

Dated: May 13, 2013



Eileen W. Hollowell

Eileen W. Hollowell, Bankruptcy Judge

UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF ARIZONA

In re:)	Chapter 13
)	
MARIANO J. RASO,)	Case No. 4:11-bk-32187-EWH
)	
Debtor.)	
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DARYL L. LEWIS,)	
)	Adv. Case No. 4:12-ap-00608-EWH
Plaintiff/Counter Defendant,)	
v.)	
)	
MARIANO J. RASO,)	
)	MEMORANDUM CLARIFYING AND
Defendant/Counter Claimant,)	SUPPLEMENTING RULING MADE IN
)	OPEN COURT ON FEBRUARY 11, 2013
MICHAEL J. RUSING, State Bar)	
No. 006617, PCC No. 50020,)	
Individually and Jointly; and)	
REBECCA K. O'BRIEN, State Bar)	
No. 021954, PCC No. 65649,)	
Individually and Jointly;)	
)	
Cross Defendants.)	
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INTRODUCTION

Plaintiff seeks a denial of Debtor's discharge pursuant to 11 U.S.C. § 523(a)(2), (4) and (6). The facts relate to a sale of Plaintiff's building ("Building"). Debtor acted as a real estate broker for the sale and earned a commission of \$34,800 ("Commission")

1 when the Building was sold to a third party in a 1031 exchange (“1031 Exchange”).¹
2 Debtor’s agreement to act as Plaintiff’s broker was memorialized in a “Contract for
3 Employment to Exchange or Sell Real Property” (“Employment Contract”). The
4 Employment Contract included several references to a possible exchange transaction,
5 as well as a sale, including:
6

7 Tierra Realty & Investments (Debtor’s wholly-owned entity) agrees to use
8 diligence in effecting an exchange or sale for its client.

9 The 1031 Exchange consisted of exchange of the Building for a lot in Nevada
10 and a lot in California (“Lots”). The party accepting the Building assumed a \$135,000
11 mortgage on the Building and paid \$45,000 in cash.

12 The Exchange Escrow Instructions executed by the Plaintiff included the
13 following language:
14

15 All Parties to this agreement acknowledge that they have investigated the
16 respective properties, and the Brokers, Title Company and Escrow Officer
17 are hereby released from all responsibility regarding valuation and
18 representation of condition (Plaintiff’s Trial Ex. E) (“Value Release”).

19 Simultaneously with the 1031 exchange of the Building, an entity wholly owned
20 by Debtor bought the Lots from Plaintiff. As part of that transaction, Debtor submitted to
21 Plaintiff a “Letter of Intent to Purchase Two Single Family Residential Building Lots”
22 (“Letter of Intent’) (Trial Ex. O). The “Other Conditions” section of the Letter of Intent
23 provided that Debtor’s entity “shall be allowed to market and obtain offers to buy, sell or
24 exchange these lots immediately upon signing of this letter of intent.” The Transfer of
25 Security section of the Letter of Intent provided that:
26
27

28 ¹ Section 1031(a) of the Internal Revenue Code governs the recognition of gains or losses that
arise as a result of a “like kind” exchange of real property.

1 In the event of sale, exchange or trade, you agree to move the security on
2 the property under the same terms and conditions as outlined in this Letter
of Intent to Purchase as long as I am current on my payments.

3 Debtor's entity paid for the Lots by executing two promissory notes—one for
4 \$175,000, secured by a Deed of Trust on the California lot, and one for \$80,000,
5 secured by a Deed of Trust on the Nevada lot (collectively the "Notes"). The Notes were
6 payable over twenty years at 6% interest, which would have resulted in Plaintiff
7 receiving a total of \$320,000 over the Notes' terms. Each of the Notes contained the
8 following provision:
9

10 Payee agrees to subordinate the lien in the event of a construction loan,
11 trade or exchange requiring subordination to consummate the exchange
12 on whatever property the payor enters into, provided payments are current
(Trial Ex. S).

13 At the conclusion of a trial held on February 11, 2013, an oral decision
14 ("Decision") was issued finding that the obligation on the Notes was discharged, but that
15 the Commission was not.
16

17 Because the Record does not provide a complete explanation for the Decision,
18 this Memorandum is issued to clarify and supplement the Decision.
19

20 A. The Notes

21 The Decision found that Plaintiff failed to meet his burden of proof under
22 § 523(a)(2) or (6) with respect to claims based on non-payment of the Notes because
23 Plaintiff failed to demonstrate that, at the time the Notes were executed, Debtor
24 knowingly made a materially false representation regarding his intent to pay the Notes.
25

26 In applying § 523(a)(2)(A), courts in the Ninth Circuit employ a five-part test:

- 27 (1) That the debtor made . . . representations;
28 (2) That the debtor knew the representations were false when made;

- 1
- 2 (3) That the debtor made the representations with the intention and
- 3 purpose of deceiving the creditor;
- 4 (4) That the creditor relied on such representations; and
- 5 (5) That the creditor sustained the alleged loss and damages as the
- 6 proximate result of the misrepresentations having been made

7 In re Hashemi, 104 F.3d 1122, 1125 (9th Cir. 1997). See also In re Gonzales, 2007

8 WL 7216267 (Bankr. S.D. Cal. Mar. 23, 2007).

9 The evidence indicated that the parties disagreed about how the Notes would be

10 repaid. Debtor testified that he intended to pay the monthly obligations on the Notes

11 only until such time as he could do a 1031 exchange on the Lots, after which he would

12 sell or transfer the newly acquired property to Plaintiff in full satisfaction of the Notes.

13 Debtor testified that Plaintiff was aware of Debtor's plan for repayment of the Notes.

14 Plaintiff denied ever being told of Debtor's re-payment plan and testified that he

15 expected the Notes to be paid by Debtor making regular monthly payments for their

16 twelve-year term. Given that the terms of the Employment Agreement, Letter of Intent

17 and the Notes all referred either to an exchange or sale of the Lots, Plaintiff's testimony

18 that he believed that the sole manner the Notes would be paid was by Debtor over their

19 twelve-year term is not credible.

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21

22 For example, the Letter of Intent specifically stated that Debtor intended to

23 immediately try to market or exchange the Lots (emphasis added). Plaintiff agreed that

24 if that occurred, his security interest could be transferred to different (presumably

25 income-producing) property. The Notes contain subordination language consistent with

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1 the Letter of Intent. The evidence, therefore, demonstrates that Debtor did not “hide”
2 from Plaintiff his intentions for repayment of the Notes.

3 Even if Plaintiff’s assertions about how he expected the Notes to be repaid were
4 credible, the result would be the same. Debtor’s intention to repay the Notes in a
5 different manner than Plaintiff expected is not evidence that at the time the Notes were
6 executed, Debtor had no intention of ever paying the Notes. In order to prevail on a
7 § 523(a)(2)(A) claim, a plaintiff must demonstrate that a representation was known to be
8 false at the time it was made. In re Eashai, 87 F.3d 1082, 1086-87 (9th Cir. 1996).
9

10 Plaintiff argues that Debtor’s failure to make more than a few payments,² and
11 only after repeated demands from Plaintiff, is further evidence that Debtor never
12 intended to pay the Notes. However, Debtor credibly testified that the reason for non-
13 payment of the Notes was that the real estate market went into a steep recession in
14 2008, which resulted in a deep decline in his income. Debtor further testified that the
15 real estate bubble busting made it impossible for him to sell or exchange the Lots even
16 though, when he signed the Notes, he intended to satisfy them.
17

18 Finally, Plaintiff argued that Debtor fraudulently misrepresented the value of the
19 Lots and, therefore, that the difference between the value of the Lots and the amount of
20 the Notes should be declared non-dischargeable. However, the Value Release
21 precludes Plaintiff from establishing that he relied on any representations made by
22 Debtor regarding the value of the Lots.
23
24

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28 ² There was conflicting evidence about whether one or two payments were made, but the
number of payments would not change the analysis.

1 Plaintiff bears the burden of proof on all the elements of § 523(a)(2). In re
2 Weinberg, 410 B.R. 19, 35 (9th Cir. BAP 2009). Plaintiff failed to meet that burden on
3 his § 523(a)(2) claims with respect to the Notes and the valuation of the Lots.

4
5 Plaintiff also cannot prevail under § 523(a)(6) because the evidence did not
6 demonstrate that Debtor subjectively intended to harm Plaintiff when the Notes were
7 executed. As a result, Debtor's conduct does not satisfy the requirement of § 523(a)(6)
8 that a debtor's conduct be willful. See In re Su, 290 F.3d 1140, 1146 (9th Cir. 2002)
9 (subjective standard for willfulness correctly focuses on a debtor's state of mind...).

10
11 Plaintiff also argued that because Arizona law imposes a fiduciary duty on real
12 estate brokers, a judgment should be entered in his favor under § 523(a)(4). The
13 Decision held, as a matter of law, that statutorily created fiduciary duties of real estate
14 agents are outside the scope of § 523(a)(4). See Honkanen v. Hopper, 446 B.R. 373
15 (9th Cir. BAP 2010).³ For all of the above explained reasons, as well as the reasons set
16 out in the Decision, Debtor's obligations under the Notes are dischargeable.

17 18 B. The Commission

19 The Decision held that the amount of the Commission is non-dischargeable, but
20 did not explain why—other than finding that there was “some misrepresentation
21 involved in terms of getting the deal to close.” February 11, 2013, Transcript at 151.
22 Further explanation of the facts and applicable law is required to explain why the
23 Commission is non-dischargeable.
24

25 In addition to the Employment Agreement, Debtor and Plaintiff executed a Real
26 Estate Agency Disclosure and Election Agreement (Agency Agreement, Exhibit 3). The
27 Agency Agreement imposed on Debtor a duty to disclose all known facts which could
28

³ Plaintiff was given additional time to brief the § 523(a)(4) issue but declined to do so.

1 materially and adversely affect the consideration to be paid by any party. This obligation
2 was separate from Debtor's obligation to pay the Notes.

3 In violation of the Agency Agreement, Debtor failed to disclose the risks involved
4 regarding his ability to satisfy the Notes through a future sale or exchange of the Lots.
5 The evidence indicates that Debtor failed to disclose those risks because he wanted the
6 1031 Exchange of the Building to close so he could receive the Commission.
7

8 Debtor's failure to inform Plaintiff of facts which could materially affect the
9 consideration Plaintiff would be paid was a material omission. Material omissions may
10 constitute false representations under § 523(a)(2)(A). "[A] false representation can be
11 established by an omission when there is a duty to disclose." Eashaj, 87 F.3d at 1089.
12 Here, the Agency Agreement imposed a duty on Debtor to disclose "facts which
13 materially and adversely affect the consideration to be paid" to Plaintiff. Debtor's
14 material omission was made for the purpose of deceiving the Plaintiff so the
15 1031 Exchange would close allowing the Debtor to receive the Commission. The
16 evidence also demonstrated that Plaintiff justifiably relied on Debtor to comply with his
17 obligation to disclose any facts which would materially and adversely affect the
18 consideration Plaintiff was to receive.
19

20 Debtor argued that Plaintiff's reliance was not justifiable because Debtor
21 repeatedly told Plaintiff he should hire lawyers or appraisers to assure that the
22 1031 Exchange of the Building would achieve the result Plaintiff wanted. In particular,
23 Debtor pointed to language in the Agency Agreement which states:
24

25 The Duties of the Broker in a Real Estate Transaction do not relieve the
26 seller or the buyer from the responsibility to protect their own interests.
27
28

1 The justifiable reliance standard, however, is subjective. Even if further inquiry by
2 Plaintiff would have informed him of the risks involved in the transaction, Plaintiff was
3 not required to engage in such an inquiry. Field v. Mans, 516 U.S. 59, 70-71, 116 S.
4 Ct. 437 (1995).

5
6 The final element which Plaintiff must prove under § 523(a)(2) is that he suffered
7 loss as the proximate result of Debtor's misrepresentation. Here, Plaintiff suffered a loss
8 equal to the amount of the Commission which was paid from the proceeds realized on
9 the 1031 Exchange. But for Debtor's material omission, the Commission would not have
10 been paid. As a result, Plaintiff is entitled to recover the amount of the Commission as a
11 non-dischargeable debt.
12

13 **CONCLUSION**

14 For the reasons explained in this Memorandum and set forth in the Decision, a
15 non-dischargeable judgment of \$34,800.00 will be entered this date in favor of Plaintiff.
16 Interest will accrue at the federal judgment rate and each side is to bear his own costs
17 and attorneys' fees.⁴
18

19 Dated and signed above.

20 Notice to be sent through the Bankruptcy
21 Noticing Center to the following:

22 Mariano J. Raso
23 4050 E. Hayhurst Lane #1
24 Tucson, AZ 85712

25 Michael J. Rusing
26 Rebecca K. O'Brien
27 Rusing Lopez & Lizardi, P.L.L.C.
28 6363 North Swan Rd., Suite 151
Tucson, AZ 85718

⁴ Plaintiff was permitted to submit a memorandum regarding a right to claim attorneys' fees but did not do so.

1 Attorneys for Plaintiff/Counter Defendant Lewis

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