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ORDERED PUBLISHED

UNITED STATES BANKRUPTCY APPELLATE PANEL
OF THE NINTH CIRCUIT

In re:)	BAP No.	NC-12-1579-PaDJu
)		
JESUS EDGAR MONTANO,)	Bk. No.	10-71788
)		
Debtor.)	Adv. No.	11-04008
_____)		
)		
)		
HERITAGE PACIFIC FINANCIAL, LLC,)		
)		
Appellant,)		
)		
v.)	O P I N I O N	
)		
JESUS EDGAR MONTANO,)		
)		
Appellee.)		
_____)		

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

Filed - November 1, 2013

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

Hon. William J. Lafferty, U.S. Bankruptcy Judge, Presiding

Appearances: Brad A. Mokri argued for appellant Heritage Pacific
Financial, LLC; Tess Meyers Santiago argued for
appellee Jesus Edgar Montano.

Before: PAPPAS, DUNN and JURY, Bankruptcy Judges.

1 PAPPAS, Bankruptcy Judge:

2

3 Creditor Heritage Pacific Financial, LLC ("Heritage") appeals
4 the decisions of the bankruptcy court: (1) granting a summary
5 judgment dismissing Heritage's § 523(a)(2) complaint against
6 chapter 7¹ debtor Jesus Edgar Montano ("Montano") because
7 enforcement of its claim was barred by Cal. Code Civ. Proc. § 726
8 (f) and (g);² and (2) after initially denying the motion, on
9 reconsideration, granting Montano's request for an award of
10 attorneys fees and costs. We AFFIRM.

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FACTS

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¹ Unless otherwise indicated, all chapter, section and rule references are to the Bankruptcy Code, 11 U.S.C. §§ 101-1532, and to the Federal Rules of Bankruptcy Procedure, Rules 1001-9037. Civil Rule references are to the Federal Rules of Civil Procedure 1-86.

² For brevity, we abbreviate Cal. Code Civ. Proc. as CCCP.

1 \$89,990, to purchase the Property.

2 Montano's loan requests were approved by WMC. On November
3 22, 2006, Montano appeared before a notary to complete the
4 paperwork for the loan applications. At that time, he signed the
5 URLA, the notes for the two loans, and separate deeds of trust
6 securing each loan. Significantly, Montano initialed each page of
7 the URLA, except for the page which contained specific information
8 regarding the income he purportedly received from wages and self-
9 employment.

10 The parties agree that the URLA contained incorrect
11 information about Montano's income. The URLA stated that Montano
12 received a total of \$8,090 per month, \$3,500 of which were wages
13 he earned working as an auto detailer at a local dealership, and
14 the remainder as income generated from his supposed business,
15 Montano Moving Services. Although Montano was in fact employed at
16 the auto dealership at the time of applying for the loans to
17 purchase the Property, Montano maintains that he was never self-
18 employed, nor that he received any income from Montano Moving
19 Services.

20 There are other documents that Heritage asserts were
21 contained in Montano's loan application materials submitted to
22 WMC: (1) separate letters of reference from Joel Rendon, Marta
23 Madriz and Vantu Tran, each stating that they were happy with the
24 moving services supposedly provided by Montano; (2) copies of two
25 Craigslist internet advertisements for Montano Moving Services;
26 and (3) a letter from Guadalupe Perez, on the letterhead of "Perez
27 Income Tax," indicating that she had provided accounting services
28 for Montano and Montano Moving Services for the previous three

1 years. Montano alleges that these documents were all forgeries
2 created without his knowledge by Joel Rendon, an employee of the
3 loan broker.

4 The Montano loan application file also contained WMC's
5 prefunding audit forms signed by Jonathan Cobb on November 30,
6 2006. One such form relates to Montano's self-employment; it
7 indicates that Cobb "spoke with tax preparer. He verified that he
8 has filed schedule C tax info for the borrower for the last 3
9 years." The second form relates to employment verification. Cobb
10 supposedly spoke with the human resources manager for the auto
11 dealership and verified that Montano was employed there. There is
12 no indication on either form that the income amounts shown in the
13 loan application were verified to be accurate.

14 WMC approved both of Montano's loans on December 4, 2006.³

15 Montano resided at the Property purchased with the loans for
16 seven months, until about June 2007. After making only five
17 payments on the loans, he defaulted on the primary loan and, on
18 July 17, 2007, WMC filed a notice of default to foreclose the
19 first priority deed of trust. A trustee's sale occurred, and the
20 Property was sold on October 22, 2007. The now-unsecured second
21 loan note was purchased by Heritage on January 20, 2009.

22 Heritage alleges that, only after purchasing the second loan
23 note, it discovered that Montano had misrepresented his income on
24 the URLA. Heritage filed a complaint in Alameda County Superior
25 Court in April 2010, alleging that Montano obtained the second

26
27 ³ There is very little information in the record concerning
28 the closing of the loan transactions. WMC refers to its December
4, 2006 actions as "settlement of the loan." We assume that the
funds were disbursed on or after this settlement.

1 loan by fraud.

2 Montano filed a chapter 7 bankruptcy petition on October 13,
3 2010. His schedule F lists a debt for \$89,990.00 owed to Heritage
4 for the second mortgage loan.

5 Heritage commenced the adversary proceeding giving rise to
6 this appeal on January 9, 2011. In its complaint, Heritage asked
7 the bankruptcy court to determine that its \$89,990.00 claim
8 against Montano based upon the second loan note was excepted from
9 discharge for fraud under § 523(a)(2)(A) and (B). According to
10 Heritage, Montano knew that the URLA and supporting documentation
11 he submitted to WMC to obtain the loans were materially false.

12 Montano's initial response to the complaint was a motion to
13 dismiss under Civil Rule 12(b)(5) and (6), filed on February 17,
14 2011, and amended on February 25, 2011. In the motion, Montano
15 challenged Heritage's right to relief because the complaint failed
16 to establish Heritage's status as a creditor. Further, Montano
17 argued that Heritage had not pled sufficient facts to support an
18 exception to discharge under either § 523(a)(2)(A) or (B). Also
19 on February 25, 2011, Montano filed a cross-complaint against
20 Heritage seeking to recover his attorneys fees and costs incurred
21 in the adversary proceeding under § 523(d).

22 A hearing on Montano's dismissal motion was conducted on
23 March 25, 2011. After hearing from the parties, the bankruptcy
24 court⁴ denied Montano's motion to dismiss, ruling, among other
25 things, that Heritage had pled sufficient facts to state a claim

26
27 ⁴ The Honorable Dennis Montali presided at the hearing on
28 March 25, 2011, and ruled on the motion. The adversary
proceeding was subsequently assigned to the Honorable William
Lafferty, who entered the orders at issue in this appeal.

1 under § 523(a)(2)(A) plausible on its face.⁵ Although Montano's
2 cross-claim seeking recovery of attorneys fees under § 523(d) was
3 not addressed at that hearing, the court made extensive comments
4 regarding the challenges Heritage would face in establishing that
5 it had substantial justification for prosecuting the adversary
6 proceeding against Montano:

7 The original lender has to show or you for Heritage have
8 to show that the original lender justifiably relied in
9 this case, not what some expert says some hypothetical
10 lender would normally do. . . . How are you going to
11 prove it [?] And I'm not hearing a very good answer. .
12 . . . But I also would like to be practical too and not
13 waste time if at the end of the day you simply don't
14 have a case to prove. . . . If we start with the fact
15 that the original lender is defunct and whoever made a
16 decision at the original lender is nowhere to be found.
17 But the law of the [Boyajian] case makes it abundantly
18 clear that you [have] got to show who made the reliance
19 and who was defrauded. Not your client. So I don't
20 know how you are going to prove it.

21
22 Hr'g Tr. 7:9-8:9, March 25, 2011.

23 After considerable sparring in discovery disputes, Montano
24 filed a motion for summary judgment on February 21, 2012.
25 Montano's motion was founded on his arguments that: (1)
26 enforcement of Heritage's claim was barred by the statute of
27 limitations; (2) the claim was barred by California's one-action
28

29 ⁵ The bankruptcy court did not address Heritage's claim
30 under § 523(a)(2)(B). This is curious since Heritage's theory is
31 that Montano obtained the loan through use of a fraudulent loan
32 application and supporting written materials concerning his
33 financial condition, a claim governed exclusively by
34 § 523(a)(2)(B). By its terms, § 523(a)(2)(A) excludes "a
35 statement respecting the debtor's or an insider's financial
36 condition." By contrast, § 523(a)(2)(B)(ii) explicitly requires
37 such a written statement. Tallant v. Kaufman (In re Tallant), 218
38 B.R. 58, 69 (9th Cir. BAP 1998).

39 At oral argument before the Panel, Heritage clarified that it
40 has abandoned its claim under § 523(a)(2)(A) and proceeded in the
41 bankruptcy court and this appeal solely under § 523(a)(2)(B).

1 rule; (3) the claim was barred by California's anti-deficiency
2 statutes; (4) the claim should be dismissed because Heritage had
3 not established that it was the real party in interest; (5)
4 Heritage was not properly assigned the claim; and (6) Heritage
5 could not establish that any fraud occurred.

6 Heritage responded to the summary judgment motion on March 1
7 and 7, 2012. In addition to some procedural arguments regarding
8 timeliness of Montano's motion under the local rules, Heritage
9 countered Montano's arguments, contending that: (1) its claim was
10 not time-barred because the statute of limitations did not begin
11 to run until the foreclosure occurred; (2) neither the one-action
12 rule nor the anti-deficiency statutes apply to a claim against a
13 borrower for fraud; (3) CCCP § 726(a) does not apply to "sold-out"
14 junior lienholders; (4) Heritage is the valid holder of the note
15 on the second mortgage loan; and (5) WMC had complied with
16 industry standards for determining Montano's creditworthiness in
17 relying on the URLA and supporting documents. Attached to
18 Heritage's response was a declaration of Mark G. Scheuerman,
19 offered as an expert witness, who stated that, in his opinion, WMC
20 abided by the general standards of practices and customs in the
21 lending industry in determining a borrower's creditworthiness at
22 the time of the loans. Also attached was a declaration of Diane
23 Taylor that had been prepared for an unrelated state court case,
24 identifying her as "assistant secretary" of WMC Mortgage, LLC, the
25 successor to WMC. Taylor declared that "WMC relied on the
26 information provided by an applicant-borrower in his/her loan
27 application through all stages of the underwriting process."

28 Lengthy hearings on the summary judgment motion took place on

1 April 11 and 23, 2012. As shown in the transcripts, all issues
2 raised by the parties were addressed by counsel, and the
3 bankruptcy court actively engaged in discussions with them. At
4 the conclusion of the hearings, the court explained the reasons
5 for its decision:

6 I am convinced that [CCCP §§] 726(f) and (g) apply to
7 this situation and on that basis I'm going to grant the
8 motion for summary judgment. . . . On this set of
9 facts, I'm concluding that this was owner-occupied
10 property and I'm also concluding that the amount of the
11 debt falls within the prohibition [of § 726(g)]. I'm
12 aware of the argument that perhaps the Legislature meant
13 something else in terms of what the aggregate debt would
14 be, but that is not what the statute says. It's
15 something that easily could have been expressed as such
16 and easily, frankly, could have been corrected
17 thereafter but it hasn't been. So I'm dealing with the
18 statute as I believe it to be. . . . I am not accepting
19 the proposition that [§] 726(f) and (g) simply parallel
20 some other doctrine of allowing fraud claims against
21 borrowers. I see nothing in the way the statute is
22 drafted or the words of the [Legislative History] to
23 indicate that. . . . I'm determining that summary
24 judgment is appropriate on the grounds of the
25 applicability of sections 726(f) and (g) in this case.
26 I think many other arguments were made are of some
27 interest, and obviously a lot of time and effort went
28 into those arguments. But because this disposes of the
matter, I'm going to leave it at that.

19 Hr'g Tr. 107:18-108:22, April 23, 2012. In response to a query by
20 Montano's counsel noting that "we had moved for fees under [§]
21 523(d) and that the debt remains discharged, it was a consumer
22 debt, and the complaint was brought without a reasonable basis in
23 law," the bankruptcy court responded, "I'm denying that. I think
24 those are close questions. I'm denying that." Hr'g Tr. 109:4-9,
25 April 23, 2012.

26 On June 5, 2012, the bankruptcy court entered an Order on
27 Defendant's Motion for Summary Judgment (the "Summary Judgment
28 Order"), granting the motion "on the basis that the [Heritage]

1 claim is barred by California Code [of Civil Procedure §] 726(f)
2 and (g) for the reasons orally stated on the record."

3 On June 19, 2012, Montano filed a motion for reconsideration.
4 In it, Montano argued that it was legal error for the bankruptcy
5 court to deny his § 523(d) motion for an award of attorneys fees
6 and costs without making appropriate findings, especially where
7 Heritage could not show substantial justification for prosecuting
8 the adversary proceeding. Heritage responded to this motion on
9 July 18, 2012, arguing that Montano was merely rearguing issues
10 that were previously raised in the summary judgment proceedings.
11 Heritage further asserted that its complaint against Montano was
12 substantially justified by the facts and the law.

13 At an initial hearing on the motion for reconsideration on
14 August 1, 2012, the bankruptcy court directed the parties to
15 submit additional briefing on whether Heritage's action against
16 Montano was substantially justified at all stages of the case. At
17 the continued hearing on September 5, 2012, after hearing more
18 argument from counsel, the bankruptcy court noted that it had
19 disposed of summary judgment by ruling on only one ground: that
20 CCCP §§ 726(f) and (g) barred Heritage from asserting its fraud
21 claim against Montano. While the court acknowledged that it had
22 not reached Montano's other arguments regarding standing,
23 assignability of the note, Montano's lack of intent to deceive, or
24 Heritage's reliance on the loan application income information,
25 the court concluded that,

26 the right analysis for [§] 523(d) is to go back and see
27 if there were facts and law on [Heritage's] side, even
28 though I didn't reach them in disposing of the summary
judgment motion. I think once I have a request under
[§] 523(d), that's what I'm supposed to do, and frankly

1 is what I didn't do at the end of the hearing because I
2 was focusing on what I did decide.

3 Hr'g Tr. 41:2-9, September 5, 2012.

4 After next hearing arguments from counsel regarding
5 Heritage's position at each stage of the litigation regarding the
6 elements of fraud, the bankruptcy court focused on one necessary
7 element of Heritage's fraud claim, reliance, and questioned
8 whether Heritage had met its burden of showing that WMC had
9 actually relied on the income representations in the loan
10 application materials submitted by Montano. The court then
11 reminded Heritage of the court's earlier admonition at the hearing
12 on the dismissal motion that Heritage would face a significant
13 hurdle to establish actual reliance by a defunct lender.

14 Heritage had submitted three declarations to support its
15 position that WMC had actually relied on the misrepresentations
16 allegedly made by Montano in approving the loans, in which: Mr.
17 Ganter, Heritage's in-house counsel, described his investigation
18 of Montano's alleged statements; Mr. Scheuerman, an expert
19 witness, opined that WMC met industry standards for determining
20 creditworthiness; and Ms. Taylor, an assistant secretary in the
21 successor business to WMC, stated that WMC relied on the income
22 assertions in the loan application at all stages of the loan
23 process.

24 The bankruptcy court rejected Heritage's showing. It noted
25 that the Ganter declaration simply did not address whether WMC
26 relied on the URLA and that, additionally, Montano had pointed out
27 several inconsistencies in Ganter's statements. The Scheuerman
28 declaration, according to the court, "helps me decide whether

1 something meets an industry standard or not. So he's not talking
2 about actual reliance [by WMC]." Hr'g Tr. 43:5-6, September 5,
3 2012.

4 The bankruptcy court expressed befuddlement regarding the
5 Taylor declaration: "I couldn't tell who she was from the
6 declaration, frankly. I couldn't tell how she'd have any
7 knowledge of the issue. She didn't identify . . . the person who
8 looked at [the URLA], and what she said was so completely
9 conclusory." Id. at 43:8-13. The court concluded:

10 I am granting the motion for reconsideration to the
11 extent that it put into issue the elements under [§]
12 523(a)(2)(B) that were set forth in the motion for
13 summary judgment. Those directly included the reliance
14 element. The predicate for any reliance element is that
15 there was actual reliance by a person, and I'm finding
16 that that simply was not demonstrated, and its not a
17 credibility issue. The declarations simply didn't go to
18 the subject in any meaningful way.

19 Id. at 45:3-11.

20 An order granting the motion for reconsideration, and
21 awarding attorneys fees and costs under § 523(d) to Montano, was
22 entered on September 27, 2012 (the "Reconsideration Order").⁶
23 Following entry of a final judgment in the adversary proceeding on
24 October 22, 2012, Heritage filed a timely appeal regarding both
25 the Summary Judgment Order and Reconsideration Order, on November
26 2, 2012.

27 JURISDICTION

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

⁶ In its order on Defendant's Motion for Attorney's Fees and
Costs, the bankruptcy court awarded Montano \$69,782.19 in
attorney's fees and \$1,085.12 in costs. Heritage has not
challenged the amount awarded in this appeal.

1 determine under the clearly erroneous standard whether its factual
2 findings and its application of the facts to the relevant law
3 were: "(1) illogical, (2) implausible, or (3) without support in
4 inferences that may be drawn from the facts in the record." Id.
5 (internal quotation marks omitted).

6 DISCUSSION

7 I.

8 **The bankruptcy court did not err in granting Montano's**
9 **motion for summary judgment against Heritage because**
10 **CCCP § 726 barred enforcement of Heritage's claim**
11 **against Montano.**

12 In the bankruptcy court, Heritage sought a § 523(a)(2)(B)
13 exception to Montano's discharge because, Heritage alleged, the
14 loan application and other materials Montano submitted to WMC to
15 obtain the second mortgage loan contained fraudulent information.
16 The bankruptcy court granted summary judgment to Montano, and
17 dismissed Heritage's exception to discharge claim, a ruling
18 Heritage challenges in this appeal. This discharge exception
19 provides:

20 § 523. Exceptions to discharge

21 (a) A discharge under section 727 . . . of this title
22 does not discharge an individual debtor from any debt

23 . . .

24 (2) for money, property, services, or an extension,
25 renewal, or refinancing of credit, to the extent
26 obtained, by . . .

27 (B) use of a statement in writing -

- 28 (i) that is materially false;
- (ii) respecting the debtor's or an
insider's financial condition;
- (iii) on which the creditor to whom the
debtor is liable for such money,
property, services, or credit
reasonably relied; and

1 (iv) that the debtor caused to be made or
2 published with intent to deceive[.]⁷

3 Summary judgment may be granted "if the movant shows that
4 there is no genuine issue as to any material fact and that the
5 movant is entitled to judgment as a matter of law." Civil Rule
6 56(a), incorporated by Rule 7056; Barboza v. New Form, Inc. (In re
7 Barboza), 545 F.3d 702, 707 (9th Cir. 2008). Where only a
8 question of law is at issue, summary judgment is proper.
9 Asuncion v. U.S. Immigration & Naturalization Serv., 427 F.2d.
10 523, 524 (9th Cir. 1970).

11 Here, the bankruptcy court determined that, as a matter of
12 law, enforcement of Heritage's claim against Montano was barred
13 under applicable state law, CCCP § 726(f) and (g). The court
14 announced its decision on summary judgment at the hearing on
15 September 5, 2012:

16 On this set of facts, I'm concluding that this was
17 owner-occupied property and I'm also concluding that the
18 amount of the debt falls within the prohibition [of CCCP
19 § 726(g)]. It's \$89,000 some-odd worth of debt. I'm
20 aware of the argument that perhaps the Legislature meant
21 something else in terms of what the aggregate debt would
22 be, but that is not what the statute says. It's
23 something that really could have been expressed as such
24 and easily, frankly, could have been corrected
25 thereafter, but it hasn't been. So I'm dealing with the

22 ⁷ Of course, Heritage did not loan any money to Montano; its
23 claim against him stems from its acquisition of the second note
24 from the original lender, WMC, after the foreclosure of the
25 primary loan mortgage. Ninth Circuit case law establishes that
26 Heritage may stand in the shoes of WMC and may pursue an exception
27 to discharge under such circumstances, but only if it can
28 establish that Montano, with the intent to deceive, used a
materially false written statement to obtain the loan from WMC,
and that WMC reasonably relied upon that statement. Boyajian v.
New Falls Corp. (In re Boyajian), 564 F.3d 1088, 1093 (9th Cir.
2009) (affirming the BAP's reasoning in New Falls Corp. v.
Boyajian (In re Boyajian), 367 B.R. 138, 148 (9th Cir. BAP 2007)).

1 statute as I believe it to be. . . . I'm determining
2 that summary judgment is appropriate on the grounds of
the applicability of Sections 726(f) and (g) in this
3 case.

4 Hr'g Tr. 107:19-108:21, September 5, 2012.

5 We agree with the bankruptcy court that the state statutory
6 provisions are dispositive of the issues on appeal and, therefore,
7 we affirm the bankruptcy court's decision to grant summary
8 judgment dismissing Heritage's exception to discharge claim.

9 In construing the state statutes in this case, we are mindful
10 of the instructions of the California Supreme Court that we are to
11 look to the statutes' plain meaning. Bonnell v. Medical Bd., 82
12 P.3d 740, 743 (Cal. 2003). When interpreting a statute, we must
13 discover the intent of the legislature to give effect to its
14 purpose, being careful to give the statute's words their "plain,
15 commonsense meaning." Kavanaugh v. W. Sonoma Cnty. Union High
16 School, 62 P.3d 54, 59 (Cal. 2003). If the language of the
17 statute is not ambiguous, the plain meaning controls and resort to
18 extrinsic sources to determine the Legislature's intent is
19 unnecessary. Id. When the statutory language is unambiguous, "we
20 presume the Legislature meant what it said and the plain meaning
21 of the statute governs." Diamond Multimedia Sys., Inc. v. Super.
22 Ct., 968 P.2d 539, 546 (Cal. 1999).

23 The parties to this appeal have not argued that CCCP § 726(f)
24 and (g) are ambiguous. Instead, they seem to agree that the
25 statutory language should be viewed as parts of an interconnected
26 series of laws laying out the rules for collection of deficiencies
27 resulting from mortgage and trust deed foreclosure sales, and the
28 exceptions to those rules. In this respect, the parties are

1 correct – no laws should be considered in isolation. Rather, we
2 must “interpret the statute[s] as a whole, so as to make sense of
3 the entire statutory scheme.” Carrisales v. Dep’t of Corrections,
4 988 P.2d 1083, 1085 (Cal. 1999). However, the process is somewhat
5 challenging in this context, given the maze of elaborate and
6 interrelated foreclosure and antideficiency statutes in California
7 relating to the enforcement of obligations secured by interests in
8 real property. Alliance Mortg. Co. v. Rothwell, 900 P.2d 601, 611
9 (Cal. 1995); Metropolitan Life Ins. Co. v. Sunnymede Shopping Ctr.
10 (In re Sunnymede Shopping Ctr.), 178 B.R. 809, 815 (9th Cir. BAP
11 1995) (describing the maze of “statutory protections and
12 procedures under California law which protect debtors by
13 restricting the secured creditor’s remedies for debts secured by
14 mortgages or deeds of trust in real property.”). We examine this
15 statutory framework below.

16 Our analysis begins by acknowledging that, in California, a
17 lender’s primary, and sometimes only, remedy to collect a loan
18 secured by a mortgage is to foreclose:

19 **[CCCP] § 726. Form of action . . .** (a) There can be but
20 one form of action for the recovery of any debt or the
21 enforcement of any right secured by mortgage upon real
22 property or an estate for years therein, which action
shall be in accordance with the provisions of this
chapter.

23 Alliance Mortg. Co., 900 P.2d at 611 (only form of action for
24 recovery of any debt or enforcement of any rights secured by a
25 mortgage or deed of trust is action for foreclosure); Bank of
26 Cal., N.A. v. Leone, 37 Cal. App.3d 444, 447 (Cal. Ct. App. 1974)
27 (“For the purposes of [CCCP § 726(a)], a deed of trust is treated
28 as a mortgage.”).

1 Of course, a foreclosure may not net the lender sufficient
2 sale proceeds to satisfy the lender's claim in full.
3 Acknowledging that reality, CCCP § 726(b)⁸ generally preserves the
4 lender's right to pursue a personal judgment against the borrower
5 for any deficiency, unless that right has been waived by the
6 creditor, "or a deficiency judgment is prohibited by CCCP § 580b."

7 CCCP § 580a⁹ prescribes the rules for a deficiency action.
8 But, as noted in CCCP § 726(b), CCCP § 580b plainly prohibits a
9 lender's right to recover a deficiency judgment for certain types
10 of indebtedness. In pertinent part, that statute provides:

11 **[CCCP] § 580b. Contract for sale; deed of trust or**
12 **mortgage; credit transaction; chattel mortgage;**
deficiency judgments prohibited

13 (a) No deficiency judgment shall lie in any event for
14 the following: . . . (3) Under a deed of trust or
15 mortgage on a dwelling for not more than four families
16 given to a lender to secure repayment of a loan which
17 was in fact used to pay all or part of the purchase
18 price of that dwelling, occupied entirely or in part by

18 ⁸ "(b) The decree for the foreclosure of a mortgage or deed
19 of trust secured by real property or estate for years therein
20 shall declare the amount of the indebtedness or right so secured
21 and, unless judgment for any deficiency there may be between the
22 sale price and the amount due with costs is waived by the judgment
23 creditor or a deficiency judgment is prohibited by Section 580b,
24 shall determine the personal liability of any defendant for the
25 payment of the debt secured by the mortgage or deed of trust and
26 shall name the defendants against whom a deficiency judgment may
27 be ordered following the proceedings prescribed in this section
28" CCCP § 726(b).

24 ⁹ "Whenever a money judgment is sought for the balance due
25 upon an obligation for the payment of which a deed of trust or
26 mortgage with power of sale upon real property or any interest
27 therein was given as security, following the exercise of the power
28 of sale in such deed of trust or mortgage, the plaintiff shall set
forth in his or her complaint the entire amount of the
indebtedness which was secured by the deed of trust or mortgage at
the time of sale, the amount for which the real property or
interest therein was sold and the fair market value thereof at the
date of sale and the date of that sale. . . ." CCCP § 580a.

1 the purchaser.¹⁰
2 See also Roseleaf, 378 P.2d at 98 ("a creditor's right to judgment
3 against debtor for a deficiency may be limited or barred by
4 section . . . 580b"); Grammercy Inv. Tr. v. Lakemont Homes Nev.,
5 Inc., 198 Cal. App.4th 903, 911 (Cal. Ct. App. 2011) (waiver by
6 creditor allowed under CCCP § 726(b)); Prestige Ltd. P'ship v. E.
7 Bay Car Wash Partners (In re Prestige Ltd. P'ship), 234 F.3d 1108,
8 1117 (9th Cir. 2000) (holding that CCCP § 580b precludes
9 deficiency judgments on purchase money notes).

10 While the one-action rule provides that a lender secured by a
11 mortgage must foreclose to collect its debt, and CCCP §§ 726(b)
12 and 580b prescribe rules and prohibitions regarding the recovery
13 of a deficiency judgment by a lender after foreclosure, CCCP § 726
14 also contains an important exception to its operation:

15 (f) Notwithstanding this section or any other provision
16 of law to the contrary, any person authorized by this
17 state to make or arrange loans secured by real property
18 or any successor in interest thereto, that originates,
19 acquires, or purchases, in whole or in part, any loan
20 secured directly or collaterally, in whole or in part,
21 by a mortgage or deed of trust on real property or an
estate for years therein, may bring an action for
recovery of damages, including exemplary damages not to
exceed 50 percent of the actual damages, against a
borrower where the action is based on fraud under
Section 1572 of the Civil Code and the fraudulent

22 ¹⁰ Operating in tandem, CCCP § 726(a) and CCCP § 580b are
23 collectively referred to as California's "antideficiency
24 statutes." There is some authority for the proposition that CCCP
25 § 726(a) does not apply to sold-out junior lienors. Roseleaf
Corp. v. Chierighino, 387 P.2d 97, 100 (Cal. 1963); see also CJA
Corp. v. Trans-Action Fin. Corp., 86 Cal. App.4th 664, 665 (Cal.
26 Ct. App. 2001) ("an exception to the one action rule has been
27 recognized in those cases where the security has been lost through
no fault of the creditor"). In this appeal, Montano concedes that
28 CCCP § 726(a) may not apply to Heritage. We conclude,
nevertheless, that CCCP § 580b does apply to all debts arising
from purchase money loans, except, as discussed below, debts
induced by fraud as provided in CCCP §§ 726(f) and (g).

1 conduct by the borrower induced the original lender to
2 make that loan.

3 Finally, even though under CCCP § 726(f) the one-action rule
4 does not bar a creditor's action to recover damages based on the
5 fraudulent conduct of the borrower that induced the original
6 lender to make a loan, that exception is itself subject to an
7 exception:

8 **[CCCP] § 726(g).**

9 (g) Subdivision (f) does not apply to loans secured by
10 single-family, owner-occupied residential real property,
11 when the property is actually occupied by the borrower
12 as represented to the lender in order to obtain the loan
13 and the loan is for an amount of one hundred fifty
14 thousand dollars (\$150,000) or less, as adjusted
15 annually, commencing on January 1, 1987, to the Consumer
16 Price Index as published by the United States Department
17 of Labor.

18 In sum, then, in California, under CCCP § 726(f), even though
19 a lender may pursue a borrower for fraud in the inducement of a
20 loan without regard to the one-action rule in CCCP § 726(a) and
21 the antideficiency limits in CCCP § 580b, CCCP § 726(g) makes
22 clear that, with respect to a certain type of loan (i.e., those
23 secured by "owner-occupied residential real property," when
24 actually occupied by the borrower, where "the loan" is for
25 \$150,000 or less), the lender may not pursue the borrower for
26 fraud.

27 CCCP §§ 726(g) applies in this case. It is undisputed here
28 that two separate loans were made by WMC to Montano, both of which
29 were secured by deeds of trust, which Montano used to pay the
30 purchase price for his acquisition of the Property. Thus, at
31 least at the time of loan origination, the deeds of trust granted

1 by Montano to WMC were purchase money mortgages.¹¹ It also seems
2 clear that enforcement of the WMC second loan, upon which
3 Montano's liability to Heritage is based, was subject to the one-
4 action rule, and to the antideficiency statutes. However,
5 Heritage argues, for several reasons, that its claim against
6 Montano is not restricted by these statutes.

7 Heritage notes that its claim against Montano seeks an
8 exception to discharge to collect on a "sold-out" junior lien. It
9 contends that CCCP § 726(b) would not apply to its action. But
10 California case law establishes that the deficiency action bar
11 allowed under CCCP § 726(b), and subject to CCCP
12 § 580b, applies to holders of purchase money second mortgage
13 loans. Kurtz v. Calvo, 75 Cal. App.4th 191, 194 (Cal. Ct. App.
14 1999) ("Section 580b prohibits a deficiency judgment after a
15 judicial or nonjudicial foreclosure under a trust deed securing a
16 purchase money loan. For purposes of section 580b, a deficiency
17 judgment includes a judgment in an action on the note by a
18 sold-out junior lienholder.") (Citations omitted.)

19 Heritage relies upon several cases it believes are at odds
20 with Calvo. For example, in Cadlerock v. Lobel, 206 Cal. App.4th
21 1531, 1541 (Cal. Ct. App. 2012), the court ruled that an assignee
22 of a junior loan, who was subsequently "sold out" by the senior
23 lienholder's nonjudicial foreclosure sale, can pursue the borrower
24 for a money judgment in the amount of the debt owed. However,
25 Cadlerock made its ruling because that case did not involve

26
27 ¹¹ A purchase money transaction occurs when "[t]he sum
28 represented by the note and trust deed was a necessary part of the
purchase price." Stockton Sav. & Loan Bank v. Massanet, 114 P.2d
592, 600 (Cal. 1941).

1 purchase money loans and, thus, CCCP § 580b did not apply:

2 Section 580b is inapplicable to the instant case because
3 the loans at issue were not used as purchase money.
4 Section 580b "prohibits all deficiency judgments" in
5 specified real property transactions involving the
6 provision of purchase money, regardless of whether the
7 creditor conducts a judicial or nonjudicial foreclosure.
8 (See In re Marriage of Oropallo (1998) 68 Cal. App.4th
9 997, 1003, 80 Cal. Rptr. 2d 669.).

10 Id. at n.2.

11 In another case cited by Heritage, Nat'l Enters., Inc. v.
12 Woods, 94 Cal. App.4th 1217, 1226 (Cal. Ct. App. 2001), the court
13 held that the one-action rule in CCCP § 726(a) did not apply to a
14 sold-out junior lienholder. But again in a footnote, the Woods
15 court acknowledged that CCCP § 580b would be applicable if Woods
16 were a purchase money mortgage case:

17 Nor is section 580b applicable here. It bars any
18 deficiency judgment after foreclosure where the debt is
19 secured by a purchase money mortgage, which is not at
20 issue here.

21 Id. at 1226 n.5.

22 In Bank of Am. Nat'l Tr. & Sav. Ass'n v. Graves, 51 Cal.
23 App.4th 607 (Cal. Ct. App. 1996), the court examined the claim of
24 a creditor who offered a borrower a line of credit secured by a
25 second trust deed on the property. The money was not used to
26 purchase the property. Id. at 610. The court explicitly ruled
27 that the debt in question was the "underlying nonpurchase money
28 note." Id. at 617 (emphasis added).

29 The parties also disagree whether, for purposes of
30 CCCP § 580b, a purchase money loan loses that status after a
31 foreclosure. Clearly, it does not. DMC Inc. v. Downey Sav. &
32 Loan Assn., 99 Cal. App.4th 190, 196 (Cal. Ct. App. 2002) ("The

1 facts and circumstances that exist at the time the debt is created
2 determine the character of the obligation as a purchase-money
3 mortgage.”). In the final analysis, Heritage has not provided us
4 with any acceptable authority for its argument that collection of
5 Montano’s debt is not barred by the antideficiency statute, CCCP §
6 580b.

7 Of course, the gravamen of this appeal is Heritage’s
8 contention that CCCP § 726(f), preserving a lender’s right to
9 pursue a borrower for damages if fraud was employed to induce the
10 loan, constitutes an exception to the antideficiency statutes, and
11 allows it to enforce its claim against Montano. We agree that,
12 fairly read, CCCP § 726(f) creates an exception to the general
13 rule prohibiting deficiency actions under CCCP § 726(b) and makes
14 § 580b applicable to purchase money loans. In other words, when a
15 loan originator makes a loan secured by a mortgage or deed of
16 trust on real estate based upon the fraudulent¹² conduct of the
17 borrower to induce the lender to make the loan, the lender may sue
18 the borrower to recover its damages. But there is an exception to
19 this exception, CCCP § 726(g).

20 The bankruptcy court concluded that, consistent with CCCP
21 § 726(g), this “was owner-occupied property and I’m also
22 concluding that the amount of the debt falls within the
23 prohibition [of CCCP § 726(g)]. It’s \$89,000 some-odd worth of
24

25
26 ¹² CCCP § 726(f) internally references Cal. Civ. Code § 1572
27 for its definition of fraud: “Actual fraud, within the meaning of
28 a party to the contract, or with his connivance, with intent to
deceive another party thereto, or to induce him to enter into the
contract: 1. The suggestion, as a fact, of that which is not
true, by one who does not believe it to be true[.]”

1 debt." Hr'g Tr. 107:19-21, September 5, 2012. In particular, the
2 court found, based upon the undisputed facts in the summary
3 judgment record the parties had submitted, that Montano had
4 occupied the property:

5 THE COURT: I would be inclined to find no triable issue
6 with respect to occupancy. And I think it - what I'm
7 looking at is occupancy on the day the loan is made.
That's the way I'm reading [CCCP §] 726. Assuming it
applies at all.

8 HERITAGE COUNSEL: Well, there is additional information
9 that we do have that hasn't been presented . . . that
defendant did not actually reside in the property.

10 THE COURT: Well, you relied on the deposition, right?

11 HERITAGE COUNSEL: Yes, that was part of the evidence.
12 There's been more . . .

13 THE COURT: What was . . . the rest of it?

14 HERITAGE COUNSEL: There's been more that's come to
light. We did a further investigation.

15 THE COURT: Well, is that before me today?

16 HERITAGE COUNSEL: No.

17 THE COURT: Okay.

18 HERITAGE COUNSEL: I would like to make the record right
19 now.

20 THE COURT: Well, let's see if they're okay with that.
Ms. Santiago [addressing MONTANO COUNSEL], we're about
21 to get a supplemental -

22 MONTANO COUNSEL: No, your Honor.

23 THE COURT: All right. Okay. . . . I'm going to hold you
to the record I have today.

24 Hr'g Tr. 66:22-67:23, April 19, 2012.

25 We agree with the bankruptcy court's conclusion in this
26 regard. The only evidence before the bankruptcy court on
27 occupancy was the deposition of Montano, in which he testified
28 that he occupied the Property from the day of the loan approvals.

1 That there may have been other evidence available to Heritage that
2 had not been submitted is no basis to deny Montano's motion for
3 summary judgment.

4 The bankruptcy court's other important conclusion was that
5 the amount of the loan to Montano that Heritage sought to enforce,
6 \$89,000, fell within the dollar limitations in § 726(g):

7 I'm aware of the argument that perhaps the Legislature
8 meant something else in terms of what the aggregate debt
9 should be, but that's not what the statute says. It's
10 something that could have been expressed as such and
easily, frankly, could have been corrected thereafter,
but it hasn't been. So I'm dealing with the statute as
I believe it to be.

11 Hr'g Tr. 107:23-108:3.

12 We also agree with the bankruptcy court that, regarding the
13 \$150,000 cap, § 726(g) is plain on its face. Under the plain
14 meaning rule, a court must assume that when passing a statute, the
15 Legislature is aware of existing related laws. Vieira Enters.,
16 Inc. v. City of E. Palo Alto, 208 Cal. App.4th 584, 604 (Cal. Ct.
17 App. 2012). While CCCP § 726 has been amended four times since
18 its enactment in 1987, neither the amount, nor method of
19 calculating the cap, was ever amended. To the extent Heritage
20 argues that policy considerations mandate that the bankruptcy
21 court should have adjusted the cap to aggregate loans made to a
22 borrower by one lender in applying § 726(g), it asks too much. It
23 is for the Legislature, not the courts, to amend statutes for
24 policy considerations. Cassell v. Super. Ct., 244 P.3d 1080, 1094
25 (Cal. 2011).

26 Heritage offers another reason why its fraud action against
27 Montano is not barred by § 726(g). It asserts, with no citation
28 to authority or reasoned argument, that CCCP § 726(g) "merely

1 limits the ability of loan originators to recover exemplary
2 damages provided for in subdivision (f).” This argument lacks
3 merit. Of course, CCCP § 726(g) makes no reference to punitive
4 damages or, indeed, to any kind of damages; by its terms it bars
5 any application of CCCP § 726(f) where the loan meets two
6 requirements: where an owner/borrower occupies the property, and
7 the loan amount is less than \$150,000. Heritage’s argument that
8 the California legislature’s sole concern in adopting § 726(f) was
9 to limit awards of punitive damages is speculation. In any case,
10 by the plain, unambiguous terms of CCCP § 726(g), CCCP § 726(f)
11 does not apply to the facts in this appeal.¹³

12 Finally, Heritage repeatedly argues that the California
13 legislature could not possibly have intended to “carve out” an
14 exception that would endorse the fraudulent behavior of borrowers
15 for smaller loans. Once again, Heritage’s position rests on
16 speculation about legislative intent. Moreover, we disagree with
17 Heritage’s suggestion that it would be absurd for the California
18 Legislature to overlook potential borrower fraud regarding loans
19 to owner-occupiers for less than \$150,000 as a means of requiring
20 lenders to exercise special diligence in making such loans. A

21
22 ¹³ In support of its speculation on the intentions of the
23 California legislature, Heritage provided the Panel with almost
24 300 pages of the legislative materials concerning § 726(f) and
25 (g). But these materials are almost entirely the reports of
26 interest groups and lobbyists, all authored by non-legislators.
27 None contain the statements of individual legislators or of the
28 governor. The California courts have observed that committee
reports and legislative counsel digests are not as useful in
understanding the intent of the legislature as the language of the
statute itself. Halbert’s Lumber, Inc. v. Lucky Stores, Inc.,
6 Cal. App.4th 1233, 1238 (Cal. Ct. App. 1992). We decline to
rely upon this sort of information to create an ambiguity in a
statute where none exists.

1 statute's plain meaning is absurd only if "it is so gross as to
2 shock the general moral or common sense." Barnhart v. Sigmon Coal
3 Co., Inc., 534 U.S. 438, 450 (2002); United States v. Fontaine,
4 697 F.3d 221, 228 (3d Cir. 2012) ("An interpretation is absurd
5 when it defies rationality or renders the statute nonsensical and
6 superfluous.")(citations omitted). Here, that California would
7 bestow protection against personal liability for a certain class
8 of borrowers for home loans of modest amounts under limited
9 circumstances does not shock the general moral or common sense,
10 nor does it defy rationality, nor is it nonsensical and
11 superfluous.

12 We conclude that the bankruptcy court did not err in granting
13 Montano's motion for summary judgment against Heritage because,
14 operating together, CCCP §§ 726 and 580b barred enforcement of
15 Heritage's claim against Montano.

16 II.

17 **The bankruptcy court did not abuse its discretion in**
18 **reconsidering its prior order and awarding attorneys**
fees and costs to Montano under § 523(d).

19 **A. The bankruptcy court did not abuse its discretion in**
20 **granting Montano's motion for reconsideration.**

21 In their briefs, Heritage and Montano both suggest that
22 Montano's motion for reconsideration was founded upon the
23 provisions of Rule 9024, which incorporates Civil Rule 60(b)(1).
24 We disagree. Because Montano's motion for reconsideration was
25 filed within fourteen days after entry of the Summary Judgment
26 Order, the motion should be treated as one to alter or amend the
27 Summary Judgment Order under Rule 9023, which incorporates Civil
28 Rule 59(e). Fadel v. DCB United LLC (In re Fadel), 492 B.R. 1, 18

1 (9th Cir. BAP 2013)(citing Am. Ironworks & Erectors, Inc. v. N.
2 Am. Constr. Corp., 248 F.3d 892, 898-99 (9th Cir. 2001)). The
3 standard for granting relief under that rule requires the movant
4 to show (a) newly discovered evidence, (b) the court committed
5 clear error or made an initial decision that was manifestly
6 unjust, or (c) an intervening change in controlling law. Duarte
7 v. Bardales, 526 F.3d 563, 567 (9th Cir. 2008).

8 To the extent that Montano sought relief in the bankruptcy
9 court under the wrong Rule, it was harmless error. In its motion,
10 Montano argued that the bankruptcy court made an error of law.
11 Under both Civil Rules 59(e) and 60(b)(1), reconsideration of an
12 order is appropriate to correct a perceived error of law by the
13 trial court.¹⁴ In re Fadel, 492 B.R at 18 (Rule 60(b)(1)); see
14 also Zimmerman v. City of Oakland, 255 F.3d 734, 740 (9th Cir.
15 2004) (applying 59(e) to correct a legal error by the court).

16 The legal mistake made by the bankruptcy court in originally
17 denying Montano's request for attorneys fees is evidenced in its
18 colloquy with Montano's counsel at the summary judgment hearing
19 reminding the court that "[Montano] had moved for fees under
20 [§] 523(d) and that the debt remains discharged, it was a consumer
21

22 ¹⁴ We discount Heritage's argument that in this context
23 reconsideration is an "extraordinary remedy, to be used sparingly
24 in the interests of finality and the conservation of judicial
25 resources . . .", citing Carroll v. Naktani, 342 F.3d 934, 945
26 (9th Cir. 2000). The Carroll court was quoting a treatise on
27 general principles applied to Civil Rules 59(e) and 60. 12 MOORE'S
28 FEDERAL PRACTICE § 59.30[4] (3d. ed. 2000). Immediately following
the quotation from Moore's, however, the Carroll court continued
with the comment, "a motion for reconsideration should not be
granted, absent highly unusual circumstances, unless the district
court . . . committed clear error[.]" The Carroll court's opinion,
therefore, would support the bankruptcy court's decision to
correct its own clear error of law.

1 debt, and the complaint was brought without a reasonable basis in
2 law." The court responded, "I'm denying that. I think those are
3 close questions. I'm denying that." Hr'g Tr. 109:4-9. As
4 Heritage is well aware, this Panel has held that:

5 To support a request for attorneys' fees under § 523(d),
6 a debtor initially needs to prove: (1) that the creditor
7 sought to except a debt from discharge under § 523(a),
8 (2) that the subject debt was a consumer debt, and (3)
9 that the subject debt ultimately was discharged. Stine
10 v. Flynn (In re Stine), 254 B.R. 244, 249 (9th Cir. BAP
11 2000), [aff'd 19 Fed. Appx. 626 (9th Cir. 2001)]. "Once
12 the debtor establishes these elements, the burden shifts
13 to the creditor to prove that its actions were
14 substantially justified." Id.

15 Heritage Pac. Fin. LLC v. Machuca (In re Machuca), 483 B.R. 726,
16 734 (9th Cir. BAP 2012). Here, the bankruptcy court erred when it
17 declined to consider Montano's § 523(d) request for an award of
18 attorneys fees and costs, after Montano made a prima facie showing
19 to support it, and without requiring Heritage to satisfy its
20 burden to demonstrate prosecution of the action against Montano
21 was substantially justified. The court appropriately acknowledged
22 this when it stated:

23 I think that the right analysis for [§ 523(d)] is for me
24 to go back and review the factors and what it is you
25 [Heritage] would have to prove and see if there were
26 facts and law on your side, even though I did not reach
27 them in disposing of the summary judgment motion. I
28 think once I have a request under [§ 523(d)], that's
what I am supposed to do, and frankly is what I didn't
do at the end of the hearing. . . . But I'm convinced
that the right answer is, I have to go back for
[§ 523(d)] purposes and look at the broad spectrum.

Hr'g Tr. 41:2-12, September 5, 2012.

Simply put, a trial court's concession that it erred in an
earlier order requires that court to set aside the order and
reconsider the parties' arguments. Duarte, 526 F.3d at 567

1 (holding that once a court "acknowledged that the basis underlying
2 its original judgment was wrong, it was error not to set aside the
3 judgment."). The bankruptcy court did not abuse its discretion in
4 reconsidering an order that it conceded was entered in error.¹⁵

5 **B. The bankruptcy court did not abuse its discretion in**
6 **granting Montano's request for attorney's fees and costs**
7 **under § 523(d).**

8 Section 523(d) provides that:

9 If a creditor requests a determination of
10 dischargeability of a consumer debt under subsection
11 (a)(2) of this section, and such debt is discharged, the
12 court shall grant judgment in favor of the debtor for
13 the costs of, and a reasonable attorney's fee for, the
14 proceeding if the court finds that the position of the
15 creditor was not substantially justified, except that
16 the court shall not award such costs and fees if special
17 circumstances would make the award unjust.

18 Under § 523(d)'s shifting burden of proof, a debtor must
19 establish three elements: (1) that the creditor sought to except
20 a debt from discharge under § 523(a), (2) that the subject debt
21 was a consumer debt, and (3) that the subject debt ultimately was
22 discharged. In re Stine, 254 B.R. at 249 (affirmed by the Ninth
23 Circuit at 19 Fed. Appx. 626). It is not disputed that all three
24 of these elements were shown by Montano. The burden of proof then
25 shifted to Heritage to prove that its actions were "substantially
26

27 ¹⁵ Of course, Civil Rules 59 and 60 are not the only tools
28 available to a trial court to reconsider its orders. In
particular, bankruptcy courts "as courts of equity [have the
power] to reconsider, modify or vacate their previous orders so
long as no intervening rights have become vested in reliance on
the orders." Zurich Am. Ins. Co. v. Int'l Fibercom, Inc. (In re
Int'l Fibercom, Inc.), 503 F.3d 933, 941 (9th Cir. 2007). While
the bankruptcy court acted properly here under Civil Rule 59(e),
it was also within its discretionary authority to reconsider its
order where, in light of Montano's prompt request, no intervening
rights arose in reliance on the original order.

1 justified." In re Machuca, 483 B.R. at 734.¹⁶

2 The Panel has adopted the "substantial justification"
3 standard employed by courts in weighing requests for fee awards
4 under the Equal Access to Justice Act. In re Machuca, 483 B.R. at
5 733; In re Carolan, 204 B.R. at 987. As explained in Pierce v.
6 Underwood, 487 U.S. 552, 558 (1987), a creditor must show that its
7 claim had a reasonable basis both in law and in fact. In re
8 Carolan, 204 B.R. at 987. Here, the bankruptcy court held that
9 Heritage comes up short in that it did not show that WMC actually
10 relied upon the written representations of Montano at the time it
11 approved his loans, a critical element to establish a claim for
12 relief under § 523(a)(2)(B).

13 To aid it in its review of Montano's § 523(d) motion, at the
14 hearing on August 1, 2012, the bankruptcy court instructed the
15 parties to prepare supplemental briefing discussing the case law
16 on § 523(d) and discussing "what did people know and when did they
17 know it." Hr'g Tr. 17:1-2, August 1, 2012. At the hearing on
18 September 5, 2012, the court heard argument from counsel for
19 Heritage and Montano detailing the history of the dispute between
20 the parties, the course of the adversary proceeding, and
21 Heritage's position at each stage of the litigation regarding its
22 assertion, first made in its adversary complaint, that Montano
23 provided fraudulent statements in the loan application on which
24 WMC had relied such that Montano's debt, now owed to Heritage,
25 should be excepted from discharge pursuant to § 523(a)(2)(B).

26
27 ¹⁶ Section 523(d) also allows a creditor to show "special
28 circumstances" that would make an award unjust, even if the
creditor could not prove substantial justification. Heritage has
not pled any special circumstances in this appeal.

1 Hr'g Tr. 16-30, September 5, 2012.

2 Recall, under § 523(a)(2)(B)(iii), a creditor must prove
3 that the creditor "reasonably relied" on any alleged false written
4 financial information submitted by the debtor. Reviewing the
5 supplemental briefing and arguments of counsel made at the hearing
6 on September 5, the bankruptcy court expressed doubt concerning
7 its ability, without a trial and attending credibility
8 determinations, to decide whether Heritage could show that Montano
9 made knowingly false statements in the loan application with the
10 intent to deceive WMC. Hr'g Tr. 42:4-8. However, the bankruptcy
11 court determined that, as a matter of law, Heritage had not shown
12 that WMC relied on Montano's written statements about his
13 financial condition. Hr'g Tr. 45:7-10, September 5, 2012. In
14 particular, the bankruptcy court concluded that before Heritage
15 could demonstrate that WMC reasonably relied on Montano's
16 allegedly false written statements, it must first establish it had
17 actually relied on those representations.¹⁷ Because Heritage could
18 not prove actual reliance by WMC, the court decided, it could not
19 establish that its prosecution of the action against Montano was
20 substantially justified for purposes of § 523(d). Heritage

21 _____
22 ¹⁷ Heritage agreed with this approach, as reflected in the
transcript:

23 THE COURT: Let me ask whether everybody agrees that
24 whether we're talking about [§] 523(a)(2)(A) or (B), the
reliance had to be actual. Right?

25 SANTIAGO(counsel for Montano): Yes.

26 THE COURT: Correct?

27 HUPE (counsel for Heritage): Yes.

28 Hr'g Tr. 30:19-24, September 5, 2012.

1 challenges the bankruptcy court's conclusion on appeal.

2 The Code confirms that the bankruptcy court's legal
3 conclusion was correct: § 523(a)(2)(B)(iii), by requiring a
4 creditor to reasonably rely on a debtor's misrepresentations to
5 qualify for an exception to discharge, by necessity implies that
6 the creditor in fact rely on the subject false statements. The
7 case law is also clear that showing actual reliance is a
8 prerequisite to establishing a creditor's reasonable reliance in
9 this context. Field v. Mans, 516 U.S. 59, 68 (1995) ("Section
10 523(a)(2)(B) expressly requires not only reasonable reliance but
11 also reliance in itself. . . ."); AT&T Universal Card Servs. v.
12 Mercer (In re Mercer), 246 F.3d 391, 413 (5th Cir. 2001) (the
13 "actual reliance" standard requires that the creditor prove that
14 it, in fact, relied on representations of the debtor); Dollar
15 Bank, F.S.B. v. Wagner (In re Wagner), 2009 Bankr. LEXIS 5540, at
16 *7 (Bankr. W.D. Pa. 2009) ("Unless a creditor actually relies upon
17 a false statement, the question whether a creditor's reliance on a
18 false statement was reasonable does not arise. Reasonable reliance
19 presupposes actual reliance.").

20 In making its decision, the bankruptcy court reminded
21 Heritage of the comments made by the presiding bankruptcy judge at
22 the hearing on Montano's motion to dismiss pointing out that,
23 while the complaint would survive that motion, Heritage was likely
24 facing formidable obstacles in proving that WMC actually relied on
25 Montano's alleged falsities because WMC was now a defunct
26 organization. In response to these warnings, counsel for Heritage
27 assured the bankruptcy judge that it would obtain competent
28 evidence of reliance in discovery from Montano, from the mortgage

1 broker who allegedly created the false documents, and from former
2 WMC agents, even though WMC was no longer in business. Hr'g Tr.
3 5:16-18, March 25, 2011. Heritage's assurances to the bankruptcy
4 court were apparently in recognition that substantial
5 justification for the pursuit of discharge litigation against
6 consumer debtors requires a showing it is justified at all stages
7 of the litigation. Gonzalez v. Free Speech Coalition, 408 F.3d
8 613, 620 (9th Cir. 2005) (holding that substantial justification
9 cannot be determined from a litigant's ultimate position, but
10 requires the court to examine its positions earlier in the
11 litigation); In re Carolan, 204 B.R. at 988 (information obtained
12 during the course of litigation that should dissuade creditor from
13 continuing litigation shows lack of substantial justification);
14 AT&T Universal Card Servs. v. Williams (In re Williams), 224 B.R.
15 523, 530 (2d Cir. BAP 1998) ("We hold that the creditor must be
16 substantially justified at all times through trial to be insulated
17 from paying attorneys' fees under § 523(d).").

18 Despite its assurances, Heritage failed to provide the
19 bankruptcy court competent evidence from knowledgeable people
20 formerly at WMC, or at all, that WMC had actually relied on the
21 contents of the URLA. Counsel for Heritage attempted to explain
22 this deficiency by indicating that, while it intended to offer
23 good proof, and was prepared to depose former officers of WMC, it
24 had run out of time for discovery:

25 [the parties] had agreed . . . to take the deposition of
26 the person most knowledgeable with respect to WMC. A
27 deposition subpoena was sent out. It was calendared; it
28 was scheduled, and I had orally agreed with opposing
counsel that this deposition would be moving forward
even though it was after the discovery cutoff date, and
after I served the deposition, [Montano] said no, we're

1 not going to do it.
2 Hr'g Tr. 36:3-10, September 5, 2012. Counsel further assured the
3 bankruptcy court that, "My client has always been in contact with
4 WMC regarding this loan, from day one." Hr'g Tr. 36:17-18,
5 September 5, 2012. Concerning Heritage's reasons for not
6 presenting direct evidence of actual reliance by WMC, the
7 bankruptcy court observed that Heritage had not requested an
8 extension of the discovery deadline to accommodate depositions.
9 Hr'g Tr. 38:7-9, September 5, 2012.

10 As noted above, Heritage submitted only three declarations
11 from witnesses to support its defense of the § 523(d) motion, all
12 of which the bankruptcy court discounted because none, by direct
13 knowledge of the witnesses, established whether WMC actually
14 relied on the Montano URLA. Specifically, the court noted that
15 the declaration of Mr. Gunter, an associate of Heritage's counsel,
16 merely described the procedures he employed in investigating
17 Montano. In the declaration of Mark G. Scheuerman, a proposed
18 expert witness, he opined that WMC abided by the general standards
19 of practices and customs in the industry in determining a
20 borrower's creditworthiness at the time of the loans. The
21 declarant offered no direct evidence that WMC followed these
22 practices in dealing with respect to the Montano loans. And the
23 declaration of Diane Taylor, prepared for an unrelated state court
24 case, who identified herself as "assistant secretary" of WMC
25 Mortgage, LLC, a successor to WMC, while stating that "WMC relied
26 on the information provided by an applicant-borrower in his/her
27 loan application through all stages of the underwriting process,"
28 also offered no insight into the details of the Montano

1 transaction. The bankruptcy court was careful to note that it was
2 not making a credibility determination as to the statements made
3 in any of the Heritage declarations, but simply ruling that the
4 contents did not show that WMC had actually relied on the URLA.
5 Hr'g Tr. 43:14-15, September 5, 2012. Even assuming the witness
6 statements are all true and correct, we cannot fault the
7 bankruptcy court for its unwillingness to accept Heritage's
8 position that it was substantially justified in alleging that WMC
9 actually relied on the income statements in the Montano URLA.
10 Hr'g Tr. 42:20-43:13, September 5, 2012.

11 In the bankruptcy court, and now in this appeal, Heritage
12 argues that WMC obviously changed its position after receiving the
13 URLA, because it made the requested loans to Montano. It argues
14 that, because it required a written loan application as a
15 condition of lending to Montano, and because it thereafter
16 extended credit to him, the bankruptcy court and this Panel must
17 infer that WMC actually relied on those false statements. They
18 cite to a venerable California case for a definition of "actual
19 reliance":

20 Actual reliance occurs when a misrepresentation is the
21 immediate cause of a plaintiff's conduct which alters
22 his legal relations and when absent such representation,
he would not, in all reasonable probability, have
entered into the contract or other transaction.

23 Engalla v. Permanente Med. Grp., Inc., 938 P.2d 903, 919 (Cal.
24 1997) (quoting Spinks v. Clark, 82 P. 45, 50 (Cal. 1905)).

25 We fear Heritage has taken this quotation out of context.
26 Immediately following this passage in the decision, the court
27 acknowledges a limitation on its prior statement:

28 It is not . . . necessary that reliance upon the truth

1 of the fraudulent misrepresentation be the sole or even
2 the predominant or decisive factor in influencing [the
3 creditor's] conduct. . . . It is enough that the
4 representation has played a substantial part, and so has
5 been a substantial factor, in influencing his decision.

6 Engalla, 938 P.2d at 919 (citing RESTATEMENT 2D TORTS § 538 com. e).

7 Fairly read, as it applies to this case, the California court
8 instructs that the bankruptcy court need not infer from the fact
9 that a creditor has changed its position (i.e., approved and made
10 a loan) that it actually relied on a fraudulent misrepresentation.
11 To sustain such an inference, an inquiry must be made concerning
12 the extent to which the creditor considered the misrepresentation
13 a substantial factor in influencing its decision (i.e., actual
14 reliance or reliance in fact).

15 Summarizing its conclusion, the bankruptcy court explained:

16 I am granting the motion for reconsideration to the
17 extent that it put into issue the elements under
18 [§] 523(a)(2)(B) that were set forth in the motion for
19 summary judgment. Those directly included the reliance
20 element. The predicate for any reliance element is that
21 there was actual reliance by a person, and I'm finding
22 that that simply was not demonstrated, and it's not a
23 credibility issue. The declarations simply did not go
24 to the subject in any meaningful way.

25 Hr'g Tr. 45:2-11, September 5, 2012. Since the bankruptcy court
26 concluded that Heritage had not proven actual reliance, an
27 essential element to prove for an exception to discharge under
28 § 523(a)(2)(B), we agree that it follows that Heritage did not
29 show that its position was substantially justified. In re
30 Carolan, 204 B.R. at 987 (to prove that its actions are
31 substantially justified, a creditor "must show that its challenge
32 had a reasonable basis both in law and fact."). And where, as
33 here, a debtor establishes that the creditor sought to except a
34 debt from discharge under § 523(a)(2), that the subject debt was a

1 consumer debt, and that the subject debt ultimately was
2 discharged, "the court shall grant judgment in favor of the debtor
3 for the costs of, and a reasonable attorney's fee for, the
4 proceeding if the court finds that the position of the creditor
5 was not substantially justified." § 523(d).¹⁸

6 Finally, at oral argument before the Panel, Heritage argued
7 that it did not have a fair opportunity to present its case on
8 actual reliance and substantial justification. Specifically,
9 Heritage argues that, after the bankruptcy court granted the
10 motion for reconsideration, it should have been given the
11 opportunity for a separate hearing on the § 523(d) issue.

12 We do not think so. In addition, this position is
13 inconsistent with Heritage's presentation at the hearing in the
14 bankruptcy court on September 5, 2012, where Heritage's counsel
15 stated that:

16 I went back and looked at the language, and it says
17 substantial justification in law and fact, so I believe
18 that we've already satisfied the substantial
19 justification in law based on the [§] 726 discussion and
20 the ruling on the MSJ and the denial of [§] 523(d) on
21 that ground alone. Now with respect to whether it's
22 substantially justified in fact, I also believe that not
23 only was that shown in the motion for summary judgment,
24 even though it wasn't ruled on, but it's also been shown
25 in . . . the evidence and facts that we've presented as
26 well.

27 Hr'g Tr. 13:23-14:8, September 5, 2012. In short, Heritage

28 ¹⁸ In the bankruptcy court and this appeal, Heritage also
argues that we should follow the conclusions reached by an earlier
Panel in In re Tovar, case no. CC-11-1696 (9th Cir. BAP August 3,
2012), that we can infer reliance based on the fact that the
creditor approved a loan based only on the loan documents.
Heritage fails to understand that the holding in Tovar concerned
reasonable reliance and the question of actual reliance was never
raised. Reasonable reliance is not actual reliance. Field v.
Mans, 516 U.S. at 68.

1 represented to the bankruptcy court that it was satisfied that it
2 had established substantial justification on the previous motions
3 and the evidence and facts they presented. We have examined the
4 transcripts of the hearings of August 1 and September 5, 2012,
5 where the reconsideration motion and § 523(d) matters were
6 discussed, as well as the additional briefs submitted by Heritage,
7 and do not find any indication that Heritage requested a further
8 hearing, or the opportunity to present more evidence, on the
9 questions of reliance and substantial justification.

10 To the extent that Heritage's concern reflects a due process
11 issue, the record is clear that Heritage had adequate notice
12 throughout the proceedings that, if it could not establish the
13 facts needed for an exception to discharge, Montano would request
14 an award of fees if Heritage's arguments were not substantially
15 justified at all stages of the proceedings. Indeed, the § 523(d)
16 issues were raised by Montano's cross-claim, explicitly addressed
17 in connection with the dismissal motion, and argued again in both
18 the Montano summary judgment motion and reconsideration motion.
19 Moreover, before it granted the reconsideration motion and
20 determined that Montano was entitled to recover attorneys fees
21 under § 523(d), the bankruptcy court went "the extra mile" and
22 allowed Heritage to address these issues via supplemental
23 briefing.

24 But most importantly, and to the extent that Heritage argues
25 here for fair or equitable treatment, we remind it that very early
26 in this case, it was advised by the bankruptcy court that proving
27 reliance would be difficult. At the hearing concerning the motion
28 to dismiss months earlier, the bankruptcy judge's warnings to that

1 effect were loud and clear. In response, Heritage assured the
2 bankruptcy court that it would obtain competent testimony from WMC
3 and other proof that WMC relied on Montano's alleged false
4 representations in approving the loans. As it turned out, and
5 though it had ample time to do so, Heritage failed to provide
6 adequate or, in fact, any evidence to support the reliance
7 allegation.

8 We conclude that the bankruptcy court did not abuse its
9 discretion in granting Montano's request for attorney's fees and
10 costs under § 523(d).

11 **CONCLUSION**

12 The orders of the bankruptcy court granting Montano summary
13 judgment and awarding him attorneys fees and costs are AFFIRMED.

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