositions. The Appellants argued that the Debtors' representation of the EKS System's accuracy was false, and because that representation was included in advertisements to promote the sale of the EKS System franchises, the Debtors necessarily intended to deceive potential buyers for their own gain. The Debtors filed a response on October 30, 2009, in which they argued that there was a genuine issue of fact regarding intent because the statements made by the Debtors about the EKS System were made honestly without an intent to harm the Appellants.

A hearing on the Renewed MSJ was held on November 18, 2009. The bankruptcy court denied the Renewed MSJ on December 3, 2009, and entered an Order Setting Trial on Remaining Issue, setting the trial date for December 15, 2009 (the Trial Order). The Trial Order compelled the parties to file (1) trial briefs, (2) any motions in limine, and (3) actual trial exhibits by December 11, 2009.

On December 7, 2009, the Debtors filed a list of witnesses and their exhibits. The Debtors listed themselves and two

other franchisees as witnesses. On December 11, 2009, the Debtors filed their trial brief.

The Appellants filed a trial brief that asserted the Depositions would be used to demonstrate the Debtors' reckless disregard of the truth and a motion in limine objecting to the testimony of the franchisees as being irrelevant to the Debtors' intent. However, the Appellants did not file exhibits or a witness list.

The Debtors filed a motion to exclude the Depositions (Motion to Exclude) based on their contention they were not admissible under Federal Rule of Civil Procedure (FRCP) 32(a)(8) (made applicable in bankruptcy proceedings by Rules 7032 and 9014), regarding the use of depositions in a later action. They also argued that the Depositions were replete with inadmissible hearsay. On December 14, 2009, the Appellants objected to the Debtors' Motion to Exclude and filed several objections to the Debtors' exhibits.

At the December 15, 2009 trial, the Debtors did not appear in person, but only through counsel. The record of the December 15, 2009 hearing is not included in the record (nor available on the bankruptcy court's electronic docketing system); however, according to the Appellants, they offered the Depositions as evidence. The Debtors objected to the use of the Depositions, arguing that they "had no notice" they would be introduced at trial since they were not included in any exhibits submitted to the bankruptcy court. The Debtors contended that there was no evidence properly before the

bankruptcy court to support the Appellants' case and orally moved to dismiss the Complaint (Motion to Dismiss).

At the hearing, the bankruptcy court granted the Appellants' motion in limine, and denied the Debtors' Motion to Exclude.[6] The bankruptcy court did not admit the Depositions but requested further briefing on the Motion to Dismiss. It continued the Trial to February 5, 2010. Orders granting the motion in limine and denying the Motion to Exclude were entered on December 31, 2009.[7]

On January 5, 2010, the Appellants filed a motion for entry of judgment on the merits (Motion for Judgment).[8] The Appellants argued that the Depositions were admissible and authorized under FRCP 32. The Appellants also argued that because the Debtors did not personally appear at the Trial, the Depositions were unrebutted and proved their case. The Appellants argued they were entitled to a default judgment as a sanction for the Debtors' "intentional disobedience of the Court's [Trial Order]" when they failed to appear at the Trial.

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[6] The bankruptcy court's electronic docket minute entry of the hearing on December 15, 2009, states that the Appellants' motion in limine and objections to testimony and evidence was granted for the reasons stated on the record and that the Debtors' Motion to Exclude was denied for the reasons stated on the record.

[7] The Debtors argue that the bankruptcy court abused its discretion in denying the Motion to Exclude. The Panel has no record of the December 15, 2009 hearing at which the bankruptcy court stated its reasons for denying that motion.

[8] The accompanying memorandum to support the motion was filed on January 19, 2010.

On January 6, 2010, the Debtors filed a brief in support of the Motion to Dismiss. The Debtors argued that because the Appellants failed to subpoena the Debtors to provide testimony at Trial, and submitted no other evidence to support their case, they failed to prove the elements of § 523(a)(2)(A). On January 15, 2010, the Debtors also filed a motion for reconsideration of the order denying the Motion to Exclude (the Reconsideration Motion), contending that the bankruptcy court erred in its analysis regarding the admissibility of the Depositions.

On February 5, 2010, the bankruptcy court heard arguments on the Motion for Judgment, the Motion to Dismiss and the Reconsideration Motion. It denied the Reconsideration Motion and admitted the Depositions subject to specific objections of the Debtors. It also denied the Motion to Dismiss and the Motion for Judgment[9] and continued the Trial to March 5, 2010.

On February 19, 2010, the Debtors filed evidentiary objections to the Depositions, to which the Appellants responded on February 25, 2010. At the continued Trial on March 5, 2010, the bankruptcy court reviewed the Debtors' evidentiary objections to the Depositions, but overruled them. The Depositions were admitted in support of the Appellants' case. The Debtors chose not to testify or enter any other exhibits or evidence. The bankruptcy court announced its findings of fact and conclusions of law orally at a continued Trial date of March 16, 2010. On April 21, 2010, it entered an

[9] The orders were entered March 1, 2010.

order holding that the AAA Judgment was dischargeable and dismissing the Complaint (Order Dismissing Complaint). The Appellants timely appealed, and the Debtors filed a timely cross-appeal.

## II. JURISDICTION

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

## III. ISSUES

(1) Did the bankruptcy court err in finding that the Debtors did not intend to deceive the Appellants?

(2) Did the bankruptcy court abuse its discretion in admitting the Depositions?

## IV. STANDARDS OF REVIEW

Whether a claim is dischargeable presents mixed issues of law and fact, which we review de novo. Peklar v. Ikerd (In re Peklar) 260 F.3d 1035, 1037 (9th Cir. 2001). The Ninth Circuit has held that the bankruptcy court's findings made in the context of the dischargeability analysis, including the court's findings with respect to intent to defraud, are factual findings reviewed under the clearly erroneous standard. Candland v. Ins. Co. of N. Am (In re Candland), 90 F.3d 1466, 1469 (9th Cir. 1996). Thus, whether there has been proof of an essential element of a cause of action under § 523(a)(2)(A) is a factual determination reviewed for clear error. Am. Express Travel Related Servs. Co., Inc. v. Vee Vinhnee (In re Vee Vinhnee), 336 B.R. 437, 443 (9th Cir. BAP 2005); Cossu v. Jefferson Pilot Sec. Corp. (In re Cossu), 410 F.3d 591, 595-96 (9th Cir. 2005). A finding is clearly erroneous when "although

there is evidence to support it, the reviewing court on the entire evidence is left with the definite and firm conviction that a mistake has been committed." Anderson v. City of Bessemer City, N.C., 470 U.S. 564, 573 (1985); see also United States v. Loew, 593 F.3d 1136, 1139 (9th Cir. 2010); United States v. Hinkson, 585 F.3d 1247, 1261-62 (9th Cir. 2009) (en banc) (holding that a court's factual determination is clearly erroneous if it is illogical, implausible, or without support in the record).

Evidentiary rulings are reviewed for an abuse of discretion. Kulas v. Flores, 255 F.3d 780, 783 (9th Cir. 2001); In re Vee Vinhnee, 336 B.R. at 442-43. A bankruptcy court's denial of a motion for reconsideration is also reviewed for an abuse of discretion. Zimmerman v. City of Oakland, 255 F.3d 734, 737 (9th Cir. 2001). A bankruptcy court abuses its discretion when it applies the incorrect legal rule or its application of the correct legal rule is "(1) illogical, (2) implausible, or (3) without support in inferences that may be drawn from the facts in the record." United States v. Loew, 593 F.3d at 1139 (quoting United States v. Hinkson, 585 F.3d 1247 at 1261-62); see also Anderson v. City of Bessemer City, N.C., 470 U.S. 564, 577 (1985).

## V. DISCUSSION

### A. The Bankruptcy Court Did Not Err In Entering The Order Dismissing Complaint.

The Bankruptcy Code excepts from discharge any debt for money, property, services, or credit obtained by false pretenses, a false representation, or actual fraud. 11 U.S.C.

§ 523(a)(2)(A). To prevail on a claim under § 523(a)(2)(A), a creditor must demonstrate five elements: (1) misrepresentation, fraudulent omission or deceptive conduct by the debtor; (2) knowledge of the falsity or deceptiveness of the debtor's statement or conduct; (3) an intent to deceive; (4) justifiable reliance by the creditor on the debtor's statement or conduct; and, (5) damage to the creditor proximately caused by its reliance on the debtor's statement or conduct. In re Candland, 90 F.3d at 1469; Turtle Rock Meadows Homewoners Ass'n v. Slyman (In re Slyman), 234 F.3d 1081, 1085 (9th Cir. 2000).

The creditor bears the burden of proving each element of § 523(a)(2)(A) by a preponderance of the evidence. Grogan v. Garner, 498 U.S. 279, 287 (1991). In order to strike a balance between allowing debtors a fresh start and preventing a debtor from retaining the benefits of property obtained by fraudulent means, § 523(a)(2)(A) is strictly construed against creditors and in favor of debtors. In re Slyman, 234 F.3d at 1085; Ghomeshi v. Sabban (In re Sabban), 384 B.R. 1, 5 (9th Cir. BAP 2008), aff'd, 600 F.3d 1219, 1222 (9th Cir. 2010).

At issue in this case is whether the Appellants established that the Debtors intended to deceive them when they represented that the EKS System had a "Proven Ability to Accurately Estimate Well Yield Within a 25% Margin and The Ability to Estimate Well Depth Within a 10%-20% Margin!"

Because direct evidence of intent to deceive is rarely available, "the intent to deceive can be inferred from the totality of the circumstances, including reckless disregard for the truth." Gertsch v. Johnson & Johnson, Fin. Corp. (In re

Gertsch), 237 B.R. 160, 167-68 (9th Cir. BAP 1999); Household Credit Servs., Inc. v. Ettell (In re Ettell), 188 F.3d 1141, 1145 n.4 (9th Cir. 1999) ("reckless conduct could be sufficient to establish fraudulent intent"); Houtman v. Mann (In re Houtman), 568 F.2d 651, 656 (9th Cir. 1978)[10]("Reckless indifference to the actual facts, without examining the available source of knowledge which lay at hand, and with no reasonable ground to believe that it was in fact correct is sufficient to establish the knowledge element."). Thus, a bankruptcy court may find the requisite intent "where there has been a pattern of falsity or from a debtor's reckless indifference to or disregard of the truth." Khalil v. Developers Sur. and Indem. Co. (In re Khalil), 379 B.R. 163, 174-75 (9th Cir. BAP 2007) (discussing intent to deceive in the context of § 727(a)).

The only evidence submitted at Trial was the Depositions. The Appellants argued that the Depositions demonstrated the Debtors knew that the EKS System had not been proven to perform as represented and, therefore, they acted with reckless disregard of the truth. The Debtors responded that they qualified that representation by stating that, based on their experiences with the EKS System, it had the ability to accurately perform within the percentages stated in the advertisement.

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[10] Houtman also held that collateral estoppel did not apply in § 523 proceedings. This aspect of Houtman was overruled by Grogan v. Garner, 498 U.S. 279, 284 (1991).

The bankruptcy court found that "it [was] clear from Mr. Kraemer's deposition that the stated accuracy reflected his understanding of how well the system could work based on his own experience" and not on rigorous scientific or statistical analysis. It determined, using a totality of the circumstances analysis, that the representation alone was insufficient to establish that the Debtors acted with a reckless disregard of the truth to satisfy the scienter requirement of § 523(a)(2)(A). Based on our review of the record, we cannot say that the bankruptcy court's finding is illogical, implausible, or without support in the record.

"Deciding when misrepresentations cross the line from negligence to reckless disregard is an inherently subjective process." Wolf v. McGuire (In re McGuire), 284 B.R. 481, 493 (Bankr. D. Colo. 2002). Even if we may have simply weighed the evidence differently as the trier of fact, we may not reverse the bankruptcy court's factual finding. Anderson v. City of Bessemer City, N.A., 407 U.S. at 573-74.

Furthermore, recklessness alone does not equate to fraudulent intent; it is only probative of intent. In re Khalil, 379 B.R. at 174. "The essential point is that there must be something about the adduced facts and circumstances which suggests that the debtor intended to deceive" the creditor. Id. at 175. As the court noted in In re McGuire, the focus must be on "the totality of the circumstances and whether they create the overall impression of a deceitful debtor." 284 B.R. at 493.

We disagree with the Appellants that the Depositions compel a singular conclusion of intent to deceive. Throughout the Depositions, the Debtors stated their belief in the accuracy of the EKS System based on their own research and experience. They admitted the research was not scientific and acknowledged that there were many variables that could skew the results, such as improper operation of the equipment, improper data collection, or substandard drilling conditions. Thus, the Debtors stated they used the word "ability" in the advertisement as a qualifier. The Debtors maintained their position that the EKS System's accuracy was not misrepresented because they believed the EKS System had the ability to function within the percentages of accuracy that they represented. Overall, the Depositions do not demonstrate that the Debtors had no basis for their belief in the stated accuracy of the EKS System. Neither do the Depositions demonstrate that the Debtors knew critical facts concerning the EKS System's lack of accuracy and knowingly made repeated false representations or consciously withheld important information about its accuracy in order to entice customers to purchase franchises. See, e.g., Idaho v. Edwards (In re Edwards), 233 B.R. 461, 478-79 (Bankr. D. Idaho 1999); In re McGuire, 284 B.R. at 494.

We conclude that the bankruptcy court's finding that the Debtors did not intend to deceive the Appellants when they made the representation about the accuracy of the EKS System was logical, plausible, and supported by the record. As a result, the Appellants failed to prove all the elements needed under

§ 523(a)(2)(A). Accordingly, we conclude that the bankruptcy court did not err in entering the Order Dismissing Complaint.

The Appellants also assign error to the bankruptcy court's denial of their Renewed MSJ and the denial of the Motion for Judgment. These orders were interlocutory and merged into the final order on the merits. However, the Appellants argue that the Motion for Judgment was not based on the merits but instead on a request for sanctions due to the Debtors' failure to appear at Trial. The Trial Order did not require the Debtors to appear; the Debtors did not intentionally disobey a scheduling order. As a result, no default judgment or other sanction was appropriate.

B. The Debtors Were Not Prejudiced By The Admission Of The Depositions.

On cross-appeal, the Debtors assert that the bankruptcy court abused its discretion in admitting the Depositions into evidence. The Debtors assign error to the bankruptcy court's denial of the Motion to Exclude, the Reconsideration Motion and the Motion to Dismiss. To reverse an evidentiary ruling, we must conclude that the bankruptcy court both abused its discretion and that the error was prejudicial. Latman v. Burdette, 366 F.3d 774, 786 (9th Cir. 2004); Fed. R. Evid. 103(a).

Like the orders denying the Renewed MSJ and the Motion for Judgment, the Motion to Exclude, Reconsideration Motion and Motion to Dismiss were interlocutory orders that merged into the final decision on the merits. Therefore, we have jurisdiction to review them. However, because we have

concluded that the Appellants did not establish the nondischargeability of the AAA Judgment even with the use of the Depositions, the Debtors were not prejudiced by their admission. Accordingly, we need not determine whether the bankruptcy court abused its discretion in admitting the Depositions. Similarly, the bankruptcy court's denial of the Reconsideration Motion did not prejudice the Debtors. Therefore, we decline to review its merits.

## VI. CONCLUSION

For the foregoing reasons we AFFIRM the bankruptcy court.