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WRITTEN DECISION - NOT FOR PUBLICATION

ENTERED <u>2/28/14</u> FILED
FEB 28 2014
CLERK, U.S. BANKRUPTCY COURT SOUTHERN DISTRICT OF CALIFORNIA BY <u>HVC</u> DEPUTY

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF CALIFORNIA

In re: Birger Greg Bacino, Debtor.	}	Bankruptcy No. 09-20080-LT7 Adversary No. 10-90315-LT
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Federal Deposit Insurance Corporation, as Receiver for La Jolla Bank FSB, Plaintiff, v. Birger Greg Bacino, Defendant.	}	POST-TRIAL MEMORANDUM DECISION AND FINDINGS OF FACT AND CONCLUSIONS OF LAW*

The Federal Deposit Insurance Corporation ("FDIC") as Receiver for La Jolla Bank FSB ("La Jolla") initiated an action seeking a declaration that La Jolla's claims against chapter 7 debtor, Birger Greg Bacino, are nondischargeable based on submission of false financial statements under § 523(a)(2)(B)¹ or fraud under § 523(a)(2)(A). The Court previously granted the FDIC's motion, in part, and summarily adjudicated certain issues.

* This document is intended only to resolve the dispute between these parties and is not intended for publication.

¹ Unless otherwise indicated, all chapter and section references are to the Bankruptcy Code, 11 U.S.C. §§101-1532, and all rule references are to the Federal Rules of Bankruptcy Procedure,

1 See Dkt. # 429. The Court then heard fourteen days of trial testimony, considered hundreds
2 of documents, and received and considered both written and oral argument regarding the
3 applicable law and the application of the facts established at trial to that law.² Based on this
4 review and analysis, and keeping well in mind the gravity of this decision in terms of
5 Mr. Bacino's financial future, the Court determines that the La Jolla claims now asserted by
6 the FDIC are nondischargeable under § 523(a)(2)(A) or (B).

7 FINDINGS

8 1. Mr. Bacino graduated from law school and was a successful trial lawyer. He
9 primarily represented plaintiffs and operated out of his own small firm. Mr. Bacino was not
10 a transactions attorney, but his legal training and practice made him familiar with legal
11 documents and contracts principles.

12 2. Ultimately, while still maintaining a law practice, he diversified into other
13 areas of business endeavor.

14 3. He became a real estate developer operating entities named ALB Properties,
15 Inc. ("ALB") and Barioni Lakes Estates LLC ("Barioni"). ALB's development efforts were
16 focused primarily on extremely high-end custom homes.

17 4. He also acquired a 35% interest in Premier Healthcare Management
18 ("Premier"). Premier was at one time the largest provider of worker's compensation related
19 healthcare services in the state of California. Premier did not provide medical services
20 directly; instead it provided the billing, collection, therapeutical, translation, and clinic
21 support for doctors. The doctors contracted with Premier for service support, and Premier
22 retained 50% of collected receivables as compensation for its services.

23 5. Prior to 2004, as relevant here, workers' compensation payments in California
24 were made by insurers. A doctor wishing to obtain payment on account of such services

25 Rules 1001-9037.

26 ² As a result of the serious illness of Mr. Bacino's attorney, the Court continued closing
27 argument with the FDIC's consent. At a later point, the FDIC balked at further continuance. The
28 Court, thus, gave the FDIC an option – agree to further continuance to allow Mr. Bacino's trial
counsel to complete treatment or waive argument (something Mr. Bacino was willing to do). The
FDIC elected oral argument. See Dkt. # 506.

1 was required to wait until the conclusion of all medical services entitled to workers'
2 compensation reimbursement. At that time, the doctor held what is known in the industry as
3 a lien claim. Premier collected the lien claims from the involved insurers. Not surprisingly,
4 given the context and the payors, collection entailed difficulties. Typically, Premier did not
5 collect 100% of its lien claims; indeed, its recovery usually was something less than 50% of
6 the total amount at issue. Having said this, however, Premier controlled millions of such
7 claims and generated substantial income.

8 6. In 2004, as Governor Schwarzenegger came into office, Premier perceived
9 that his legislative agenda included substantial changes in the workers' compensation arena.
10 Premier, as a result, concluded that it would cease doing business related to the generation
11 of new lien claims. But in 2004 Premier still held substantial lien claims; its post-2004
12 efforts focused exclusively on collecting these claims and defending against litigation
13 related to these liens.

14 7. Finally, Mr. Bacino also had less significant business ventures including those
15 involving a yacht for rental in Baja California and an airplane.

16 8. In 2003 and 2004, the first years directly relevant to this case, Mr. Bacino
17 financed his real estate endeavors, at least in part, from conventional loans from First
18 National Bank ("First National"). La Jolla was interested in acquiring development loans
19 and becoming more aggressively involved in what it perceived as a hot San Diego real
20 estate development market. The matchmakers for Mr. Bacino's First National divorce and
21 new lending relationship with La Jolla were the Aldridges. These loan brokers were heavily
22 involved in identifying Mr. Bacino to La Jolla, convincing Mr. Bacino to leave First
23 National, and finalizing the La Jolla loan documents for the first series of loans. Mr. Bacino
24 apparently presented as a highly desirable borrower to La Jolla; it paid a broker's fee when it
25 finalized its initial loans to Mr. Bacino that was three times the loan fees that Mr. Bacino
26 paid to La Jolla.

27 9. Ultimately, Mr. Bacino obtained eight loans from La Jolla, either individually
28 or as the principal of ALB or Barioni, and also entered into numerous extensions in relation

1 to existing loans. For ease of reference, the Court includes a chart hereafter showing each
 2 loan, its loan number, the original principal amount, and any extension in connection
 3 therewith (by date and, in the case of a future advance, by amount). In connection with each
 4 of these loans, Mr. Bacino was either a borrower or a guarantor. And in the case of each of
 5 these loans, he was the person solely responsible for certification to La Jolla as to the
 6 accuracy of the information provided to La Jolla in connection with the loans.

7	Loan #	Borrower	Origination Date	Original Amount	Modification Date	Balance / Date
8						
9	#1 014121130	ALB Properties, LLC	October 28, 2004	\$4,184,500	Yes; 8/11/06 #10 Increased by \$1,000,000 Yes; 7/1/08 #18 Extended 1 year	\$1,246,028.48 9/7/12
10						
11						
12						
13	#2 015121197	ALB Properties, LLC	October 29, 2004	\$1,850,000	Yes; 8/1/05 #4 \$3,290,000 (total or new)	\$847,411.76 9/7/12
14						
15	#3 015121001	ALB Properties, LLC	October 29, 2004	\$1,850,000	Yes; 8/1/05 #5 \$2,240,000 (total or new)	\$1,103,852.20 9/7/12
16						
17	#4 Mod of #2		August 1, 2005 (9 months after original loan)	\$3,290,000 (new appears to be \$1,440,000)		See #2 above
18						
19						
20	#5 Mod of #3		August 1, 2005 (9 months after original loan)	\$2,240,000 (new appears to be \$390,000)		See #3 above
21						
22						
23	#6 1041022090	ALB Properties, LLC	February 7, 2006 (15 months after original loans)	\$8,075,000	Yes; 8/1/06 #9 Increased by \$2,513,400	\$2,407,373.71 9/7/12
24						
25						
26						
27						
28						

Loan #	Borrower	Origination Date	Original Amount	Modification Date	Balance / Date
#7 1063800033 (106322225)	Bacino	March 8, 2006	\$3,000,000	Yes; 5/1/07 #13 Increased by \$3,000,000 Yes; 4/1/08 #16 Increased by \$1,600,000	\$4,607,521.89 9/7/12
#8 1051022354	Barioni Lakes Estates, LLC	June 20, 2006	\$2,015,000		\$1,078,815.76 9/7/12
#9 Mod of #6		August 1, 2006	\$2,513,400 new money		See #6 above
#10 Mod of #1		August 11, 2006	\$1,000,000 new money		See #1 above
#11 1071800066	ALB Properties, LLC	December 13, 2006	\$1,000,000	Yes; 2/1/07 #12 Increased by \$1,224,500 Yes; 9/1/08 #17 Increased <u>to</u> \$3,433,000	\$3,433,000 9/7/12
#12 Mod of #11		February 1, 2007	\$1,224,500 new money		See #11 above
#13 Mod of #7		May 1, 2007	\$3,000,000 new money		See #7 above
#14 1041023203	ALB Properties, LLC	December 28, 2007	\$2,540,000		Paid in full by 1st Am Title (litigation result; but FDIC seeks nondischargeability for possible subsequent adverse litigation ruling)
#15 Mod of #8	Loan assumed by Barioni La Brie, LLC	January 1, 2008	Loan assumed (appears no new \$\$)		See #8 above
#16 Mod of #7		April 1, 2008	\$1,600,000 new money		See #7 above

Loan #	Borrower	Origination Date	Original Amount	Modification Date	Balance / Date
#17 Mod of #11		Sept 1, 2008	Increased to \$3,433,000 (may be new money)		See #11 above
#18 Mod of #1		July 1, 2008 [note: out of chronological order]	1 year extension		See #1 above (although balance appears to be off by \$100,000 possibly due to a typing error)
Totals			\$38,115,400 (est.)		\$14,724,003.80

10. The ABI and Barioni real estate projects financed by La Jolla were of high quality. The loan to value ratios at loan inception, and during some period thereafter, well supported the lending decision and met industry standards. Thus, both Mr. Bacino and La Jolla reasonably believed that sales proceeds after completion of construction would be sufficient to pay the related loans in full. These loans also included interest reserves in light of the borrower's lack of liquidity prior to sale. The evidence establishes that Mr. Bacino did not misappropriate or misuse La Jolla loan proceeds.

11. Ultimately, however, the sharp downturn in the real estate market in the later part of the last decade prevented complete repayment from the real estate project sale proceeds.

12. Mr. Bacino correctly argues that this was not his fault. He incorrectly argues, however, that the facts set forth in paragraphs 10-11 above provide a complete defense.

13. The evidence established that the standard practice in the industry was to require a credit enhancement such as a guaranty in connection with a construction loan. La Jolla acted consistent with this practice. Mr. Bacino provided no contrary evidence on this point. The guaranty was intended to provide an alternate source of repayment given the risk inherent in all construction projects, including those such as the ones encountered here.

1 14. La Jolla relied on Mr. Bacino's guaranties. Internal La Jolla documents
2 repeatedly note Mr. Bacino's high net worth as a strength supporting the lending decision.

3 15. From the first transaction, Mr. Bacino was not careful in connection with the
4 information he provided to La Jolla. FDIC's expert, Robert Wallace, provided compelling
5 testimony that outlined many problems. Some problems involved Mr. Bacino's failure to
6 accurately disclose liabilities and income. Others involved errors involving confusion of
7 income reporting due to the difference between cash basis and accrual basis accounting.
8 Finally, problems arose based on Mr. Bacino's omission of information related to his
9 sources of income. In regard to this final category, in particular, Mr. Bacino never disclosed
10 to La Jolla material changes in his law business – his resignation from the California and
11 Texas Bars – and material issues related to Premier – not merely the existence of lien
12 lawsuits by insurers, a perennial feature of Premier's business, but the escalation and
13 diversification of this litigation and the continuation and commencement of regulatory and
14 criminal investigations. In the case of Premier, the litigation ultimately resulted in a
15 criminal complaint against Premier, Mr. Bacino, and his business partner, a stay of the
16 collection of significant liens, a plea bargain wherein Mr. Bacino pled guilty to one count of
17 capping, and, finally, Premier's waiver of all lien collections.

18 16. The FDIC asserts that the express errors and the omissions support a
19 conclusion that La Jolla's claims should be nondischargeable. In defense, Mr. Bacino
20 argues that the FDIC fails to establish intent, reliance, materiality, and proximate cause. In
21 particular, the evidence establishes that La Jolla's underwriters discovered omitted
22 information and corrected erroneous information in many respects. Mr. Bacino argues that
23 the Bank could not have relied on erroneous information where it discovered the error,
24 conducted underwriting based on accurate assumptions, and made the loans
25 notwithstanding. He also argues that the errors were so significant that La Jolla, in effect,
26 could not rely on anything he offered. He provided expert testimony on this point, but only
27 as to the initial loans. Mr. Bacino further notes that he made substantial payments on the
28 loans and fully intended to pay them in full. He argues that the reason he was not successful

1 in repayment was not the culmination of a fraud on the Bank, but the collapse of the real
2 estate development market.

3 17. Mr. Bacino relied on others to assist him in the management of his personal
4 wealth and business ventures and in preparation of documents related to the La Jolla loans.
5 Of most relevance to this dispute are Warren Thefeld, Anne Berens (testifying as Anne
6 Shackelford), and Judy Brenning.

7 18. Mr. Thefeld was Mr. Bacino's CPA. While Mr. Bacino testified that
8 Mr. Thefeld was actively involved in the La Jolla loan process, Mr. Thefeld testified to a
9 much more limited involvement. Mr. Thefeld was believable on this point; Mr. Bacino was
10 not. In short, Mr. Thefeld provided only limited input in connection with direct questions in
11 the application process.

12 19. The Court determines that Mr. Thefeld's principle role was in tax planning.
13 He was the architect and construction crew for the Tammy ESOP, an entity that held
14 significant assets, including an interest in Premier. Due to changes in the tax law, he
15 orchestrated an event where Tammy, anticipating significant future income from Premier
16 and faced with the termination of advantageous tax laws, accelerated recognition of
17 significant anticipated income. Mr. Thefeld and Mr. Bacino, in reliance on his advice,
18 anticipated significant tax savings.

19 20. Mr. Thefeld was not actively involved in development of financial statements
20 or completion of La Jolla loan applications. He answered questions from Judy Brenning,
21 Mr. Bacino's bookkeeper, in connection with early loans. He also wrote a letter to La Jolla
22 discussing Premier and Tammy. But he never provided quality control for the application
23 process itself, and Mr. Bacino's attempts to suggest to the contrary are not credible.

24 21. Judy Brenning was Mr. Bacino's bookkeeper until her death. Her testimony
25 came into evidence through videotaped deposition testimony. The evidence establishes that
26 she was honest, but unsophisticated. Mr. Bacino relied on her for early loans to prepare his
27 financial statements and to fill out some or all of the loan applications. She actually signed
28 some of these documents for him. But Mr. Thefeld's testimony made clear that she was in

1 way over her head. She did not understand points material to Mr. Bacino's finances.
2 Ms. Brenning's testimony makes clear that she relied on Mr. Bacino for all information and
3 assumed that he would review her work. The Court determines that she was not an
4 independent source of input. Mr. Bacino testified that he did review all documents provided
5 to La Jolla – at the closing. There is no evidence that he ever made a change or a correction.
6 And the errors were multiple.

7 22. Ms. Berens ran Mr. Bacino's law practice. She became involved with the
8 La Jolla loans after Ms. Brenning's illness. Again, the evidence establishes that she was not
9 an independent source of information, but assumed that Mr. Bacino approved prior loan
10 applications and would review the new documents. Much of the information that she
11 included was simply adopted from prior documents. She did remind Mr. Bacino of
12 obligations previously omitted, but she was not in a position by virtue of knowledge,
13 training, or experience to verify the financial information provided to La Jolla or to insure
14 its completeness. Again there is no evidence that Mr. Bacino made a change or correction
15 to the documents that she prepared.

16 23. Mr. Bacino's reliance on others to complete the financial statements and loan
17 applications would be harmless if these documents were accurate; they were not. And it
18 might be understandable if the individuals actually involved had the education, training,
19 sophistication and resources to complete them on their own; they did not. And it also might
20 be understandable if Mr. Bacino had a reasonable basis for a belief that they were providing
21 quality control, verifying the accuracy of information other than through him, or had the
22 access to information, training, or experience sufficient to do his job for him; he did not.
23 And Mr. Bacino's failure to correct the errors might be explainable if the errors were hidden
24 or even subtle; they were not. The Court does not find credible Mr. Bacino's testimony that
25 he actually or reasonably believed that Mr. Thefeld, Ms. Berens, and Ms. Brenning were
26 capable of completing the documents he provided to La Jolla without significant input and
27 oversight from him. And the evidence is clear that he did not provide the input, oversight,
28 and quality control that was appropriate.

1 24. The Court determines that Mr. Bacino did not act with appropriate care in
2 completing his financial statements, the loan applications, and the related documents. He
3 signed documents (or authorized signature on his behalf), and submitted them to La Jolla
4 notwithstanding that they were rife with error; and he knew it. He admits reviewing each
5 document. The errors were obvious, particularly given that they involved facts well within
6 his personal knowledge.

7 25. These errors included the following as detailed by the FDIC's expert,
8 Mr. Wallace:

9 • (Dkt. # 451 at 54:4 - 63:12): From 2004 - 2008, there were overstatements of the
10 value of Tammy (\$25 million) and understatement of ALB liabilities (\$13 million).
11 Tammy's value/net worth included \$12 million of Premier receivables (of which only
12 \$7.5 million was collected) and a \$13 million receivable from ALB which was uncollectible
13 and improperly recorded due to erroneous representations from Mr. Bacino. The
14 corresponding liability from ALB was never included on the loan applications. Also, when
15 Tammy collected the \$7.5 million, it loaned the money out to Mr. Bacino's other entities;
16 they never repaid the loans and never included the loans as liabilities on the loan
17 applications. The effect on net worth was an overstatement of \$13 to \$25 million.

18 • (Dkt. # 451 at 66:11 - 67:2): In 2004, the loan applications valued Lot 15 at
19 \$8 million value and showed it as encumbered by \$552,500 of debt. The debt should be
20 \$5.5 million. The effect on net worth was an overstatement of \$5 million.

21 • (Dkt. # 451 at 68:14 - 71:22): Loan applications listed a Bank of America bank
22 account (06001-06671) at \$2,394,000 in June 2005 and \$4.2 million in June 2006. This was
23 a Tammy bank account so it was already included in the Tammy value. The account had a
24 book balance at the time of the loan application of between \$44,000 and \$480,000 in June
25 2005 and less than \$1,000 in June 2006 based on the records of Tammy. The effect on net
26 worth was an overstatement of between \$2 million and \$4.2 million.

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1 • (Dkt. # 451 at 72:1 - 74:21): The loan application dated June 15, 2005 included
2 14732 El Rodeo with a market value of \$8.5 million. The property was sold on June 10,
3 2005. The effect on net worth was an overstatement of up to \$8.5 million.

4 • (Dkt. # 451 at 75:16 – 80:5): From 2005 - 2008, there was a double or triple
5 counting of the same assets by including income of approximately \$200,000 to \$600,000 a
6 month (collections on Tammy receivables from Premier), \$11 million to \$31 million vested
7 pension (pension is ESOP value created by Tammy receivables from Premier) and there was
8 no separate vested pension and Tammy equity (\$15 million to \$32 million) created by
9 accrual of Tammy receivables from Premier. The effect on net worth was an overstatement
10 of up to \$11 to \$31 million in addition to the overstatement related to Tammy already
11 discussed.

12 • (Dkt. # 451 at 80:6 – 85:16): From 2005 - 2008, Bacino failed to include loans
13 payable/liabilities of Barioni from other Bacino entities such as Tammy on the loan
14 applications. The effect on net worth was an overstatement of between \$4 million and
15 \$9 million.

16 • (Dkt. # 451 at 85:17 – 91:9): From 2006 - 2008, the net assets of Transpacific
17 Equities were double counted as its only asset (a charter yacht) was included on the loan
18 application for \$3 million and the only liability to Charter One was included at \$2.1 million
19 for a net of \$900,000. In addition, the equity of Transpacific Equities was included for
20 \$977,000. In other applications, the charter yacht value was included but the debt to Charter
21 One was omitted. The effect on net worth was an overstatement of \$900,000 to \$2.1 million.

22 • (Dkt. # 451 at 91:10 – 93:10): In 2006, "Other assets" on the loan application dated
23 March 2006 included Centurion Equity for \$7,376,767. Centurion is Centurion Practice
24 Office Affiliates, Inc. ("CPA"). CPA had assets of approximately \$10 million, liabilities of
25 approximately \$10 million, which means there was no equity. The effect on net worth was
26 an overstatement of \$7,376,767.

27 • (Dkt. # 451 at 93:11 – 95:4): The June 2006 loan application included the Barioni
28 property referred to as Imperial at a value of \$26.3 million. The property was purchased for

1 \$3.1 million, approximately 7 months earlier in November 2005. An increase of
2 748 percent in the value in 7 months was not reasonable. The effect on net worth was an
3 overstatement of up to \$23 million.

4 • (Dkt. # 451 at 95:8 – 100:25; 101:9 - 21): From 2005 - 2008, the liabilities to
5 unrelated parties due from ALB were included on the loan applications at significantly less
6 than the actual liabilities of ALB. The effect on net worth was an overstatement by as much
7 as \$25 million.

8 • Dkt. # 451 at 102:14 – 104:9). On the June 2006 loan application, the airplane is
9 included with a value of \$1.2 million, but the debt related to the airplane of \$1.55 million is
10 omitted. The effect on net worth was an overstatement of \$1.55 million.

11 26. While the FDIC's expert, Mr. Wallace, did a comprehensive job and identified
12 numerous errors, it is unclear to the Court that the undisclosed loans he identified actually
13 included all loans that were out there. Mr. Bacino or his entities borrowed money from his
14 business partner Mr. Fish (as much as \$6 million according to Ms. Berens), a Mr. Fardeen,
15 and Jerry Hall, the father of the President of La Jolla. He (or one of his entities) even
16 borrowed \$300,000 from Ms. Berens and \$75,000 from her brother. He failed to repay the
17 entire amount owed to Ms. Berens.

18 27. These points evidence problems not readily identifiable by La Jolla from the
19 face of the loan documents. Perhaps in isolation, Mr. Bacino could argue that an omitted
20 fact was a mere oversight. However, taken together in light of the magnitude of the
21 problems, and given the testimony of all experts which either characterize the problems as
22 material or suggest materiality of some or all of the erroneous information, they raise
23 significant concerns.

24 28. La Jolla did not blindly accept these documents, however. The evidence
25 establishes appropriate underwriting that identified many errors. For example, undisclosed
26 loans from institutional lenders were identified from credit reports. The expert testimony of
27 Mr. Tartar establishes that La Jolla's underwriting met industry standards. The underwriting
28 established two things, some sloppiness, but substantial net worth. Mr. Bacino's expert did

1 not review most of the loans and expressed only limited opinions. He expressed the opinion
2 that the errors were such that La Jolla could not trust the documents provided. The Court
3 considered this testimony, but ultimately concluded that it was not sufficient to overcome
4 the opinions of Mr. Tartar given, among other things, the limited scope of his review.

5 29. Unfortunately, however, Mr. Bacino not only failed to provide accurate
6 information, he also failed to disclose material information relevant to his financial health.
7 The unrefuted expert testimony establishes that La Jolla could not and did not discover this
8 information through underwriting. And Mr. Schiller, Mr. Bacino's own expert, testified as
9 to many of these nondisclosures that he would have expected Mr. Bacino to provide this
10 information. In some cases, he qualified his testimony by saying that disclosure was
11 necessary only to the extent it materially impacted Mr. Bacino's ability to make payment,
12 but this qualification is irrelevant. The Court determines that the undisclosed information
13 meets this criterion.

14 30. Mr. Bacino was required by industry standards to disclose the challenges
15 confronting Premier and their impact. Information related to the impact on his law practice
16 was also required. Again, his own expert largely so agreed. He never provided this
17 information in written form and certainly did not include it in any fashion in the loan
18 application documents.

19 31. And Mr. Bacino signed documents that required such disclosures either
20 individually or as the principal of ALB or Barioni. These documents include:

21 • **Guaranties:** Mr. Bacino signed a Commercial Guaranty in connection with each
22 loan to one of his entities. Each contained a representation and warranty that: "(F) Upon
23 Lender's request, Guarantor will provide to Lender financial and credit information in form
24 acceptable to Lender, and all such financial information which currently has been, and all
25 future financial information which will be provided to Lender is and will be true and correct
26 in all material respects and fairly present Guarantor's financial condition as of the dates the
27 financial information is provided." He further, repeatedly represented that: "(G) No
28 material adverse change has occurred in Guarantor's financial condition since the date of the

1 most recent statements provided to Lender and no event has occurred which may materially
2 adversely affect Guarantor's financial condition." And finally, he repeatedly represented
3 that: "(H) No litigation, claim, investigation, administrative proceeding or similar action
4 (including those for unpaid taxes) against Guarantor is pending or threatened." See Ex.
5 # 59, 67, 76, 96, 106 (guaranty by Tammy), 118, 129, and 260.

6 • **Loan Applications:** The loan applications concluded with a certification at Part IX
7 "Acknowledgement and Agreement" as follows: ". . . undersigned specifically represents to
8 [La Jolla] . . . that: (1) the information provided in this application is true and correct as of
9 the date set forth opposite my signature and that any intentional or negligent
10 misrepresentation . . . may result in civil liability . . . and/or criminal penalty. . ." See Ex.
11 # 60, 68, 77, 84, 90, 97, 98, 107, 109, 119, and 120.

12 • **Personal Financial Statement:** Each personal financial statement concluded with
13 a representation as follows:

14 I have carefully read and submitted the foregoing information provided on all
15 three pages of this statement to [La Jolla]. The information is presented as a
16 true and accurate statement of my financial condition on the date indicated... I
17 agree that if any material change(s) occur(s) in my financial condition that I
18 will immediately notify [La Jolla] of said change(s) and unless [La Jolla] is so
19 notified it may continue to rely upon this financial statement and the
20 representations made herein as a true and accurate statement of my financial
21 condition.

22 I fully understand that it is a federal crime punishable by fine or imprisonment
23 or both to knowingly make any false statements concerning any of the above
24 facts, pursuant to 18 U.S.C. [§] 1014.

25 [See, e.g. Ex. # 150, 174, 423, 541, 595, 596, and 598.]

26 • **Change in Terms Agreement for Loan:** In connection with loan modifications,
27 Mr. Bacino signed documents containing a "Continuing Validity" clause disclosing that,
28

1 unless expressly changed, all previously stated conditions still applied. *See, e.g.*, Ex. # 83
2 and 188.

3 • **Construction Loan Agreements:** These documents also included a representation
4 and warranty as follows:

5 Financial Information: Each of Borrower's financial statements supplied to
6 [La Jolla] truly and completely disclosed Borrower's financial condition as of
7 the date on the statement, and there has been no material adverse change in
8 Borrower's financial condition subsequent to the date of the most recent
9 financial statement supplied to [La Jolla]. Borrower has no material
10 contingent obligations except as disclosed in such financial statements. *See,*
11 *e.g.*, Ex. # 318 and 290.

12 32. Mr. Bacino testified that he orally provided Mr. Hall, La Jolla's president, with
13 information that went beyond that set forth in his financial statements and loan documents,
14 and in particular that he detailed the problems at Premier, at some point in the lending
15 relationship. There is no evidence, however, that Mr. Hall presented this evidence to
16 anyone else at La Jolla and there is not a shred of written evidence establishing that
17 La Jolla's underwriters, loan committee, or Board had this information. Further, Mr. Hall
18 had some incentive to keep the evidence from La Jolla. His father loaned Mr. Bacino or his
19 entities significant amounts. The Court does not find that Mr. Hall received this information
20 and withheld it from La Jolla, but he had an incentive to do so. Mr. Bacino had an
21 obligation to formally convey material adverse information to La Jolla; he does not meet
22 this duty through a verbal exchange – particularly with a bank officer whose loyalties can
23 reasonably be assumed to be divided.

24 **Section 523(a).**

25 33. When determining whether a debt is excepted from discharge, a bankruptcy
26 court must construe the evidence against the creditor and in favor of the debtor. *Mele v.*
27 *Mele (In re Mele)*, 501 B.R. 357, 363 (9th Cir. BAP 2013). Thus, a creditor objecting to the
28 dischargeability of its claim bears the burden of proving, by a preponderance of the

1 evidence, that the particular debt falls within one of the exceptions to discharge enumerated
2 in § 523(a). *Grogan v. Garner*, 498 U.S. 279, 286-91 (1991). "Proof by the preponderance
3 of the evidence means that it is sufficient to persuade the finder of fact that the proposition
4 is more likely true than not." *United States v. Arnold & Baker Farms (In re Arnold & Baker*
5 *Farms)*, 177 B.R. 648, 654 (9th Cir. BAP 1994). The fresh start opportunity that drives this
6 allocation of the burden of proof is limited, however, to the "honest but unfortunate debtor."
7 *Grogan*, 498 U.S. at 286-87.

8 **Section 523(a)(2)(B).**

9 34. Under § 523(a)(2)(B), a discharge under § 727 does not discharge an
10 individual debtor from any debt for money...or an extension, renewal, or financing of credit
11 to the extent obtained by use of a statement in writing that is materially false, respecting the
12 debtor's or an insider's financial condition, on which the creditor to whom the debtor is
13 liable for such money, property, services, or credit reasonably relied, and that the debtor
14 caused to be made or published with intent to deceive.

15 35. A creditor seeking nondischargeability under § 523(a)(2)(B), thus, must show:

- 16 1. Creditor provided debtor with money, property, services or credit based
17 on a written representation of fact by the debtor as to the debtor's
18 financial condition;
- 19 2. The representation was materially false;
- 20 3. The Debtor knew the representation was false when made;
- 21 4. The debtor made the representation with the intention of deceiving the
22 creditor;
- 23 5. The creditor relied on the representation;
- 24 6. The creditor's reliance was reasonable; and
- 25 7. Damage proximately resulted from the representation.

26 *See Siriani v. Northwestern Nat'l Ins. Co. (In re Siriani)*, 967 F.2d 302, 304 (9th Cir. 1992).

27 36. In order to establish that the debts are nondischargeable under § 523(a)(2)(B),
28 the FDIC must show that Mr. Bacino provided materially false statements regarding his

1 financial situation to La Jolla, that Mr. Bacino made these representations with the intention
2 to induce La Jolla's reliance on those representations, that La Jolla reasonably relied on
3 those representations, that La Jolla sustained losses, and that Mr. Bacino's actions were the
4 proximate cause of those losses. Based on the evidence then before it, the Court granted
5 partial summary judgment. It determined as to all loans and extensions of credit that
6 La Jolla provided Mr. Bacino or his entities with money or credit extension based on a
7 written representation of Mr. Bacino's financial condition. The Court also determined that
8 certain financial information where Mr. Bacino conceded inaccuracy was materially false.
9 The Court then found actual reliance, but left for another day whether reliance was
10 reasonable except as to the initial advances under Loans 1, 2, and 3. The Court previously
11 determined that La Jolla's reliance on the materially false information was reasonable in
12 connection with those transactions. *See* Dkt. # 429.

13 37. Here, there is no dispute, and the Court previously concluded, that La Jolla
14 made the loans at issue based on financial documents signed by Mr. Bacino. Further, there
15 is no dispute that these documents contained significant falsity. Indeed, Mr. Bacino's own
16 expert, who reviewed only a small subset of documents, was of the opinion that the falsities
17 were so egregious that La Jolla should have been on notice that something was seriously
18 wrong. With narrow exception, there is no dispute that Mr. Bacino knew about the
19 inaccuracies and the facts that made the loan-related documents inaccurate. He testified that
20 he did not understand the Tammy double counting issue, but even if the Court found this
21 testimony consistently credible throughout the lending relationship (it does not), the other
22 errors were squarely within Mr. Bacino's personal knowledge. At issue here, thus, is,
23 insofar as not already decided, the materiality of the falsehoods, Mr. Bacino's intent, to the
24 extent not already decided whether La Jolla relied on the false information, and if so, except
25 as to the initial advances under Loans 1, 2, and 3, was this reliance reasonable, and the
26 proximate cause of La Jolla's unpaid loans.

27
28

1 **Materiality.**

2 38. To define a material fact, courts, in general, tend to rely on the Restatement
3 (Second) of Torts § 551 (1977). The Restatement explains that there must be a duty to
4 disclose facts which the other party is entitled to know based on the relationship between the
5 parties; facts which, if not disclosed, may be misleading; facts which are subsequently
6 acquired which a party knows will make untrue or misleading a previously understood
7 representation; facts about which the party made representations without the expectation of
8 them being acted on, subsequently learns the other is going to act in reliance on those facts;
9 and facts which are basic to the transaction, the other party is about to enter the transaction
10 under a mistake as to those facts, and that the other party, because of the relationship
11 between the parties, would reasonably expect disclosure of those facts.

12 39. More specifically, to meet the requirements for materiality under §
13 523(a)(2)(B), a statement may include information which is substantially inaccurate and is
14 of the type that would affect the creditor's decision making process. "To except a debt from
15 discharge, the creditor must show not only that the statements are inaccurate, but also that
16 they contain important and substantial untruths." *Candland v. Ins. Co. of No. Am. (In re*
17 *Candland)*, 90 F.3d 1466, 1470 (9th Cir. 1996) (quoting *First Interstate Bank of Nev. (In re*
18 *Greene)*, 96 B.R. 279, 283 (9th Cir. BAP 1989)).

19 40. In *Tallant v. Kaufman (In re Tallant)*, the Panel explained that "'material
20 falsity' in a financial statement can be premised upon the inclusion of false information or
21 upon the omission of information about a debtor's financial condition." 218 B.R. 58, 71
22 (9th Cir. BAP 1998).

23 41. In *Candland*, the defendant, familiar with business transactions and applying
24 for bonds, inappropriately calculated his pensions and annuities by summing future
25 payments rather than discounting the future payments to their present value. 90 F.3d at
26 1469-70. He also omitted several notes payable which totaled over \$150,000. *Id.* The court
27 held that these incorrect representations and omissions were material when such information
28 would generally affect a lender's or guarantor's decision. *Id.*

1 42. In contrast, in *Tallant*, the Panel determined that there was no material
2 misrepresentation when the defendant offered an accurate statement of his law firm's
3 profitability but omitted personal debts of \$3 million when the plaintiff never requested a
4 statement regarding the defendant's personal liabilities and there was no statement made that
5 would indicate the firm's profitability statement reflected the defendant's personal financial
6 situation. 218 B.R. at 71. Because there was no indication that the plaintiff would have
7 relied on the personal financial statements, the defendant's failure to provide them was not a
8 material omission.

9 43. The Court concludes that the preponderance of the evidence establishes that
10 the facts of this case are consistent with those of *Candland*. There erroneous information
11 was provided on financial statements submitted as part of each loan application package.
12 The information requested was typical for this lender, the industry, and the particular
13 transactions at issue. There is no part of the information erroneously provided (or
14 incorrectly omitted) that was volunteered as was the case in *Tallant*. The evidence is that
15 the inaccuracies at issue were of the type actually relied upon in making the decision to
16 advance the La Jolla loans.

17 44. The Court also notes that the omitted information as to the law practice and
18 Premier, and the various regulatory and criminal matters, in particular, was also material as
19 it reflected on Mr. Bacino's character. The FDIC expert, Mr. Tartar, testified that one of the
20 "5 C's" of credit is character – the lender needs to trust the borrower and view him to be of
21 appropriate character. Information of this type would be material to La Jolla in deciding to
22 lend. And repeatedly failing to disclose required (and problematic) information means that
23 each prior non-disclosure becomes more and more troubling from a character perspective.

24 **Intent.**

25 45. In assessing intent, the Court need not rely on the debtor's protestations of
26 innocence or lack of intent. A debtor is charged with the knowledge of the natural
27 consequences of his actions. *Ormsby v. First Am. Title Co.*, 591 F.3d 1199, 1206 (9th Cir.
28 2010). And a bankruptcy court also may consider circumstantial evidence that tends to

1 establish what the debtor must have actually known when taking the injury-producing
2 action. *Jett v. Sicroff (In re Sicroff)*, 401 F.3d 1101, 1106 (9th Cir. 2005).

3 46. While the intentional conduct standard is defined as purposefully committing
4 the act for the purpose of the harm resulting, a Court also may find that § 523(a)(2)(B)'s
5 intent standard is satisfied where the debtor acts with the requisite recklessness. *Merchants*
6 *Bank of Cal. v. Oh (In re Oh)*, 278 B.R. 844, 858 (Bankr. C.D. Cal. 2002).

7 47. To meet the standard of gross recklessness, one must be both subjectively and
8 objectively reckless. Thus, where a defendant knew or should have known of facts which
9 create a high degree of risk of harm and deliberately proceeds to act or fail to act, in
10 conscious disregard of, or indifference to, that risk gross recklessness is appropriately found.
11 Restatement (Second) of Torts § 500.

12 48. A recent Supreme Court decision, *Bullock v. BankChampaign, N.A.*, 133 S.Ct.
13 1754 (2013), applied the Model Penal Code standard for recklessness in a § 523(a)(4)
14 context. The Court stated that:

15 [W]here the conduct at issue does not involve bad faith, moral turpitude, or other
16 immoral conduct, the term requires an intentional wrong. We include as intentional
17 not only conduct that the fiduciary knows is improper but also reckless conduct of the
18 kind that the criminal law often treats as the equivalent.

18 *Id.* at 1759.

19 49. The Model Penal Code includes willful blindness within the definition of
20 gross recklessness. *See In re Rahman*, 2013 WL 2237537 (Bankr. M.D. Fla. 2013); *L.W. v.*
21 *Grubbs*, 92 F.3d 894 (9th Cir. 1996) ("The risk must be of such a nature and degree that,
22 considering the nature and purpose of the actor's conduct and the circumstances known to
23 him, its disregard involves a gross deviation from the standard of conduct that a law-abiding
24 person would observe in the actor's situation.") (quoting Model Penal Code § 2.02).

25 50. The FDIC argues that the evidence here mandates a conclusion that
26 Mr. Bacino acted with express fraudulent intent throughout the La Jolla lending relationship.
27 The Court is not so sure. While the evidence strongly suggests actual intent as to later
28 loans, this is less clear at the early stages of the lending relationship. But the Court need not

1 establish whether and if Mr. Bacino's state of mind crossed this line because it concludes
2 that the strong preponderance of the evidence establishes that at all points in time
3 Mr. Bacino acted with requisite recklessness. Similarly, the Court need not determine
4 whether the *Bullock* standard of gross recklessness within the meaning of the Model Penal
5 Code applies in a § 523 (a)(2) context and if this results in a heightened recklessness
6 requirement from that found sufficient in prior cases; if a higher standard is required, it is
7 met here.

8 51. Mr. Bacino borrowed or guaranteed millions of dollars through the use of
9 documents that were highly inaccurate. They presented a false sense of his personal net
10 worth. They failed to disclose facts known to Mr. Bacino that created significant risk to him
11 and to anyone relying on him for repayment. He delegated his responsibility for truthful
12 disclosure to others who lacked the information, opportunity, or sophistication to provide an
13 accurate picture of his financial situation. And he did so again, and again, and again. He
14 testified that he read the documents prior to the closings of the various loans, but there is no
15 evidence that he corrected a single syllable.

16 **Reasonable Reliance.**

17 52. To meet the reliance standard under § 523(a)(2)(B), there must be reasonable
18 reliance. As stated in the standard itself, this is a reasonable person standard. Reasonable
19 reliance focuses on whether reliance would have been reasonable to the hypothetical
20 average person. *Beneficial Cal., Inc. v. Brown (In re Brown)*, 217 B.R. 857, 863 (Bankr.
21 S.D. Cal. 1998). Reasonable reliance is analyzed under a "prudent person" test. *Cashco*
22 *Fin. Servs., Inc. v. McGee (In re McGee)*, 359 B.R. 764, 774 (9th Cir. BAP 2006); *First*
23 *Mut. Sales Fin. v. Cacciatori (In re Cacciatori)*, 465 B.R. 545, 555 (Bankr. C.D. Cal. 2012)
24 (court must objectively assess the circumstances to determine if creditor exercised the
25 degree of care expected from a reasonably cautious person in the same business transaction
26 under similar circumstances). Reasonable reliance is judged in light of the totality of the
27 circumstances on a case-by-case basis. *Id.* A creditor's reliance may be reasonable if it
28 adhered to its normal business practices. *Nat'l City Bank. v. Hill (In re Hill)*, 2008 WL

1 2227359 at *3 (Bankr. N.D. Cal. May 23, 2008). The Court may consider whether the
2 lender's normal practices align with industry standards, or if there were any red flags that
3 would have alerted an ordinarily prudent creditor under similar circumstances to the
4 possibility that the representations relied on were not accurate, and whether even minimal
5 investigation would have revealed the inaccuracy. *Id.*; *see also, Highline Capital Corp. v.*
6 *Register (In re Register)*, 2010 WL 605314 at *6 (Bankr. W.D. Wash., Feb. 19, 2010).

7 53. Mr. Bacino argues that La Jolla did not actually or reasonably rely on his
8 misrepresentations. He points out that La Jolla actually discovered some of his errors, such
9 as those identifiable from credit reports, and utilized its own information in connection with
10 the credit decision. This is true, and if the discovered errors were the only ones out there,
11 Mr. Bacino would have a defense. But they are not. Mr. Bacino failed to disclose a bevy of
12 transactions that were not discoverable by La Jolla except with his assistance. These
13 included transactions between his various entities and non-commercial loans such as those
14 from Ms. Berens, her brother, his business partner, Mr. Fish, a Mr. Fardeen, and Mr. Hall,
15 the father of La Jolla's President. He also failed to divulge when he was no longer licensed
16 to practice law in California and Texas. And perhaps most troubling, he failed to disclose
17 the serious challenges, ultimately leading to criminal liability, that faced Premier.

18 Mr. Bacino states that the Premier problems really weren't a source of concern, especially at
19 the beginning of the lending relationship. But in order to convey an accurate financial
20 picture, these many issues needed to be disclosed. They were not.

21 54. Mr. Bacino also argues, in effect, that for most loans, La Jolla was relying not
22 on his net worth, but on the real estate development projects. The Court finds this defense
23 lacking. First, La Jolla required a guaranty. This was consistent with its general practice
24 and industry standards. Further, the loan write-ups consistently point to Mr. Bacino's net
25 worth as support for the loans. What Mr. Bacino was supposed to provide through his
26 guaranty was a credit enhancement, a source of repayment if, notwithstanding everyone's
27 belief that it was unlikely, the real estate developments did not generate proceeds sufficient
28 to pay off the related costs and the loans. As a result of the erroneous information,

1 Mr. Bacino's net worth and liquidity were not as represented in the documents he signed.
2 La Jolla identified some of the errors – and reduced its estimate of net worth accordingly.
3 But La Jolla could not find all the errors through any reasonable means. Inter-company
4 transactions and loans from private individuals will not show up on a credit report. A bank
5 is not required to contact the state bar to see if someone who represents themselves as an
6 attorney remains in fact licensed. The Premier issues were undiscoverable with any
7 reasonable due diligence. As a result of these errors and nondisclosures, La Jolla was
8 unaware that Mr. Bacino's guaranty failed to provide appropriate support for the loans. If
9 the ALB and Barioni real estate projects failed, so did he.

10 55. Mr. Bacino's allegation that he disclosed some of the omitted information to
11 Mr. Hall, La Jolla's President, also fails as a defense. There is no evidence that the
12 information went from Mr. Hall to La Jolla. Indeed, there is no mention of the alleged
13 disclosures in any La Jolla document. The FDIC enjoys special protections where there is
14 an allegation that an insider participated in a fraud on a bank. The Court does not find such
15 an affirmative fraud here, but given Mr. Hall's conflict given the loans to Mr. Bacino by
16 Mr. Hall's father and given the total absence of evidence that this information was conveyed
17 to the La Jolla Board or loan committees, this fact, even if true, does not provide a defense.

18 56. Mr. Bacino's final attack as to the reasonableness of any reliance relies on his
19 expert's opinion that red (or yellow) flags alerted La Jolla to the fact that the financial facts
20 were not as represented. The Court disagrees. The FDIC establishes both through its
21 expert, Mr. Tartar, and through the factual testimony, that La Jolla could reasonably rely on
22 Mr. Bacino's submissions – even if it identified serious errors. The errors identified still
23 resulted in a conclusion that Mr. Bacino had significant net worth. There were no alerts that
24 led to the identification of the many loans and transactions that would never be disclosed by
25 a balance sheet or the serious problems with Premier. The Court finds compelling that
26 Mr. Bacino and his entities were repeat customers and that Mr. Bacino's legal training
27 reasonably led to the conclusion that he was sophisticated and aware of his obligations for
28 full disclosure.

1 57. The Court concludes that the preponderance of the evidence establishes that
2 La Jolla actually and reasonably relied on the erroneous and incomplete information
3 provided by Mr. Bacino.

4 **Proximate Cause.**

5 58. To establish proximate cause, bankruptcy courts are not required to "divine
6 what might have happened." *In re Siriani*, 976 F.2d at 306. Therefore, in the absence of
7 contrary evidence (there is no such direct evidence here), proximate cause is established
8 when the falsehoods were material and involved significant amounts of money. *In re*
9 *Candland*, 90 F.3d at 1471.

10 59. The court concludes based on the totality of the evidence that the FDIC meets
11 its burden of proof that the losses sustained were the proximate result of Mr. Bacino's
12 actions as discussed above. It is clear that La Jolla required a true credit enhancement. It is
13 clear that Mr. Bacino failed to provide information such that La Jolla could accurately
14 assess his financial situation. The mistakes were material and involved significant
15 falsehoods. Mr. Bacino defends on the basis that the FDIC did not introduce testimony
16 from a loan officer stating what the bank would have done had it known. The FDIC did not
17 need to do so, and Mr. Bacino failed to offer this same type of testimony favorable to his
18 cause when the burden of proof shifted in his direction given the standard articulated in
19 *Siriani* and *Candland*.

20 **Section 523(a)(2)(A).**

21 60. Under § 523(a)(2)(A), a discharge under § 727 does not discharge an
22 individual debtor from any debt for money or an extension, renewal, or financing of credit
23 to the extent obtained by false pretenses, a false representation, or actual fraud, other than a
24 statement respecting the debtor's or an insider's financial condition.

25 61. In the Ninth Circuit, to prove actual fraud, a creditor must establish each of the
26 following elements:

- 27 1. That the debtor made the representations;
- 28 2. That at the time he knew they were false;

- 1 3. That he made them with the intention and purpose of deceiving the
- 2 creditor;
- 3 4. That the creditor relied on such representations; [and]
- 4 5. That the creditor sustained the alleged loss and damage as the
- 5 proximate result of the representations having been made.

6 *Britton v. Price (In re Britton)*, 950 F.2d 602, 604 (9th Cir. 1991).

7 62. It is also necessary in evaluating a § 523(a)(2)(A) claim that a court determine
8 whether the fraud involves "statements other than respecting a debtor's financial condition."
9 "In determining whether a statement relates to a debtor's financial condition, courts agree
10 the term is not limited to formal financial statements." *See Spencer v. Bogdanovich (In re*
11 *Bogdanovich)*, 292 F.3d 104, 112 (2d Cir. 2002) citing *Norcross v. Ransford (In re*
12 *Ransford)*, 202 B.R. 1, 4 (Bankr. D. Mass. 1996). "Two views have emerged over how to
13 interpret the scope of § 523(a)(2)(A)'s exception. A broad interpretation would include any
14 statement that reflects the financial condition of the debtor. On the other hand, a narrow
15 interpretation would find that a statement relates to financial condition only when it
16 provides information "as to [a debtor's] overall financial health. *Id.* The Ninth Circuit has
17 not decided, to date, whether to apply the broad or the narrow interpretation of what
18 constitutes a statement of financial condition.

19 63. Here, some of the erroneous information clearly and directly involves
20 Mr. Bacino's financial condition and § 523(a)(2)(B). But § 523(a)(2)(A) may also be
21 applicable. In each of the many guarantees and in some of the other documents that
22 Mr. Bacino executed, he broadly represented that all information provide by him was
23 accurate. He also represented that information previously provided remained accurate and
24 that there had been no material adverse change since he provided such information and that
25 there was no proceeding or investigation that threatened him. These statements either
26 constitute an additional basis for nondischargeability based on § 523(a)(2)(B) or, in whole
27 or in part, support an alternative nondischargeability determination under § 523(a)(2)(A).

28

1 64. Thus, in order to establish that the La Jolla claims are nondischargeable under
2 § 523(a)(2)(A), the FDIC must show that Mr. Bacino made false or fraudulent
3 representations to La Jolla in relation to something other than his financial condition, that
4 Mr. Bacino made these representations with the intention to induce La Jolla's reliance on
5 those representations, that La Jolla justifiably relied on those representations, that La Jolla
6 sustained losses, and that Mr. Bacino's actions were the proximate cause of those losses.

7 65. The Court relies on its prior discussion regarding the serious omissions and
8 misstatements in the information provided to La Jolla. The FDIC meets its burden of proof
9 in this regard.

10 **Justifiable Reliance.**

11 66. Under § 523(a)(2)(A), the required reliance is justifiable. This is a subjective
12 standard which considers the "qualities and characteristics of the particular plaintiff, and the
13 circumstances of the particular case, rather than the application of a community standard of
14 conduct to all cases." *Field v. Mans*, 516 U.S. 59, 71 (1995) (quoting Restatement (Second)
15 of Torts § 545A (1976)). In *Field v. Mans*, the Supreme Court held that § 523 (a)(2)(A)
16 requires justifiable reliance rather than reasonable reliance. *Id.* at 65-66. The Court had two
17 primary reasons for this holding. First, Congress specified in § 523 (a)(2)(B) that the
18 reliance standard was reasonable reliance. The lack of specification in § 523 (a)(2)(A) did
19 not eliminate reliance nor was it rational to assume that Congress meant for reasonable
20 reliance to apply to both subsections when it only specified reasonable reliance in the
21 second sub-section. *Id.* at 68.

22 67. The Supreme Court also observed that § 523 (a)(2)(B) referenced terms that
23 were not traceable to another context where the elements were already defined; while § 523
24 (a)(2)(A) used common law terms which implied application of those common law
25 elements. *Id.* at 68-69. These pre-defined terms included the requirement that the reliance
26 is justifiable rather than reasonable and there was no reason to doubt Congress's intent to
27 apply the common law understanding of the terms. *Id.* at 69-70. The application of
28 justifiable reliance, however, does not wholly eliminate the need for some reasonableness

1 application. *Id.* at 76. Reasonableness is still partially necessary because "the greater the
2 distance between the reliance claimed and the limits of the reasonable, the greater the doubt
3 about reliance in fact." *Id.* Reasonableness should be taken into consideration within the
4 actual circumstances and considering the actual parties involved in said circumstances,
5 rather than comparing the parties' actions to a reasonable person standard, therefore making
6 the reliance standard for § 523 (a)(2)(A) subjective and justifiable.

7 68. Reliance may be presumed when "the case can be characterized as one that
8 primarily alleges omissions." *Binder v. Gillespie*, 184 F.3d 1059, 1064 (9th Cir. 1999); *See*
9 *also Poulos*, 379 F.3d at 666-67.

10 69. Here, the preponderance of the evidence establishes that La Jolla's reliance
11 was justifiable. Of particular relevance here is Mr. Bacino's legal training and the nature of
12 the undisclosed information. The evidence regarding industry practices from the FDIC's
13 expert was also compelling. Indeed, Mr. Bacino's own expert stated, although somewhat
14 conditionally, that Mr. Bacino had an obligation to disclose certain information, and his
15 testimony based on limited review and assignment did not adequately address the Court's
16 concerns based on the totality of the contrary evidence.

17 **Intent.**

18 70. As was the case with § 523(a)(2)(B), recklessness can satisfy the intent
19 element. A reckless indifference to the truth supports a cause of action under
20 § 523(a)(2)(A). *Arm v. A. Lindsay Morrison, M.D., Inc. (In re Arm)*, 175 B.R. 349, 354
21 (9th Cir. BAP 1994).

22 71. A debtor's silence or omission of a material fact can constitute a false
23 representation which is actionable under § 523(a)(2)(A). *Citibank (South Dakota), N.A. v.*
24 *Eashai (In re Eashai)*, 87 F.3d 1082, 1089 (9th Cir. 1996). However, in order to find
25 liability for fraud based upon omission or silence, there must also be a duty to disclose. *Id.*
26 Nondisclosure of a material fact in the face of a duty to disclose can establish the requisite
27 reliance and causation for actual fraud under the Code. *Apte v. Romesh Japra, M.D.*,

28

1 *F.A.C.C., Inc. (In re Apte)*, 96 F.3d 1319, 1323 (9th Cir. 1996). Mr. Bacino had a duty to
2 provide complete and accurate financial information to La Jolla.

3 72. The Court relies on its previous discussion and again comes to the conclusion
4 that whatever recklessness standard applies here, Mr. Bacino acted with at least the requisite
5 recklessness throughout the La Jolla lending relationship. Again, it is likely that affirmative
6 fraudulent intent could be found at some point in the relationship; it is hard to believe the
7 repeated republication of the false representations in the guaranties was done with less than
8 fraudulent intent as the Premier problems and Mr. Bacino's other problems multiplied. But
9 as with § 523(a)(2)(B), the Court need not pinpoint the existence of affirmative fraud with
10 precision – recklessness suffices.

11 **Proximate Cause.**

12 73. Proximate cause under §523(a)(2)(A) is met when a material fact is not
13 disclosed in the face of a duty to disclose. *Id.* at 1323.

14 74. To establish materiality under § 523 (a)(2)(A), case law relies on the
15 Restatement (Second) of Torts § 551 (1997). For facts to be material, the Restatement
16 requires that there be a duty to disclose:

- 17 (a) Facts which the other is entitled to know based on the parties' relationship;
- 18 (b) Facts which, if not disclosed may be misleading;
- 19 (c) Facts which are subsequently acquired which a party knows will make
20 untrue or misleading a previously understood representation;
- 21 (d) facts about which a party made representations without the expectation of
22 them being acted on, subsequently learns the other is going to act in reliance
23 on those facts;
- 24 (e) And when the other party is about to enter the transaction under a mistake
25 as to facts which are basic to the transaction, and the other party, because of
26 the relationship between them, would reasonably expect disclosure of those
27 facts.

1 See also *In re Apte*, 96 F.32d at 1324 (defendant did not disclose to a sub-leaser that the
2 owner of a property did not accept pertinent terms of the sub-leaser's contract when the sub-
3 leaser did not have an opportunity to discover this for himself); see also *In re Tallant*,
4 218 B.R. 58 at 65 (applying § 551 of the Restatement, an attorney's failure to disclose
5 information that he has a duty to disclose under the professional responsibility rule may
6 constitute a false representation of nondisclosure under § 523 (a)(2)(A)).

7 75. Courts acknowledge that proximate cause is extremely difficult to prove in
8 cases of fraudulent non-disclosure. See generally *In re Apte*, 96 F.3d at 1323. Courts have
9 extended this reasoning to bankruptcy cases due to the equivalency of the elements in fraud
10 claims. *Id.* In light of this, courts have held that non-disclosure of a material fact in the face
11 of a duty to disclose establishes the requisite reliance and causation for actual fraud under
12 the Bankruptcy Code. *Id.*; see also *Inahara v. Harris (In re Harris)*, 458 F. Supp. 238, 242
13 (D. Or. 1976) (the obligation to disclose and the nondisclosure of a material fact establish
14 the requisite element of causation in fact), *aff'd*, 587 F.2d 451 (9th Cir. 1978).

15 76. In *Tallant*, the appellant - an attorney - had a duty to disclose a conflict of
16 interest to his client and the right of the appellee to seek independent counsel, but failed to
17 do so. 218 B.R. at 65-66. The Panel determined that the appellant's failure to disclose
18 either of these rights established material fact. *Id.* at 65. Requiring a plaintiff to prove
19 causation through speculation would put an "unnecessarily unrealistic evidentiary burden on
20 the plaintiff." *Id.* at 68 (citation omitted). Based on the appellant's failure to disclose and
21 reasoning in *Apte*, the Panel concluded that "[r]eliance may be inferred from Appellant's
22 failure to disclose the requisite material information." *Id.* at 69.

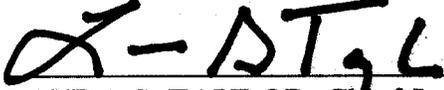
23 77. The Court concludes, based on the discussion above, that to the extent a
24 § 523(a)(2)(A) claim is appropriate, proximate cause is established by the preponderance of
25 the evidence.

26 78. The Court, thus, concludes that the FDIC is entitled to judgment in its favor.
27 The Court rejects the "damages calculation" argument advanced by Mr. Bacino.
28 Section 523 discusses the nondischargeability of debts. Here, the debt includes all amounts

1 owed on account of the La Jolla loans. Mr. Bacino's suggested calculation would disregard
2 the right to collect contractual interest. Mr. Bacino advances no authority that adequately
3 supports his argument.

4 79. The FDIC must promptly file a judgment consistent with these findings.

5
6 DATED: February 28, 2014


LAURA S. TAYLOR, Chief Judge
United States Bankruptcy Court

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In re Birger G. Bacino, Bankruptcy No. 09-20080-LT7
FDIC as Receiver for La Jolla Bank, FSB v. Birger Greg Bacino, Adversary No. 10-90315-LT

CERTIFICATE OF MAILING

The undersigned, a regularly appointed and qualified employee in the office of the United States Bankruptcy Court for the Southern District of California, at San Diego, hereby certifies that a true copy of the attached document, to wit:

**POST-TRIAL MEMORANDUM DECISION AND
FINDINGS OF FACT AND CONCLUSIONS OF LAW**

was enclosed in a sealed envelope bearing the lawful frank of the bankruptcy judges and mailed via first class mail to the party at their respective address listed below:

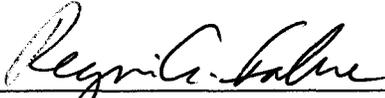
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Said envelope(s) containing such document was deposited by me in the City of San Diego, in said District on February 28, 2014.



Regina A. Fabre, Judicial Assistant