

OCT 10 2013

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

ORDERED PUBLISHED

UNITED STATES BANKRUPTCY APPELLATE PANEL
OF THE NINTH CIRCUIT

In re:)	BAP No. NC-12-1362-PaDJu
)	
WILLIAM ROGER UTNEHMER and)	Bk. No. 11-12159
MARIE CLAIRE UTNEHMER,)	
)	Adv. No. 11-01239
Debtors.)	
_____)	
)	
WILLIAM ROGER UTNEHMER;)	
MARIE CLAIRE UTNEHMER,)	
)	
Appellants,)	
vs.)	O P I N I O N
)	
PATRICK CRULL; MARY CRULL,)	
)	
Appellees.)	
_____)	

Argued and Submitted on September 20, 2013
at San Francisco, California

Filed - October 10, 2013

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

Hon. Alan Jaroslovsky, Chief Bankruptcy Judge, Presiding

Appearances: William Roger Utnehmer argued pro se. Steven
Marc Olson argued for appellees Patrick and Mary
Crull.

Before: PAPPAS, DUNN and JURY, Bankruptcy Judges.

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1 PAPPAS, Bankruptcy Judge:
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3 Chapter 7¹ debtors William Roger Utnehmer ("William")² and
4 Marie Claire Utnehmer ("Marie" and together, "Debtors") appeal
5 pro se³ the judgment of the bankruptcy court awarding creditors
6 Patrick ("Patrick") and Mary Crull (together, "Crulls") \$100,000
7 plus interest, and determining that the judgment debt is
8 excepted from discharge under § 523(a)(4). We REVERSE.

9 **FACTS**

10 John Kwan ("John") and William did business as CW
11 Development Partners ("CWDP"), a general partnership involved in
12 real estate development in California. In February 2005, CWDP
13 purchased a property in Venice, California (the "Property") for
14 \$1,250,000, which the partners intended to develop as a "spec
15 house" by tearing down the existing structure and building a new
16 luxury residence for resale. Title to the Property was taken in
17 Debtors' individual names because John's credit was not as good
18 as theirs. However, both William and John always considered the
19

20 ¹ Unless otherwise indicated, all chapter and section
21 references are to the Bankruptcy Code, 11 U.S.C. §§ 101-1532, and
22 "Rule" references are to the Federal Rules of Bankruptcy
23 Procedure. Civil Rule references are to the Federal Rules of
24 Civil Procedure.

25 ² We refer to several of the parties by their first names
26 for clarity; no disrespect is intended.

27 ³ While appearing pro se in this appeal, Debtors were
28 represented in the bankruptcy court by counsel. The record
indicates that William has in the past been a member of the
California bar.

1 Property to be owned by CWDP.

2 Crulls were long-term acquaintances of John. Sometime in
3 2005, John offered Crulls "an opportunity to get in on this
4 particular project." Trial Tr. 69:16-17, June 12, 2012. In
5 June 2005, there was a telephone conversation between William
6 and Patrick. The record is unclear as to who initiated the call
7 and the specifics of the conversation. After the conversation,
8 William sent Crulls a packet of documents, including the
9 following:

- 10 1. A transmission letter addressed to Mary⁴ Crull,
11 indicating that a "cover letter, loan
12 agreement/note and the private offering was
13 attached."
- 14 2. A cover letter from William to Crulls. The
15 letter contained the following statement: "Until
16 the formal operating agreement is drafted and
17 executed pursuant to the terms of the Private
18 Offering, John and I will be executing promissory
19 notes with you for the amount of your equity
20 contribution."
- 21 3. A "Loan Agreement" proposing a \$100,000 loan from
22 Crulls to CWDP, including the following material
23 terms:
 - 24 (A) The loan was to be for a term of not more
25 than twelve months. The interest rate was
26 twelve percent per annum, payable monthly.
27 The entire balance of principal and interest
28 was due upon sale of the property, or at the
end of the twelfth month, whichever was
sooner. The loan could be paid off at any
time without any penalty for prepayment.
 - (B) The loan was to be secured by a trust deed
on the Property.
 - (C) The loan proceeds were to be used by CWDP at

26 ⁴ In their dealings with one another, and in submissions to
27 the courts, the parties occasionally refer to Marie as Mary.

1 their sole discretion.

2 (D) CWDP would procure liability, property and
3 worker's compensation insurance as required,
4 and name Lender [Crulls] as loss payee for
5 an amount equal to the loan.

6 (E) The Parties agreed that \$50,000 of the
7 initial \$100,000 loan was intended to be
8 super[s]eded by execution of a formal
9 operating agreement which would
10 recharacterize this \$50,000 of the lenders'
11 interest as an investors' equity interest in
12 a limited liability company to be formed,
13 with a 10% annual preferred return, and 35%
14 participation in profits on a prorated
15 basis. The documents for formation of the
16 limited liability company, and the operating
17 agreement, were supposedly being drafted.

18 3. A promissory note ("Note") to be executed by
19 William and John consistent with the Loan
20 Agreement. However, the Note makes no reference
21 to the Loan Agreement's provision for
22 recharacterizing \$50,000 of the money to be
23 loaned as an equity interest at some later time.

24 4. A twelve-page "Private Offering," describing the
25 Property and the investment opportunity.

26 On or about June 15, 2005, Crulls wire-transferred \$100,000
27 to the CWDP Partnership Account at Bank of America. On June 15,
28 2005, William signed the Note evidencing the loan from Crulls.

29 William and John expected, and had informed Crulls of their
30 intention, to complete the Property project within ten months.
31 However, significant delays were experienced resulting from
32 design changes. Over the next two years, Debtors obtained
33 several additional loans to finance the construction project,
34 which loans were secured, at least in part, by the Property.⁵

35
36 ⁵ For example, in November 2005, Debtors borrowed \$1.025
37 million from Bay Area Financial Corporation. In June 2006,
38 Debtors borrowed another \$200,000 from Bay Area Financial
39 Corporation, secured in part by the Property. In the fall of

(continued...)

1 Patrick testified at trial that Crulls were never informed about
2 these refinancings of the Property. Trial Tr. 71:13 ("We had no
3 idea there was refinancings at all."). This is not disputed by
4 Debtors.

5 The check ledger for the Property project reflects that
6 \$25,175.00 in interest payments were paid to Crulls from mid-
7 2006 to mid-2008. Although the Loan Agreement with Crulls by
8 its terms ended on June 15, 2007, the principal balance was not
9 repaid.

10 By early 2008, the Property project had been completed.
11 Crulls retained counsel to attempt to enforce their rights. On
12 April 7, 2008, their attorney sent a letter to Debtors,
13 confirming the parties' intention "to modify the [Loan]
14 agreement." Those revisions provided that Debtors would pay
15 Crulls \$50,000 by April 28, 2008, plus \$2,000 per month until
16 the remaining balance due on the Note of \$50,000 had been
17 repaid. Notably, the modified terms of the parties' agreement
18 included the following:

19 When the Property sells, the remaining \$50,000
20 principal sum of the Note shall be re-characterized as
21 an investor's equity interest in the Property and the
22 Crulls shall be paid first, their initial \$50,000
equity, second 10% preferred return thereon, third
their pro rata 35% share of the net sales proceeds.

23 ⁵(...continued)

24 2006, Debtors obtained a \$2,083,000 construction loan from Anchor
25 Loans for development of the Property. The loan cleared existing
26 encumbrances against the Property, including a first and second
27 deed of trust of Countrywide Mortgage held on the Property, and
28 made a partial payment of the loans held by Bay Area Financial
Corporation. In Summer 2007, Debtors borrowed another \$110,000
from a Mr. Propp, using the Property in part as collateral. In
Autumn 2007, Debtors refinanced the construction loan from Anchor
Loans with a \$2,550,000 loan from Loan Oak Fund.

1 William signed the modification, consenting to the revision of
2 the Loan Agreement on April 8, 2008. Debtors made only one
3 \$4,000 payment on the obligations created in the revisions to
4 the Loan Agreement.

5 In June 2008, the Property was sold for \$3,725,000. All
6 creditors on the Property project were paid in full from the
7 proceeds, but no payment was made to Crulls. Crulls asserted
8 that William informed them that he was unable to pay the debt
9 from the proceeds of sale.

10 On September 30, 2009, Crulls filed a complaint against
11 William in Los Angeles Superior Court, to collect the balance
12 due on the Note. Crull v. Utnehmer, Case no. SC105077. When
13 William did not respond, a default judgment was entered in favor
14 of Crulls against him on June 28, 2010, in the amount of
15 \$213,645.17.

16 Debtors filed a chapter 7 bankruptcy petition on June 6,
17 2011. On their Schedule F and Statement of Financial Affairs,
18 they listed a contingent, unliquidated, disputed debt owed to
19 Crulls for \$220,259.43 for the default judgment.

20 Crulls filed an adversary complaint against Debtors on
21 September 12, 2011. In it, they requested that their claim
22 against Debtors be excepted from discharge under § 523(a)(2) and
23 (a)(6), alleging that William made numerous false statements on
24 which they relied in connection with the Loan Agreement and to
25 persuade them to refrain from objecting to the closure of escrow
26 for the sale of the Property. Debtors answered the complaint on
27 October 1, 2011, generally denying the allegations in the
28 complaint.

1 A trial in the adversary proceeding was held on June 12,
2 2012. Early in the trial, the bankruptcy court indicated that
3 it had read the parties' proposed findings of fact and
4 conclusions of law that had been submitted earlier, and that it
5 was not convinced that Crulls could establish any fraud or
6 malice sufficient for exception to discharge under § 523(a)(2)
7 or (a)(6). However, the court "saw that there may be liability
8 under [§] 523(a)(4) . . . if a partnership arrangement is
9 shown." Trial Tr. 10:12-14.⁶

10 John, William and Patrick testified at the trial. At the
11 close of testimony, the bankruptcy court repeated its conclusion
12 that Crulls had not established that any fraud or malicious
13 actions occurred to support an exception to discharge under
14 § 523(a)(2) or (a)(6). Addressing Crulls' counsel, the court
15 stated that "Your case, if at all, is based on your client's
16 status as a partner If your client was a fiduciary in
17 relation to the venture and cannot account for the proceeds, I
18 think that that's enough to establish defalcation." Trial Tr.
19 78:3-5, 82:18-20.

20 The bankruptcy court took the issues under submission and,
21 on June 18, 2012, entered a Memorandum after Trial. In it, the
22 court dismissed Crulls' § 523(a)(2) and (a)(6) claims because

24 ⁶ Though Crulls at no time asked to amend their complaint,
25 significantly, the parties offered no formal objection to the
26 bankruptcy court proceeding with a trial on a claim for an
27 exception to discharge under § 523(a)(4), even though a right to
28 relief under this Code provision had not been pled in Crulls'
complaint. They also do not cite the bankruptcy court's decision
to adjudicate the issues based on this new theory as error on
appeal. Accordingly, we, also, will examine the merits of the
parties' arguments concerning that claim under § 523(a)(4).

1 there was no evidence to show fraud in the inducement, or
2 willful and malicious conversion, by Debtors. Crulls have not
3 appealed this aspect of the court's decision.

4 The bankruptcy court, however, made other factual findings
5 regarding the original Loan Agreement:

6 The parties memorialized their transaction in a "loan
7 agreement." Under the terms of this agreement, the
8 \$100,000 was to be paid in full when the property was
9 sold, or after 12 months, whichever came first.
10 However, they also agreed that "\$50,000 of this
11 initial \$100,000 is intended to be super[s]eded by
12 execution of [a] formal operating agreement which will
13 re-characterize \$50,000 of the lender's interest to an
14 investor's equity interest with a 10% annual preferred
15 return and 35% participation in profits on the equity
16 contribution on a prorated basis."

17 Based on these findings, the bankruptcy court concluded that
18 Crulls were entitled to an exception to discharge under
19 § 523(a)(4) because the Loan Agreement was:

20 sufficient to make Utnehmer a partner of Crulls in the
21 project. A partner has the responsibilities of a
22 fiduciary within the meaning of § 523(a)(4) as to
23 partnership property. Ragsdale v. Haller, 780 F.2d
24 794, 796-97 (9th Cir. 1986). Since Utnehmer took
25 title to the project in his own name and refinanced
26 several times without involving the Crulls, he has the
27 burden of accounting for all of the proceeds as well
28 as the costs and expenditures relating to the venture;
failure to do so is defalcation, notwithstanding lack
of demonstrated intent to harm or cheat his partners.
In re Lewis, 97 F.3d 1182, 1186-87 (9th Cir. 1996).
Utnehmer has not met his fiduciary duties. His
accounting is not professional[ly] prepared and
admittedly contains expenses not attributable to the
partnership. He has not met his burden of showing
that nothing is due to the Crulls.

29 On June 25, 2012, the bankruptcy court entered judgment for
30 Crulls against William, and the community property interest of
31 Marie,⁷ for the \$100,000 in principal owed under the Note, plus

32 ⁷ The bankruptcy court at trial had indicated its
33 willingness to grant Debtors' request to dismiss Crulls' claims

(continued...)

1 interest from April 1, 2008. The judgment declared this debt
2 excepted from discharge under § 523(a)(4).

3 Debtors filed a timely appeal on July 7, 2012.

4 JURISDICTION

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

8 ISSUES

- 9 1. Whether the bankruptcy court erred in determining that a
10 partnership relationship existed between William and
11 Crulls.
- 12 2. Whether the bankruptcy court erred in determining that the
13 debt owed by Debtors to Crulls was excepted from discharge
14 pursuant to § 523(a)(4).

15 STANDARDS OF REVIEW

16 "In bankruptcy discharge appeals, the Panel reviews the
17 bankruptcy court's findings of fact for clear error and
18 conclusions of law de novo, and applies de novo review to 'mixed
19 questions' of law and fact that require consideration of legal
20 concepts and the exercise of judgment about the values that
21 animate the legal principles." Oney v. Weinberg (In re
22 Weinberg), 410 B.R. 19, 28 (9th Cir. BAP 2009), aff'd 407 Fed.
23 Appx. 176 (9th Cir. 2010), citing Wolkowitz v. Beverly (In re
24 Beverly), 374 B.R. 221, 230 (9th Cir. BAP 2007), aff'd in part &
25 dismissed in part, 551 Fed. Appx. 1092 (9th Cir. 2008), citing

26 _____
27 ⁷(...continued)
28 against Marie personally, but her interest in the community
property could be liable for exception to discharge. Trial Tr.
6:21-24.

1 Murray v. Bammer (In re Bammer), 131 F.3d 788, 791-92 (9th Cir.
2 1997).

3 The bankruptcy court's determination that a partnership
4 existed between the parties under California law was based on
5 its interpretation of the Loan Agreement. A trial court's
6 interpretation of the terms of a contract is reviewed de novo.
7 Ameron Int'l Corp. v. Ins. Co. of State of Pa., 242 P.3d 1020,
8 1024 (Cal. 2010).

9 DISCUSSION

10 Applying California law to the facts of this case, we
11 conclude that the bankruptcy court erred when it decided that a
12 partnership existed between William and Crulls based upon the
13 Loan Agreement. Since there was no partnership, William owed no
14 fiduciary obligations to Crulls and, as a result, the bankruptcy
15 court also erred in determining that William's debt to Crulls
16 should be excepted from discharge as a defalcation by a
17 fiduciary pursuant to § 523(a)(4). We therefore REVERSE.

18 The exception to discharge relied upon by the bankruptcy
19 court, § 523(a)(4), provides that:

20 (a) A discharge under section 727 [discharge in a
21 chapter 7 case such as this one] . . . does not
22 discharge any debtor from any debt - . . . (4) for
fraud or defalcation while acting in a fiduciary
capacity, embezzlement, or larceny[.]”

23 Case law makes clear that the broad, general definition of
24 fiduciary - a relationship involving confidence, trust and good
25 faith - is inapplicable in the context of exception to a
26 bankruptcy discharge. Ragsdale v. Haller, 780 F.2d 794, 796
27 (9th Cir. 1986). Whether the debtor was acting in a fiduciary
28 capacity within the meaning of § 523(a)(4) is a question of

1 federal law. Lewis v. Scott (In re Lewis), 97 F.3d 1182, 1185
2 (9th Cir. 1996). A debt is nondischargeable under § 523(a)(4)
3 only "where (1) an express trust existed, (2) the debt was
4 caused by fraud or defalcation, and (3) the debtor acted as a
5 fiduciary to the creditor at the time the debt was created."
6 Otto v. Niles (In re Niles), 106 F.3d 1456, 1459 (9th Cir.
7 1997). Thus, § 523(a)(4)'s exception to discharge results only
8 where, among other things, the fiduciary relationship between
9 the debtor and the creditor arises in relation to an express or
10 technical trust that pre-dates the alleged defalcation. In re
11 Lewis, 97 F.3d at 1185.

12 State law determines whether the requisite trust
13 relationship exists. Id. Under California law, "all partners
14 [are] trustees over the assets of the partnership." Ragsdale,
15 780 F.2d at 796; see CAL. CORP. CODE § 16404(b)(1) (partner has a
16 duty to hold as trustee any "property, profit, or benefit
17 derived" from partnership business or use of partnership
18 property). Accordingly, "California partners are fiduciaries
19 within the meaning of § 523(a)(4)." Ragsdale 780 F.2d at
20 796-97. Thus, the determination by a bankruptcy court that a
21 partnership existed between William and the Crulls under
22 California law would establish one important component of the
23 proof required for an exception to discharge under § 523(a)(4).

24 However, even if a fiduciary relationship existed, the
25 bankruptcy court must also find that William committed a
26 "defalcation." As that term was understood in the Ninth Circuit
27 at the time the bankruptcy court entered its judgment, a
28 defalcation was a "misappropriation of trust funds or money held

1 in any fiduciary capacity; [the] failure to properly account for
2 such funds." In re Lewis, 97 F.3d at 1186 (quoting BLACK'S LAW
3 DICTIONARY 417 (6th ed. 1990)).

4 The court also ruled in Lewis that, for purposes of
5 § 523(a)(4), a defalcation "includes the innocent default of a
6 fiduciary who fails to account fully for money received. . . .
7 In the context of section 523(a)(4), the term 'defalcation'
8 includes innocent, as well as intentional or negligent defaults
9 so as to reach the conduct of all fiduciaries who were short in
10 their accounts." Id. at 1186 (internal citations omitted).
11 But in this respect, In re Lewis is no longer good law.

12 In May 2013, after the bankruptcy court entered its
13 judgment, the United States Supreme Court decided Bullock v.
14 BankChampaign, N.A., 133 S. Ct. 1754 (2013). Bullock
15 effectively abrogated that part of In re Lewis holding that a
16 debtor who failed to account to another need not possess any
17 particular state of mind to except a debt from discharge based
18 on fiduciary defalcation under § 523(a)(4). To the contrary, in
19 Bullock, the Supreme Court interpreted § 523(a)(4) to require
20 that, in order to except a debt for a defalcation by a
21 fiduciary, the debtor must possess "a culpable state of mind
22 . . . akin to that which accompanies application of the other
23 terms in the same statutory phrase. We describe that state of
24 mind as one involving knowledge of, or gross recklessness in
25 respect to, the improper nature of the relevant fiduciary
26 behavior." Id. at 1757.

27 Based upon the Supreme Court's holding in Bullock, the
28 bankruptcy court erred when it concluded that William committed

1 a defalcation "notwithstanding [his] lack of demonstrated intent
2 to harm or cheat his partners. In re Lewis, 97 F.3d [at 1186-
3 87]." Memorandum after Trial at 3, June 16, 2012. As the
4 Crulls acknowledged at oral argument, at a minimum, then, the
5 bankruptcy court's judgment must be vacated and the matter
6 remanded to the bankruptcy court to address the intent
7 requirement for a defalcation under Bullock.

8 But there is a more consequential error in the bankruptcy
9 court's decision which requires reversal, not merely remand. As
10 discussed above, a bankruptcy court's determination that a
11 California partnership was formed by the parties would
12 ordinarily allow us to conclude that the requisite fiduciary
13 relationship was established for § 523(a)(4) purposes. In this
14 case, though, the bankruptcy court simply ruled, without
15 explanation, that

16 The court somewhat reluctantly agrees with the Crulls
17 that there is liability under § 523(a)(4). The 'Loan
18 Agreement' is sufficient to make Utnehmer a partner of
19 the Crulls in the project. A partner has the
responsibilities of a fiduciary within the meaning of
§ 523(a)(4) as to partnership property. Ragsdale v.
Haller, 780 F.2d 794, 796-97 (9th Cir. 1986)).

20 Memorandum after Trial at 2.

21 We disagree that, without more, the Loan Agreement's terms
22 were sufficient under California law to create a partnership
23 agreement at the time the Loan Agreement was executed. We
24 therefore must reverse the bankruptcy court's conclusions that a
25 partnership existed based on the Loan Agreement and was
26 effective at the time the Loan Agreement was signed.

27 In this appeal, Crulls argue strenuously that the
28 bankruptcy court's decision that a partnership existed was a

1 finding of fact which may only be reversed for clear error, a
2 highly deferential standard.⁸ While, as noted above, the
3 bankruptcy court's decision construing the parties' contract is
4 reviewed de novo, even if the clear error standard applied, it
5 would not protect a finding based on "an erroneous view of the
6 law." Power v. Union P.R. Co., 655 F.2d 1380, 1382-83 (9th Cir.
7 1981) ("We may regard a finding of fact as clearly erroneous
8 . . . if it was induced by an erroneous view of the law. . . .
9 The question, then, is whether the [trial] court's findings and
10 conclusions are based on a proper view of [] state law[.]").
11 Indeed, the Supreme Court has cautioned that the clear error
12 rule is not a shield for a fact finding that is inconsistent
13 with underlying law:

14 But Rule 52(a) [applicable in bankruptcy adversary
15 proceedings via Rule 7052] does not inhibit an
16 appellate court's power to correct errors of law,
including . . . a finding of fact that is predicated
on a misunderstanding of the governing rule of law.

17 Bose Corp. v. Consumers Union of United States, Inc., 466 U.S.
18 485, 501 (1984); see also, Inwood Labs., Inc. v. Ives Labs.,
19 Inc., 456 U.S. 844, 855 n.15 (1982); United States v. Singer
20 Mfg. Co., 374 U.S. 174, 194 n.9 (1963).

21 As we discuss below, the bankruptcy court's finding that
22 there was a partnership established by the Loan Agreement was
23 inconsistent with the governing law applicable in this case, the
24 California law of partnerships. Moreover, since at bottom we

26 ⁸ At oral argument, William also seemed to agree that,
27 based on the testimony at trial, the parties considered
28 themselves partners at all times. However, as reflected in its
decision, the bankruptcy court's finding that a partnership
existed was based solely on documentary evidence, and in
particular the Loan Agreement, and not on testimony at trial.

1 are determining whether William's debt to Crulls should be
2 discharged, we review the bankruptcy court's determination of
3 that question as a mixed question of law and fact de novo and
4 not as a simple fact determination for clear error. In re
5 Weinberg, 410 B.R. at 28.

6 To determine whether the Loan Agreement established a
7 partnership, its legal effect, we look first to the terms of the
8 Loan Agreement as directed by the California courts. Kersch v.
9 Taber, 67 Cal. App. 2d 499, 501 (Cal. Ct. App. 1945) ("The
10 question of the existence of a partnership should be determined
11 primarily by ascertaining the intention of the parties, and
12 where they have entered into a written agreement such intention
13 should be determined chiefly from the terms of the writing.").
14 In examining the written agreement, we are obliged to follow a
15 plain meaning analysis:

16 The fundamental rules of contract interpretation are
17 based on the premise that the interpretation of a
18 contract must give effect to the mutual intention of
19 the parties. Under statutory rules of contract
20 interpretation, the mutual intention of the parties at
21 the time the contract is formed governs
22 interpretation. Such intent is to be inferred, if
23 possible, solely from the written provisions of the
24 contract. The clear and explicit meaning of these
25 provisions, interpreted in their ordinary and popular
26 sense, unless used by the parties in a technical sense
27 or a special meaning is given to them by usage,
28 controls judicial interpretation. . . . An agreement
is not ambiguous merely because the parties (or
judges) disagree about its meaning. Taken in context,
words still matter.

25 In re Installment Fee Cases, 211 Cal. App. 4th 1395, 1409 (Cal.
26 Ct. App. 2013).

27 As noted above, the Loan Agreement is composed of five
28 paragraphs. The first four paragraphs clearly reflect the terms

1 of what appears to be a loan of money from Crulls to CWDP; they
2 make no reference to the creation or existence of a partnership
3 between the parties. The only paragraph in the Loan Agreement
4 that could arguably serve as the foundation of a partnership is
5 paragraph 5, which provides:

6 The Parties agree that \$50,000 of this initial
7 \$100,000 loan is intended to be super[s]eded by
8 execution of a formal operating agreement which will
9 recharacterize \$50,000 of the lender's interest to an
10 investor's equity interest with a 10% annual preferred
11 return and 35% participation in profits on the equity
12 contribution on a prorated basis. Said operating
13 agreement and formation of a Limited Liability Company
14 is being drafted.

15 There can be no dispute about the plain meaning of this
16 paragraph: it contemplates that, at some future point in time
17 (i.e., upon the "execution of a formal operating agreement" for
18 a yet-to-be formed limited liability company), a portion of the
19 Crulls' loan would be "recharacterized" as an equity interest in
20 the Property project entitling them, thereafter, to participate
21 in the profits of the venture. There is nothing in the Loan
22 Agreement to indicate any intent to form a partnership or LLC at
23 the time of signing the Loan Agreement, nor at any point before
24 the execution of the operating agreement or LLC formation. As
25 we discuss below, this would be an essential element for
26 defalcation under § 523(a)(4), because if the partnership was
27 not in existence before any alleged wrongful behavior, there was
28 no fiduciary duty and therefore there cannot be defalcation
under § 523(a)(4).

Although the bankruptcy court's reasoning was perhaps not
fully presented in its decision, we assume that the court relied
upon the Loan Agreement's provisions for sharing profits by the

1 parties as an indication that the parties intended to form a
2 partnership. But if this was the court's conclusion, it is
3 inconsistent with the requirements of California law regarding
4 formation of partnerships. Simply stated, "where the parties
5 purport to establish a partnership to engage in business at a
6 future time or upon the happening of a contingency, the
7 partnership does not come into being until the time specified or
8 until the contingency is removed." Solomont v. Polk Development
9 Co., 245 Cal. App. 2d 488, 496 (Cal. Ct. App. 1966) [2d Dist.];
10 Kersch v. Taber, 67 Cal. App. 2d at 504 [3d Dist.]; Taylor v.
11 Nelson, 26 Cal. App. 681, 682 (Cal. Ct. App. 1915) [1st Dist.];
12 accord Hollis v. Rock Creek Pack Station, 594 F. Supp. 156, 160
13 (D. Ariz. 1984) (applying California law: "where parties purport
14 to establish a partnership to engage in business upon the
15 happening of a contingency, the partnership does not come into
16 being until the contingency has occurred."). We have located no
17 California case law varying the rule that an agreement to form a
18 partnership in the future, upon fulfillment of a contingency,
19 does not, at the time of entry of the agreement, create a
20 partnership.

21 In this case, if no partnership between William and Crulls
22 was formed at the time they executed the Loan Agreement then,
23 under California law, no fiduciary duty by William to Crulls
24 arose at that time. If there was no partnership, no trust
25 relationship existed between the parties, and no fiduciary duty
26 was imposed upon William at the time of execution of the Loan
27 Agreement. And any subsequent behavior, whether or not
28 accompanied by bad intent, would not be a fiduciary breach

1 triggering exception to discharge under § 523(a)(4). In re
2 Lewis, 97 F.3d at 1185 (holding that an express trust [i.e., a
3 partnership] must exist before any defalcation).

4 Other concerns arise from the bankruptcy court's reasoning
5 that a partnership arose from the Loan Agreement. As discussed
6 above, the court apparently considered a future agreement to
7 share profits as an indication of partnership. It is true that
8 an agreement to share profits may be evidence of a partnership
9 agreement. Holmes v. Lerner, 74 Cal. App. 4th 442, 453-54 (Cal.
10 Ct. App. 1999); Bank of Cal. v. Connolly, 36 Cal. App. 3d 350,
11 364 (Cal. Ct. App. 1973). However, the presence of profit
12 sharing does not support a presumption of the existence of the
13 partnership unless there was also an actual sharing of the
14 profits. CAL. CORP. CODE § 16202 (2013) ("A person who receives a
15 share of the profits of a business is presumed to be a partner
16 in the business.") (emphasis added). Here, the facts are
17 undisputed that no limited liability company was ever formed, no
18 operating agreement was ever executed, and there was no actual
19 sharing of profits between William and Crulls.

20 Moreover, profit-sharing is not considered the most
21 important indicia of a partnership under California law. The
22 existence of a partnership is ordinarily evidenced by some
23 degree of participation by alleged partners in the management
24 and control of the business. Sperske v. Rosenberg, 2013 WL
25 3817067, at *2 (C.D. Cal. 2013); Fredianelli v. Jenkins, 2013 WL
26 1087653 (N.D. Cal. 2013); Dickinson v. Samples, 104 Cal. App.2d
27 311, 315 (Cal. Ct. App. 1951) ("To participate to some extent in
28 the management of a business is a primary element in partnership

1 organization, and it is virtually essential to a determination
2 that such a relationship existed."). Here, the Loan Agreement
3 grants Crulls no rights to participate in the management of the
4 Property project, and in particular in paragraph 4, reserves the
5 right to decide how the loan proceeds will be used solely to
6 CWDP. Consistent with these terms, at trial, Patrick
7 acknowledged that he was not consulted concerning management
8 decisions, nor about the multimillion dollar financing
9 arrangements made concerning the Property: "we had no idea
10 there was refinancings at all." Trial Tr. 71:13.

11 Perhaps in recognition of the deficiencies in the
12 bankruptcy court's conclusion concerning the existence of a
13 partnership, on appeal, Crulls raise the alternative argument
14 that because the Crulls detrimentally relied on William's
15 promise to form a limited liability company, he should be
16 estopped from denying the existence of such a promise. They
17 urge that, under California law, since a manager of an LLC owes
18 a fiduciary duty to members, we should hold that William was a
19 fiduciary to Crulls when he "helped himself to millions of
20 dollars from refinancing the partnership's Abbot Kinney
21 property."

22 Our review of the record satisfies us that Crulls did not
23 properly raise this argument in the bankruptcy court. An
24 appellate court in this circuit will not consider arguments that
25 "were not properly raised in the trial court." O'Rourke v.
26 Seaboard Sur. Co. (In re E.R. Fegert, Inc.), 887 F.2d 955, 957
27 (9th Cir. 1989); see also In re Cybernetic Servs., Inc., 252
28 F.3d 1039, 1045 n.3 (9th Cir. 2001) (stating that the appellate

1 court will not explore ramifications of an argument because it
2 was not raised in the bankruptcy court and therefore waived).

3 Not only was the promissory estoppel argument not made in
4 the bankruptcy court, Crulls have not properly raised it in this
5 appeal. Crulls cite no authority for their argument that the
6 manager of an LLC has the fiduciary duties as contemplated by
7 § 523(a)(4) to other members of the LLC.⁹ And in their brief,
8 Crulls do not explain how a fiduciary duty that may arise in an
9 LLC that does not come into existence until sometime in the
10 future does not suffer from the same infirmity as a future
11 partnership (i.e., defalcation under § 523(a)(4) requires the
12 fiduciary duty to arise before any alleged wrongdoing takes
13 place).

14 For these reasons, we conclude that the bankruptcy court
15 erred in its determination that a partnership was formed by the
16 Loan Agreement. At best, the parties agreed to form an LLC
17 based upon events to occur in the future, events that never came
18 to pass. Since no partnership existed between the parties
19 during their dealings, we conclude that, as a matter of law,
20 William was not a fiduciary as to Crulls for purposes of
21 § 523(a)(4), and that the bankruptcy court erred in excepting
22 the debt from discharge under that provision of the Bankruptcy
23 Code.

24
25 ⁹ Even if this were so, since no LLC was ever formed and no
26 operating agreement ever drafted, there is no evidence that
27 William would be the managing member with a fiduciary duty to
28 other members. Additionally, we observe that the Ragsdale rule
that a California partnership implies the fiduciary duty for
defalcation purposes under § 523(a)(4) only applies to a
partnership. We have found no case law that applies the Ragsdale
rule to a California LLC.

1 **CONCLUSION**

2 The bankruptcy court erred in ruling that it need not find
3 that William acted with bad intent toward Crulls to conclude
4 that the debt was excepted from discharge under § 523(a)(4).
5 The Supreme Court's recent decision in Bullock overrules prior
6 Ninth Circuit authority allowing such a conclusion. Therefore,
7 at best, a remand to the bankruptcy court would be required to
8 examine William's intent under the Bullock standard.

9 However, in this case, no remand is necessary because we
10 conclude that the bankruptcy court erred when it decided that a
11 partnership existed between Crulls and CWDP based on the Loan
12 Agreement. Since no partnership was created, and no fiduciary
13 duty existed, we REVERSE the decision of the bankruptcy court
14 excepting William's debt to Crulls from discharge under
15 § 523(a)(4).