FILED

AUG 12 2011

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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NOT FOR PUBLICATION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

In re:	BAP No. CC-10-1258-PaKiSa
DANNY WAYNE PRYOR,	Bk. No. 09-23842-BR
Debtor.	Adv. No. 09-2322-BR
DANNY WAYNE PRYOR,	
Appellant,	
v.	**M E M O R A N D U M**[1]
ITEC FINANCIAL, INC.,	
Appellee.	

Argued and Submitted on May 13, 2011
at Pasadena, California

Filed - August 12, 2011

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

Honorable Barry Russell, Bankruptcy Judge, Presiding

Appearances: Appellant Danny Wayne Pryor appeared pro se. David Brian Lally appeared for appellee ITEC Financial, Inc.

Before: PAPPAS, KIRSCHER and SARGIS[2], Bankruptcy Judges.

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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.

[2] The Honorable Ronald H. Sargis, U.S. Bankruptcy Judge for the Eastern District of California, sitting by designation.

Chapter 7[3] debtor Danny Wayne Pryor ("Pryor") appeals the decision of the bankruptcy court granting a default judgment determining that his debt to creditor ITEC Financial, Inc. ("ITEC") is excepted from discharge under § 523(a)(2), and denying him a discharge under §§ 727(a)(2), (3), (4) and (5). We AFFIRM the bankruptcy court's decision to except the ITEC debt from discharge under § 523(a)(2)(A). However, we VACATE the court's denial of Pryor's discharge under § 727(a)(2), (3), (4) and (5) and REMAND this matter to the bankruptcy court for entry of an amended judgment.

FACTS

ITEC is a California corporation engaged in the business of real estate investments, construction and loan funding in Los Angeles. Pryor is a general contractor and real estate developer.

In 2006 and 2007, ITEC and Pryor engaged in three separate projects for the development of real estate owned by Pryor. ITEC loaned Pryor, directly or through one of his controlled companies, $6,725,000 to develop the projects, prepare plans and obtain city approval, and construct the projects.

<u>The Avenue J-4 Property ("J-4")</u>. On March 8 and May 19, 2006, American Commodities Real Estate Securities, Inc., ("ACRES"), a company wholly owned by Pryor, executed and delivered to ITEC two promissory notes for $550,000 and $425,000, respectively. The notes were secured by deeds of trust in favor

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[3] Unless otherwise indicated, all chapter, section and rule references are to the Bankruptcy Code, 11 U.S.C. §§ 101-1532, and to the Federal Rules of Bankruptcy Procedure, Rules 1001-9037. The Federal Rules of Civil Procedure are referred to as "Civil Rules."

of ITEC relating to the J-4 property. The loans were intended to supply the funds to construct a condominium project on the property. On May 19, 2006, Pryor executed a personal guaranty of the J-4 loans.

South 26th Street Property ("South 26"). On April 25, 2006, Pryor personally executed a promissory note in favor of ITEC for $1,500,000, together with a deed of trust to ITEC relating to the South 26th Street property. This loan was for construction of a private residence.

The 23 Lots in Lancaster, California ("23 Lots"). On May 2, 2006, AKP Development, Inc., Pryor's wholly-owned company, executed a note for $3,500,000 in favor of ITEC with accompanying deed of trust to ITEC relating to the 23 Lots. This loan was intended to fund construction of twenty-three private residences.[4] The same date, Pryor executed a personal guarantee of the 23 Lots loan.

Between 2006 and 2007, ITEC alleges that Pryor made repeated representations to ITEC that he had secured approval from the appropriate government agencies for the construction plans for all three projects. ITEC has shown, and Pryor has failed to prove otherwise, that no approvals were ever granted for these plans. Further, the evidence shows Pryor made frequent representations to ITEC that he had obtained a completion bond for the projects, and ITEC has shown that a bond was never obtained. Again, Pryor has

[4] On March 25, 2008, Pryor executed and recorded a Claim of Mechanics' Lien as to each of the three project properties totaling over $4.5 million. These lien claim are only relevant in this appeal because Pryor failed to list them as assets in his schedules.

not proven otherwise.

Senior deeds of trust to those held by ITEC had been granted to other lenders on each of the projects. ITEC alleges, and Pryor does not dispute, that Pryor failed to make any loan payments to ITEC or any senior lender on the three projects.

ITEC alleges that, between 2006 and 2007, Pryor drew a total $2.9 million from the various ITEC construction loan funds. ITEC also argues that Pryor failed to account to ITEC for his use of these funds.

On March 25, 2008, Pryor as president of ACRES, executed and recorded several notices claiming mechanics' liens against the three properties, representing that ACRES and another of his controlled companies, Turnkey Development, Inc., furnished work on the properties but had not been paid: a claim against the J-4 property for $1,800,000; against the 23 Lots property for $1,400,000; and against the South 26 property for $1,500,000.

On March 28, 2008, Pryor filed a chapter 11 petition. This bankruptcy case was dismissed on May 21, 2008, for cause under § 1112(b) in an order by the bankruptcy court containing a one-year bar to filing another bankruptcy petition. In clear violation of that order, Pryor nonetheless filed a chapter 7 petition on March 9, 2009. That case was also promptly dismissed on May 5, 2009.

On June 7, 2009, Pryor filed yet another chapter 7 petition, initiating the bankruptcy case involved in this appeal. Attached to Pryor's Schedule F is a list of pending lawsuits, including one captioned ITEC v. Danny Pryor; no other information was provided about this action.

On October 13, 2009, ITEC filed a Complaint to Deny Discharge Pursuant to 11 U.S.C. § 523 and § 727. ITEC asserted that its claim against Pryor should be excepted from discharge under § 523(a)(2) because he fraudulently obtained "money, property, services, or an extension, renewal, or refinancing of credit to the Debtor obtained by (A) false pretenses, a false representation, and actual fraud, through the use of a statement in writing that is materially false; respecting the debtor's on which Plaintiff reasonably relied; and with which the debtor caused to be made or published with intent to deceive."[5] ITEC also asserted grounds for denial of discharge under § 727(a)(2), (3), (4) and (5).

Pryor filed an answer on December 24, 2009, generally denying the allegations in the complaint.[6]

On December 29, 2009, ITEC filed a Unilateral Status Report indicating that it had had no communications with Pryor about the adversary proceeding and Pryor had not met and conferred as required pursuant to Bankr. C.D. Cal. L.R. 7026-1.

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[5] As discussed later, this allegation is an attempt to paraphrase the relevant Code provisions, but instead conflates § 523(a)(2)(A) and (B), and the allegation omits the critical phrase "respecting a debtor's financial condition" found in subsection (B).

[6] Pryor initially moved to dismiss ITEC’s complaint under Civil Rule 12(b)(6), arguing that under Rule 4004(a), a complaint objecting to discharge must be filed no later than 60 days after the first date set for the meeting of creditors. Pryor later withdrew his motion, apparently because the bankruptcy court had approved a stipulation between another creditor and the Chapter 7 trustee on August 10, 2009, extending the deadline for objections to discharge to October 12, 2009. Since October 12 was Columbus Day, a national holiday recognized in Rule 9006(a)(6)(A), ITEC’s filing of its complaint the next day, on October 13, was timely.

The bankruptcy court conducted a status conference on January 13, 2010. ITEC was present but Pryor failed to appear. Consequently, on February 1, 2010, the court entered its Order to Show Cause why Pryor's answer should not be stricken and default judgment entered. The OSC recited that Pryor had not cooperated in the preparation of, or responded to, the proposed Joint Status Report, and that Pryor had not appeared at the January 13, 2010 status conference. The OSC ordered Pryor to appear before the bankruptcy court on March 16, 2010, to explain why his answer should not be stricken and default judgment entered against him. Finally, the bankruptcy court directed that if Pryor had any response to the OSC, it must be filed by March 2, 2010.

On March 11, 2010, ITEC filed its second Unilateral Status Report. ITEC repeated that there still had not been any communications with Pryor, that Pryor had not complied with the meet and confer requirements of Local Rule 7026-1, and that Pryor had not responded to any discovery requests.

The day before the scheduled hearing, on March 15, Pryor filed a response to the OSC. He apologized to the bankruptcy court for his failure to appear at the status conference, pleading ignorance and failure to note the hearing date on his calendar. As an appendix to his response, he included his information for inclusion in the Joint Status Report, and also disputed that he had had no communications with ITEC’s attorney. According to Pryor, he sent a letter to counsel on February 17, 2010, indicating that he was preparing a large volume of discovery documents for ITEC. Most importantly, Pryor’s response to the OSC alleged that he had provided all the documents requested to ITEC’s counsel in the state court litigation between ITEC and Pryor, Pryor v. ITEC, case no. MC 01967 (Los Angeles Superior Court), and that counsel for ITEC in that action (who was not the attorney in the bankruptcy court litigation) had acknowledged receipt of the discovery requests.

The OSC hearing was held on March 16, 2010. ITEC was represented by counsel and Pryor appeared pro se. As reflected in the hearing transcript, the attorney for ITEC informed the bankruptcy court that Pryor's response to the OSC was only received the previous afternoon, two weeks beyond the deadline set by the court, Hr'g Tr. 3:24-25 (March 16, 2010); that, despite Pryor's claims, Pryor had not responded to ITEC's discovery, Hr'g Tr. 15:8; and that it was inappropriate that discovery material, if sent at all, had been directed by Pryor to a different attorney, in a different litigation, in a different court, Hr'g Tr. 4:20-24.

The bankruptcy court did not believe Pryor's representation that he had responded to the ITEC discovery requests.

> THE COURT: You say you gave discovery. The fact is its not happening, Mr. Pryor.
>
> PRYOR: Your Honor, I provided [ITEC's attorney] with over 400 pages of documentation, and this is not new information. . . . [ITEC's attorney] has received an enormous amount —
>
> THE COURT: In this case?
>
> PRYOR: In this case.
>
> THE COURT: Well, not according to [ITEC's attorney].

Hr'g Tr. 8:24—9:12.

> THE COURT: But, the problem is, Mr. Pryor, you haven't complied with any of the rules. . . . I am going to grant the OSC as far as to strike your answer.

Hr’g Tr. 17:25–18:1, 18:21.

The bankruptcy court directed ITEC’s counsel to prepare an order striking Pryor's Answer, directing the entry of default, and scheduling a prove-up hearing to consider entry of a default judgment against Pryor. Hr’g Tr. 20:10-12. An order granting such relief was entered on March 24, 2010, which recited that Pryor’s answer was stricken for not appearing at the status conference and his failure to cooperate in the discovery process. The order provided that any opposition by Pryor to default judgment must be filed at least fourteen days before the prove-up hearing.

Pryor filed a motion for reconsideration of the order striking his Answer on March 25, 2010. The gist of his motion was that the bankruptcy court should consider the arguments he made in his opposition to default filed the day before the OSC hearing on March 16. ITEC did not file an opposition to the motion. The bankruptcy court denied the motion for reconsideration on April 2, 2010, stating that “good cause” had not been shown for either reconsideration or vacatur of the order. The order denying reconsideration was not appealed.

ITEC filed its motion for default judgment on June 5, 2010. ITEC supported the motion with the declaration of Nina Patel, president of ITEC (the "Patel Declaration"). The motion, with its extensive declaration and exhibits, sought entry of a nondischargeable fraud judgment in favor of ITEC and against Pryor under § 523(a)(2), and denial of Pryor’s discharge under § 727(a)(2), (3), (4) and (5).

Pryor responded to this motion on June 30, 2010, the day of the prove-up hearing, but his response did not address any of the representations contained in the Patel Declaration. Moreover, this response was filed two weeks after the deadline set by the bankruptcy court for oppositions.[7]

At the prove-up hearing, the bankruptcy court heard from both Pryor and ITEC's attorney. At the end of the hearing, the court stated, "This is an unfortunate case for everybody, Mr. Pryor. But I agree [with ITEC], I will grant the motion for a default judgment." Hr'g Tr. 23:20-22 (June 30, 2010).

Judgment was entered on July 30, 2010. The judgment against Pryor awarded ITEC $11,414,788.21, comprised of actual monetary damages resulting from the three loans, including principal, interest, late fees, legal fees, foreclosure fees, advances to senior lienholders, and property taxes.[8] It determined that this debt was excepted from discharge under § 523(a)(2). The judgment also denied Pryor's discharge under § 727(a)(2), (3), (4) and (5).

Pryor filed a timely appeal.

JURISDICTION

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

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[7] The proof of service attached to Pryor's opposition was dated April 2, 2010. This was obviously incorrect because the opposition purported to challenge the default judgment motion and the Patel Declaration, which were filed on June 5, 2010.

[8] Pryor has not challenged the amount or computation of the damage award in this appeal.

ISSUES

Whether the bankruptcy court abused its discretion in directing entry of default or in its decision to enter a default judgment.

Whether the bankruptcy court erred in determining that ITEC's claim was nondischargeable under § 523(a)(2).

Whether the bankruptcy court erred in denying Pryor's discharge under §§ 727(a)(2), (3), (4) and (5).

STANDARDS OF REVIEW

A trial court’s decision to order entry of default, or to enter default judgment, is reviewed for abuse of discretion. Speiser, Krause & Madole, P.C. v. Ortiz, 271 F.3d 884 , 886 (9th Cir. 2001).

Whether a claim is excepted from discharge under § 523(a) presents mixed issues of law and fact and is reviewed de novo. Barboza v. New Form, Inc. (In re Barboza), 545 F.3d 702, 704 (9th Cir. 2008); Wolkowitz v. Beverly (In re Beverly), 374 B.R. 221, 230 (9th Cir. BAP 2007), aff'd in relevant part, 551 F.3d, 1092 (9th Cir. 2008).

On appeal of a denial of discharge under § 727(a), the bankruptcy court's determinations of the historical facts are reviewed for clear error; its selection of the applicable legal rules under § 727(a) is reviewed de novo; and its application of the facts to the applicable rules is reviewed de novo because it requires the exercise of judgment about values animating those rules. Murray v. Bammer (In re Bammer), 131 F.3d 788, 791-92 (9th Cir. 1997)(en banc); Searles v. Riley (In re Searles), 317 B.R.

368, 373 (9th Cir. BAP 2004).

In applying an abuse of discretion test, we first "determine de novo whether the [bankruptcy] court identified the correct legal rule to apply to the relief requested." United States v. Hinkson, 585 F.3d 1247, 1262 (9th Cir. 2009). If the bankruptcy court identified the correct legal rule, we then determine whether its "application of the correct legal standard [to the facts] was (1) illogical, (2)implausible, or (3) without support in inferences that may be drawn from the facts in the record." Id. (internal quotation marks omitted). If the bankruptcy court did not identify the correct legal rule, or its application of the correct legal standard to the facts was illogical, implausible, or without support in inferences that may be drawn from the facts in the record, then the bankruptcy court has abused its discretion. Id.

“Under the ‘clear error’ standard, we accept findings of fact unless they leave the ‘definite and firm conviction that a mistake has been committed.’” In re Beverly, 374 B.R. at 230.

DISCUSSION

I.

The bankruptcy court did not abuse its discretion in striking Pryor’s Answer and directing entry of default.

Civil Rule 37(b)(2)(A), made applicable in bankruptcy adversary proceedings by Rule 7037, provides that “[i]f a party fails to obey an order to provide or permit discovery, the court where the action is pending may issue just orders [including] . . . (iii) striking pleadings in whole or in part; . . .

(vi) rendering a default judgment against the disobedient party." The Ninth Circuit has long recognized a bankruptcy court's authority under Civil Rule 37(b) to strike a debtor's answer and enter default. Visioneering Constr. v. U.S. Fidel.& Guar. (In re Visioneering Constr.), 661 F.2d 119, 122 (9th Cir. 1981) (affirming the bankruptcy court's imposition of Rule 37 sanctions, including striking the answer and entering default, for the debtor's "obstructionist and delaying tactics" in discovery); Brunson v. Rice (In re Rice), 14 B.R. 843, 846 (9th Cir BAP 1981) (bankruptcy court may strike answer and enter default under Civil Rule 37(b) for discovery abuses).

As a preliminary matter, before considering the imposition of severe sanctions, the Ninth Circuit requires that a party's sanctionable conduct be the result of the "willfulness, bad faith, or fault" of the party. Jorgensen v. Cassiday, 320 F.3d 906, 912 (9th Cir. 2003). In the context of sanctions, "willfulness is disobedient conduct not outside the control of the litigant." Henry v. Gill Indus., Inc., 983 F.2d 943, 948 (9th Cir. 1993). Pryor has never suggested that his failure to participate in discovery or attend meetings was caused by some external force. In fact, he apologized for failing to attend the status conference because he did not enter it on his calendar. His defense to ITEC's claims of discovery abuse was that he had already provided the material in the state court action. In short, there is no question that Pryor's conduct was willful.

Before entering a "severe sanction," which includes striking an answer, directing entry of default, entering default judgment, or dismissal as a sanction, the Ninth Circuit requires consideration of the following criteria:

> We have constructed a five-part test, with three subparts to the fifth part, to determine whether a case-dispositive sanction under Rule 37(b)(2) is just: "(1) the public's interest in expeditious resolution of litigation; (2) the court's need to manage its dockets; (3) the risk of prejudice to the party seeking sanctions; (4) the public policy favoring disposition of cases on their merits; and (5) the availability of less drastic sanctions." (Quoting Jorgensen v. Cassiday, 320 F.3d 906, 912 (9th Cir. 2003) (quoting Malone v. U.S. Postal Serv., 833 F.2d 128, 130 (9th Cir. 1987)). The sub-parts of the fifth factor are whether the court has considered lesser sanctions, whether it tried them, and whether it warned the recalcitrant party about the possibility of case-dispositive sanctions. This "test" is not mechanical. It provides the district court with a way to think about what to do, not a set of conditions precedent for sanctions or a script that the district court must follow[.]

Conn. Gen. Life Ins. Co. v. New Images of Beverly Hills, 482 F.3d 1091, 1096 (9th Cir. 2007); Computer Task Group v. Brotby, 364 F.3d 1112, 1115 (9th Cir. 2004).

The five-part test applies whenever the court is considering severe sanctions, not only to discovery sanctions under Civil Rule 37(b). Although the New Images court traces the five-part test to the Malone case in 1987, the test actually originated at least a year earlier in Henderson v. Duncan, 779 F.2d 1421, 1424 (9th Cir. 1986). The Henderson case is of particular interest, because it applied the test and sanctioned the party for dilatory tactics and failure to comply with local rules. The bankruptcy court in this appeal sanctioned Pryor for both discovery abuses and for failure to attend scheduled conferences. Consequently, we may apply the five-part test in this appeal.

The first two criteria focus upon the public interest in expeditious resolution of litigation, and the trial court’s interest in docket control. Both of these factors clearly favor imposition of sanctions under these facts. Pryor had an established track record of improper and dilatory conduct in the bankruptcy court. He had filed multiple bankruptcy cases, one of which violated the bankruptcy court's clear time bar; he sought dismissal of this action arguing it was untimely when the bankruptcy court had already granted an extension of time to file such complaints; he failed to attend a compulsory status conference though he had received notice of the hearing; he failed to comply with Local Rule 7026-1 regarding meet and confer requirements; and he had generally failed to properly respond to ITEC's discovery requests. In short, Pryor's conduct significantly impeded resolution of this action, caused delay, and prevented the bankruptcy court from adhering to its trial schedule.

The third criteria is the risk of prejudice to the party seeking sanctions. There is clear evidence of prejudice to ITEC. The bankruptcy court found, after issuance of an OSC to Pryor, that he had failed to provide responses to discovery requested by ITEC and that ITEC was prejudiced by Pryor's refusal to provide the discovery responses and his failure to attend court hearings. A party is prejudiced if the opposing party impairs its ability to go to trial. Adriana Int'l Corp. v. Thoeren, 913 F.2d 1406, 1412 (9th Cir. 1990); Chism v. Nat'l Heritage Life Ins. Co., 637 F.2d 1328, 1331 (9th Cir. 1981) (indicating that defendant had been prejudiced by plaintiff's continual flouting of discovery rules, and failure to comply with pretrial conference obligations).

The fourth criterion is the public policy favoring decisions on the merits. On its surface, this criterion would seem to be opposed to imposing sanctions that would end the dispute. But we note that the court struck the answer and directed entry of default, but did not enter default judgment at this stage. Consequently, there was still an opportunity for Pryor in the prove-up hearing to challenge the merits of ITEC's case.

Finally, the fifth criterion is the availability of less drastic sanctions. The court of appeals instructs us that this criterion has three subparts: whether the court has considered lesser sanctions, whether it tried them, and whether it warned the recalcitrant party about the possibility of different sanctions. New Images of Beverly Hills, 482 F.3d at 1096. Pryor had clear warning of the sanctions that could be imposed, because the OSC indicated that striking the answer, directed entry of default, and entry of default judgment were under consideration. The court struck the answer and directed entry of default, but did not impose the more drastic sanction of default judgment. The court exercised its discretion and ruled that a prove-up hearing would be required. Later, at the prove-up hearing, Pryor's right to be heard was challenged, but the court allowed Pryor to appear and contest ITEC's arguments. We are confident in concluding that the bankruptcy court considered the availability of lesser sanctions, and indeed employed the lesser sanction of striking the answer and entering default, deferring consideration of the greater sanction of default judgment to a hearing where Pryor would have the opportunity to be heard again.

The bankruptcy court did not abuse its discretion in striking Pryor's answer and ordering entry of default.

II.

The bankruptcy court did not err in granting default judgment to ITEC for an exception to discharge under § 523(a)(2)(A).

In its complaint, ITEC asked the bankruptcy court to order that its claim against Pryor be excepted from discharge under § 523(a)(2). The complaint did not specify whether ITEC sought relief under subsection (A) or (B) of § 523(a). The complaint alleged fraud occurred when Pryor "obtained by (A) false pretenses, a false representation, and actual fraud, through the use of a statement in writing that is materially false. . . and with which the debtor caused to be made or published with intent to deceive." This allegation conflates the two prongs of § 523(a)(2). Although a writing that is not a statement of the debtor's financial condition could possibly be a false representation under § 523(a)(2)(A), the (A) subsection does not require that such a writing be either materially false or published. That the complaint also eliminated the critical phrase "respecting the debtor's . . . financial condition" would also suggest that the complaint did not seek nondischargeabiilty under § 523(a)(2)(B). Subsection (B) unambiguously requires a false writing respecting the debtor's financial condition. Boyajian v. New Falls Corp. (In re Boyajian), 564 F.3d 1088, 1091 (9th Cir. 2009) (§ 523(a)(2)(B) only applies where the debt was obtained by means of a materially false written financial statement as to the debtor's financial condition).

Finally, the information submitted by ITEC to the bankruptcy court included no written financial condition statements of Pryor. The complaint, and the declaration submitted by ITEC, together with the bankruptcy court's judgment, all refer to § 523(a)(2) without explicit reference to the subsection. However, both the complaint and Patel Declaration assert that Pryor made numerous false representations that resulted in injury to ITEC.

> No building plans were completed correctly and approved by city as promised, no completion bond was purchased as promised.

Complaint at ¶ 8.

> The Debtor failed to disclose that his building Plans for the various projects were never approved by the City, despite the Debtor's representations to ITEC to the contrary.

Patel Declaration at ¶ 21.

> No building Plans were completed correctly or approved by the City as promised by the Debtor, no building permits [were] obtained as promised by the Debtor, no completion bond was purchased as promised by the Debtor.

Patel Declaration at ¶ 27.

Because these facts relate to misrepresentations, and not to any false written statements about Pryor's financial condition, we construe ITEC's request to be one for an exception to discharge under 523(a)(2)(A).

The exception to dischargeability of debts under § 523(a)(2)(A) is intended to "strike a balance" between competing goals. Ghomeshi v. Sabban (In re Sabban), 600 F.3d 1219, 1222 (9th Cir. 2010). In order to avoid impairing a debtor's fresh start, the exception "should be construed strictly against creditors and in favor of debtors." Klapp v. Landsman (In re Klapp), 706 F.2d 998, 999 (9th Cir. 1983). On the other hand, Congress created the exception "to prevent a debtor from retaining the benefits of property obtained by fraudulent means and to ensure that the relief intended for honest debtors does not go to dishonest debtors." Turtle Rock Meadows Homeowners Ass'n v. Slyman (In re Slyman), 234 F.3d 1081, 1088 (9th Cir. 2000). In describing the reach and purpose of the exception, the Supreme Court has remarked that it is “unlikely that Congress . . . would have favored the interest in giving perpetrators of fraud a fresh start over the interest in protecting victims of fraud." Grogan v. Garner, 498 U.S. 279, 287 (1991). To support a claim of nondischargeability under § 523(a)(2)(A) requires the creditor to prove five elements: (1) the debtor made . . . representations; (2) that at the time he knew they were false; (3) that he made them with the intention and purpose of deceiving the creditor; (4) that the creditor relied on such representations; and (5) that the creditor sustained the alleged loss and damage as the proximate result of the misrepresentations having been made. In re Sabban, 600 F.3d at 1222.

Although the bankruptcy court struck Pryor's Answer and directed entry of default, entry of a default does not necessarily entitle a plaintiff to a default judgment. Cashco Fin. Servcs. v McGee (In re McGee), 359 B.R. 764, 773 (9th Cir. BAP 2006). Whether to enter default judgment requires the exercise of discretion by the bankruptcy court, and that it consider, inter alia, "the merits of the substantive claim and the sufficiency of the complaint.” All Points Capital Corp. v. Meyer (In re Meyer), 373 B.R. 84, 88 (9th Cir. BAP 2007). Whether to hold a prove-up hearing before entering a default judgment is within the discretion of the bankruptcy court. In re McGee, 359 B.R. at 773. The bankruptcy court elected to hold a prove-up hearing, examining the complaint, the Patel Declaration, and Pryor's Opposition.

ITEC presented evidence to the bankruptcy court that Pryor had informed ITEC that the city had approved the construction plans, he had obtained the required permits, and he had obtained a construction bond. ITEC presented evidence that Pryor’s representations were false. Since Pryor represented to ITEC that plans, permits and the bond were in place, when in fact they were not, the bankruptcy court could infer that Pryor acted with fraudulent intent. Ormsby v. First Am. Title Co. (In re Ormsby), 591 F.3d 1199, 1206 (9th Cir. 2010) (“Fraudulent intent . . . may be inferred from the totality of the circumstances and the conduct of the person accused.”). ITEC presented evidence that the lack of the permits and plan approvals resulted in code violations and fines from the City, and the lack of a construction bond and permits prevented Pryor, or another contractor, from completing the projects, resulting in the effective loss of ITEC’s investment.

The bankruptcy court had ample evidence from the complaint and Patel Declaration supporting nondischargeability of Pryor’s debt to ITEC under § 523(a)(2)(A). Pryor did not effectively address any of the nondischargeability arguments raised in the complaint or Patel Declaration. We agree and conclude that the bankruptcy court did not err in determining that ITEC’s claim was nondischargeable under § 523(a)(2)(A).

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III.

<u>The bankruptcy court erred in denying discharge under § 727(a)(2), (3), (4) and (5)</u>.

<u>§ 727(a)(4)(A)</u>

There is considerable confusion in both the complaint and Patel Declaration regarding ITEC's position concerning ITEC's claim to deny Pryor a discharge under § 727(a)(4).[9] The complaint alleges, in relevant part,

> The Debtor, knowingly and fraudulently, in or in connection with the case — (A) made a false oath or account; (B) presented or used a false claim; and (D) withheld from an officer of the estate entitled to possession under this title, recorded information, including books, documents, records and papers, relating to the Debtor's property or financial affairs as alleged herein with respect to the Construction Loan Draws, the Acres Inc., Dan Pryor and Turkeys developments Account Withdrawals, the Royrp payments, and the Missing Vehicles.

Complaint at ¶ 28.

Besides denial of discharge under § 727(a)(4)(A), the complaint and Patel Declaration also request denial of discharge under § 727(a)(4)(B) and (D). Complaint at ¶ 28; Patel Declaration at ¶¶ 24, 48 and 50. However, nowhere in the

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[9] 727. **Discharge**

> (a) The court shall grant the debtor a discharge, unless — . . .
>
> (4) the debtor knowingly and fraudulently, in or in connection with the case–
>
> (A) made a false oath or account;
>
> (B) presented or used a false claim; . . . [or]
>
> (D) withheld from an officer of the estate entitled to possession under this title, any recorded information, including books, documents, records, and papers, relating to the debtor's property or financial affairs[.]

complaint, Patel Declaration, or anywhere in the record of this appeal, is there proof that Pryor ever used or presented a false claim. Further, there are no facts anywhere in the record to show that the bankruptcy trustee had requested documents that Pryor failed to provide. Indeed, Pryor stated that he met with the trustee and amended his schedules to comply with the trustee's requests. Hr'g Tr. 18:22-25 (June 30, 2010). There is also no mention in the complaint of any mechanics liens. Since denial of discharge under § 727(a)(4)(B) and (D) is not supported anywhere in the record, we will consider ITEC's argument only as to § 727(a)(4)(A) — made a false oath or account.

At the June 30, 2010 hearing, counsel for ITEC noted that Pryor's failure to list almost $5 million in mechanics' liens he had filed against the construction projects on his bankruptcy schedules was "the best evidence" that Pryor had failed to provide information on his significant assets. Hr'g Tr. 14:15-16 (June 30, 2010). This argument is supported by the Patel Declaration, detailing the history of the mechanics' liens, and providing documentary evidence that Pryor had executed them. Patel Declaration at ¶¶ 3-19, 38.

Section 521 requires all debtors to "file a list of creditors, and unless the court orders otherwise, a schedule of assets and liabilities, a schedule of current income and current expenses, and a statement of the debtor's financial affairs." Rule 1008 requires that "[a]ll petitions, lists, schedules, statements and amendments thereto shall be verified or contain an unsworn declaration as provided in 28 U.S.C. § 1746." A false statement in, or an omission from, the debtor's bankruptcy schedules or statement of financial affairs can constitute a false oath. Searles v Riley (In re Searles), 317 B.R. at 368, 377 (9th Cir. BAP 2004).

To prevail on a § 727(a)(4)(A) claim based on a false oath, the plaintiff must show: "(1) the debtor made a false oath in connection with the case; (2) the oath related to a material fact; (3) the oath was made knowingly; and (4) the oath was made fraudulently." Roberts v. Erhard (In re Erhard), 331 B.R. 876, 882 (9th Cir. BAP 2005), aff'd, 241 Fed. Appx. 420 (9th Cir. 2005); see also Fogal Legware of Switz., Inc. v. Wills (In re Wills), 243 B.R. 58, 62 (9th Cir. BAP 1999).

Pryor signed his petition and schedules, certifying under penalty of perjury that they were true and correct. He did not disclose the existence of the mechanics' liens in his schedules. However, two months before filing his bankruptcy petition, Pryor sought enforcement of the three mechanics' liens in the state court to recover $4.4 million. During the course of the bankruptcy proceeding, he vigorously defended the merits of those mechanics' liens, asserting that they were earned and significant. Thus, it appears that Pryor may have made a false oath in his initial petition by failing to include the mechanics' liens.

Materiality for these purposes is broadly defined: "A false statement is material if it bears a relationship to the debtor's business transactions or estate, or concerns the discovery of assets, business dealings, or the existence and disposition of the debtor's property." Roberts, 331 B.R. at 883. Arguably, Pryor's rights to enforce a multi-million dollar group of liens is material, because his recovery could constitute the largest potential asset in Pryor’s bankruptcy estate.

For purposes of § 727(a)(4)(A), a debtor "acts knowingly if he or she acts deliberately and consciously." Roberts, 331 B.R. at 883. At the hearing on June 30, 2010, the bankruptcy court asked Pryor why he did not include the liens on his schedules. Pryor argued that he listed the lawsuits in his statement of financial affairs. Hr’g Tr. at 21-25. The court corrected him, stating that listing the lawsuits was not the same as identifying assets. Hr’g Tr. 19:10-11. Although the court properly corrected Pryor’s misapprehension of the law, Pryor is a pro se litigant. It is the long standing practice of this circuit that pleadings from a pro se party are to be construed liberally. Beaty v. Schiro, 554 F.3d 780, 783 (9th Cir. 2004). Given the misunderstanding discussed on the record, the evidence that Pryor discussed the mechanics liens with the trustee and disclosed the existence of the lawsuits, and that Pryor is a pro se litigant, it is reasonable to conclude that Pryor did not act “deliberately and consciously” in failing to list the mechanics’ liens on his schedules.

On this record, we conclude the evidence was insufficient to show that Pryor made a deliberate and conscious false oath.

Moreover, the evidence is slim that, if his disclosure of the mechanic’s liens is inadequate, Pryor acted with fraudulent intent. Of course, fraudulent intent can be inferred from the totality of the circumstances. In re Ormsby, 591 F.3d at 1206. One circumstance to consider in detecting fraud is the debtor’s willingness to amend his schedules. In re Searles, 317 B.R at 377 (amending the schedules may be "evidence probative of a lack of fraudulent intent."). Here, the record shows that after conferring with the trustee, Pryor amended his statement of financial affairs to identify the lawsuits. Although the lien claims should also have been listed in his schedules of his assets, his amendment of the SOFA to identify the lawsuits provided creditors and the trustee with information on potential assets.

The record also fails to show what incentive Pryor would have to intentionally conceal the liens. Presumably, a debtor omits an asset from the schedules because the debtor wants to protect the asset from the reach of the trustee and creditors. In this case, Pryor’s largest creditor, ITEC, was fully aware of the existence of Pryor’s claims based on the mechanics’ liens which had been first asserted a year before the bankruptcy was filed.

In sum, we conclude the record does not show Pryor made a false oath sufficient to deny him a discharge based upon his failure to list the mechanic’s liens in his schedules.

In ITEC’s original complaint and its treatment of § 727(a)(4), a passing reference is also made to Royrp Plans and missing vehicles. ITEC alleges that in February 2009, Pryor executed a UCC-1 Financing Statement in which he purportedly transferred funds and motor vehicles to a limited partnership, Royrp. This allegation was repeated in the Patel Declaration. Patel Declaration at ¶48. The Patel Declaration also asserted that Pryor testified at his § 341(a) meeting that he created Royrp to fund litigation, and that he received over $700,000 from investor parties. Pryor challenged this assertion in his Declaration in Opposition to the Patel Declaration, asserting that no transfer of assets to or from Royrp ever occurred, and that because Nina Patel did not attend the § 341(a) meeting, she was not competent to testify as to his alleged testimony.

We have carefully examined the record and conclude that ITEC’s arguments relating to Royrp and the missing vehicles are not supported in the record. The UCC-1 financing statement referenced by Patel does not appear in the excerpts of record presented in this appeal or in the adversary proceeding, so there was no evidence opposing Pryor’s statement that he never transferred funds to Royrp. Further, although the Patel Declaration makes numerous challenges to Pryor’s testimony allegedly given at the § 341(a) meeting, Pryor swears she was not present, no transcript of the meeting was submitted to the bankruptcy court, and there is no evidence in the record that Patel attended that meeting. Consequently, because the basis for Patel’s allegations concerning Pryor’s testimony at the § 341(a) meeting has not been established, it would be inappropriate to conclude Pryor made a false oath.

Based upon our review of the record, ITEC did not provide the minimum evidence necessary to prove its allegations that Pryor made a false oath by omitting information on the missing vehicles or Royrp payments in his schedules and consequently did not prove a false oath by omission. In addition, based on the evidence in the record, we cannot conclude that Pryor’s omission of the mechanic liens from his asset schedules demonstrated either that he acted knowingly or with fraudulent intent.

Because the proof was inadequate, the bankruptcy court erred in denying Pryor a discharge under § 727(a)(4)(A).

§ 727(a)(2)(A)

Section 727(a)(2)(A) provides that the bankruptcy court must deny discharge if, "the debtor, with intent to hinder, delay, or defraud a creditor or an officer of the estate charged with custody of property under this title, has transferred, removed, destroyed, mutilated, or concealed, or has permitted to be transferred, removed, destroyed, mutilated, or concealed-- (A) property of the debtor, within one year before the date of the filing of the petition." The burden of proof is on the creditor to show by a preponderance of the evidence that (1) the debtor transferred or concealed property; (2) the property belonged to the debtor; (3) the transfer occurred within one year of the bankruptcy filing; and (4) the debtor executed the transfer with the intent to hinder, delay, or defraud a creditor. Aubrey v. Thomas (In re Aubrey), 111 B.R. 268, 273 (9th Cir. BAP 1990.

ITEC presents two different arguments regarding § 727(a)(2)(A). In the complaint, ITEC argues that Pryor concealed the missing vehicles. As discussed above, there is no support in the record for this allegation. Moreover, without the UCC financing statement or other evidence, there is no factual support in the record to show that Pryor owned the vehicles, or that the transfer itself of the vehicles occurred within one year of the bankruptcy filing. And finally, even if there is a UCC financing Statement, ITEC provides no argument to show Pryor was acting with fraudulent intent. In determining fraudulent intent of a transfer under § 727(a)(2)(A), the Ninth Circuit expects to see the presence of badges of fraud:

In examining the circumstances of a transfer under

> 11 U.S.C.S. § 727(a)(2), certain badges of fraud may support a finding of fraudulent intent. Those factors, not all of which need be present, include (1) a close relationship between the transferor and the transferee; (2) that the transfer was in anticipation of a pending suit; (3) that the transferor-debtor was insolvent or in poor financial condition at the time; (4) that all or substantially all of the debtor's property was transferred; (5) that the transfer so completely depleted the debtor's assets that the creditor has been hindered or delayed in recovering any part of the judgment; and (6) that the debtor received inadequate consideration for the transfer.

In re Retz, 606 F.3d at 1200. ITEC points to the existence of no "badges" in this case.

The Patel Declaration addresses ITEC's § 727(a)(2)(A) argument in only one paragraph, simply paraphrasing the statute. Patel Declaration at 23. Therefore, the record does not support denial of Pryor's discharge under § 727(a)(2)(A).

§ 727(a)(3)

Under § 727(a)(3), the bankruptcy court must deny discharge if, "the debtor has concealed, destroyed, mutilated, falsified, or failed to keep or preserve any recorded information, including books, documents, records, and papers, from which the debtor's financial condition or business transactions might be ascertained, unless such act or failure to act was justified under all of the circumstances of the case." To prevent a discharge under § 727(a)(3), a creditor must prove: (1) that the debtor failed to maintain and preserve adequate records; and (2) that the debtor's failure makes it impossible for debtor's creditors to determine the debtor's financial condition and material business transactions. Landsdowne v. Cox (In re Cox), 41 F.3d 1294, 1296 (9th Cir. 1994).

ITEC alleges that discharge may be denied under this provision based upon Pryor’s noncompliance with ITEC discovery requests. However, the discovery requests apparently focused on records relating to financial relations with ITEC, rather than Pryor’s overall finances and financial condition. The record in this appeal contains no evidence concerning ITEC’s specific document requests, and how those financial records relate to Pryor’s finances or financial condition. Instead, ITEC appears concerned almost exclusively with Pryor’s failure to produce records concerning the draws he made on the ITEC loans.

ITEC also avers in the complaint and via the Patel Declaration that Pryor has not provided records relating to Royrp funds and the missing vehicles. As discussed above, however, there is a lack of proof in the record relating to the Royrp matters. In contrast, in Pryor’s declaration, he represents that he never transferred funds or the missing vehicles to Royrp. Again, the record does not support the bankruptcy court’s conclusion that Pryor concealed information relating to Royrp or the missing vehicles.

The record is inadequate to support the bankruptcy court’s decision to deny Pryor a discharge under § 727(a)(3).

<u>§ 727(a)(5)</u>

Finally, under § 727(a)(5), a discharge must be denied when “the debtor has failed to explain satisfactorily . . . any loss of assets or deficiency of assets to meet the debtor’s liabilities.” To demonstrate that a debtor should be denied discharge under § 727(a)(5), a creditor must show that, “(1) the debtor at one time, not too remote from the bankruptcy petition date, owned identifiable assets; (2) on the date the bankruptcy petition was filed or order of relief granted, the debtor no longer owned the assets; and (3) the bankruptcy pleadings or statement of affairs do not reflect an adequate explanation for the disposition of the assets.” In re Retz, 606 F.3d at 1205.

In both the complaint and Patel Declaration, ITEC argues that “the Debtor has failed to explain satisfactorily the loss of assets or deficiency of assets to meet the Debtor’s liabilities with respect to the Construction Loan Draws.” Complaint ¶ 20, Patel Declaration at ¶ 51. In particular, ITEC’s argument under § 727(a)(5) is that, over a two-year period, Pryor embezzled or stole money from the construction loan fund. However, ITEC did not show that at a certain point in time Pryor had a specific, “identifiable” asset. Without providing evidence that on a certain date, Pryor owned an identifiable asset, we cannot compare that putative asset to the assets listed in the petition and schedules.

The record presented to us does not support denial of discharge under § 727(a)(5).

CONCLUSION

We AFFIRM the bankruptcy court’s determination that Pryor’s debt to ITEC is excepted from discharge under § 523(a)(2)(A). However, we VACATE that portion of the bankruptcy court's judgment denying discharge under § 727(a)(2), (3), (4) and (5), and REMAND this matter to the bankruptcy court for entry of an amended judgment.