



Signed and Filed: July 25, 2013

A handwritten signature in black ink, appearing to read "Hannah L. Blumenstiel", is written over a horizontal line.

HANNAH L. BLUMENSTIEL
U.S. Bankruptcy Judge
UNITED STATES BANKRUPTCY COURT

FOR THE NORTHERN DISTRICT OF CALIFORNIA

In re) Case No. 11-12669 AJ
)
ROBERT GREGG ROY and) Chapter 7
NICA SARAH ORLICK-ROY,)
)
Debtors.)
)
WORLD HERITAGE TRAVEL) Adv. Proc. No. 12-3033 HLB
GROUP, INC.,)
)
Plaintiff,)
)
ROBERT GREGG ROY and)
NICA SARAH ORLICK-ROY,)
)
Defendants.)

MEMORANDUM DECISION

The above-captioned adversary proceeding came to trial on April 24, 2013. Steven M. Olson appeared for Plaintiff World Heritage Travel Group, Inc. ("WHTG" or "Plaintiff"). Matthew D. Metzger appeared for Defendants Robert G. Roy ("Mr. Roy" or "Defendant") and Nica S. Orlick-Roy ("Mrs. Orlick-Roy"). The Court hereby issues the following memorandum decision.

INTRODUCTION

Mr. Roy and Mrs. Orlick-Roy filed a joint petition for relief under Chapter 7 of the Bankruptcy Code. Plaintiff filed a timely action seeking to except his debt from Defendants'

1 discharge under section 523(a)(2)(A), alleging that Defendants
2 fraudulently induced Plaintiff to invest in their travel agency
3 business. Plaintiff seeks a determination that its claim is
4 nondischargeable with respect to Mr. Roy's separate property
5 and Mr. Roy and Mrs. Orlick-Roy's community property, as well
6 as an award of fees and costs of suit. Plaintiff concedes that
7 Mrs. Orlick-Roy was not directly involved in Mr. Roy's
8 activities and only seeks relief against her interest in
9 community property.

10 **JURISDICTION**

11 This Court has subject-matter jurisdiction over the
12 present action under 28 U.S.C. § 1334(b). This action is a
13 core proceeding under 28 U.S.C. § 157(b)(2)(I).

14 **FACTS**

15 Defendant bought Siemer and Hand Travel Inc. ("S&H"), a
16 travel agency business, in July 2002. By that time, S&H had
17 been in business for approximately 43 years and had established
18 itself as well known and well regarded in the travel agency
19 industry. Upon his purchase of S&H, Defendant became S&H's
20 primary shareholder and president.

21 After purchasing S&H, Defendant continued many of its
22 existing business practices, including its maintenance of a
23 single business bank account for all of its operational
24 expenses. This particular practice became unlawful in 1995
25 with the enactment of the California Seller of Travel Law
26 ("CSTL"). Among other conditions, the CSTL requires sellers of
27 travel, such as S&H, to maintain customer deposits in separate
28 trust accounts and to confirm their compliance with this

1 requirement by annually completing and filing a California
2 Seller of Travel Attestation ("Attestation"). S&H filed an
3 Attestation each year it was required to do so. Each of S&H's
4 Attestations were false, however, because S&H never maintained
5 the required trust accounts.

6 By January 2009, S&H began to have financial difficulties,
7 which led Defendant to contact Innovative Travel Acquisitions
8 Inc. ("ITA"), a broker for tour operators, for assistance in
9 attracting investors who could infuse S&H with some badly
10 needed capital. ITA prepared a prospectus ("Prospectus") for
11 distribution to potential investors. Plaintiff received the
12 Prospectus towards the end of April 2009. In addition to
13 providing a wealth of other information, the Prospectus
14 included a section that specifically mentioned the "investment
15 opportunity" as a way to help with marketing, to "ramp up [its]
16 operation in Cuba," and to support "day-to-day operations."

17 Plaintiff has been involved with the travel industry for
18 approximately 40 years and is the president of WHTG. He was
19 drawn to the Prospectus because he had known of S&H's
20 reputation since the 1970's and viewed the investment
21 opportunity as an attractive one.

22 After meeting in early May 2009 to discuss S&H's business
23 affairs, Plaintiff and Defendant met again on May 10, 2009. At
24 this meeting, Plaintiff learned that S&H's financial situation
25 was much more strained than he had initially understood. In
26 particular, Plaintiff discovered that S&H did not have enough
27 money to complete an upcoming trip to China ("China Trip").
28 Plaintiff understood that any investment made by him would be

1 used to cover the costs associated with the China Trip.
2 Plaintiff and Defendant hoped that this would ameliorate S&H's
3 cash flow issues.

4 It was with a sense of urgency, as the China Trip was
5 imminent, that Plaintiff drafted, and both parties executed, a
6 Corporate Resolution ("Resolution") between WHTG and S&H on
7 June 5, 2009. The resolution transferred a 67% interest in S&H
8 to WHTG in exchange for \$250,000. It also contained a clause
9 requiring S&H to "maintain [its] financial management as
10 required by the California Seller of Travel Law..." followed by
11 a representation that "S&H operations, management and sale of
12 shares are legal in the state of California." Of additional
13 importance was a clause that established July 31, 2009 as the
14 latest date upon which Defendant could provide "all financial
15 records and tax returns of S&H" to Plaintiff. Finally, the
16 Resolution acknowledged that one of its purposes, and the need
17 for the \$250,000, was to resolve the cash shortfalls associated
18 with the China Trip.

19 At the time Plaintiff reviewed the Prospectus, as well as
20 at the time he executed the Resolution, Plaintiff contends he
21 understood that S&H maintained trust accounts as required by
22 California Business and Professions Code § 17550.15. According
23 to Plaintiff, he based his understanding on the accounting
24 information contained in the Prospectus, which indicated that
25 S&H did not book revenue for any particular trip until after
26 the travel occurred, and upon his review of one or more of
27 S&H's annual "Attestations". Notwithstanding, the Court
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1 received no evidence that Plaintiff ever specifically asked
2 Defendant whether S&H maintained such trust accounts.

3 Between June 5-15, 2009, Plaintiff transferred \$250,000 to
4 S&H. In or around June or July 2009, Plaintiff learned that
5 S&H was not in compliance with the CSTL. On or about July 21,
6 2009, Plaintiff received S&H's financial records and tax
7 returns. In or around July 2009, Plaintiff made additional
8 advances to S&H of \$66,000.

9 Despite the capital influx from Plaintiff and the eventual
10 establishment of trust accounts in November 2009, S&H continued
11 to struggle financially. On or about December 18, 2009,
12 Plaintiff, apparently concerned that his equity would be wiped
13 out if S&H went out of business, sent Defendant a promissory
14 note that purported to convert Plaintiff's equity to debt. The
15 promissory note was back-dated to June 15, 2009. In or around
16 August 2010, Defendant repaid Plaintiff approximately \$7,009.
17 Thereafter, Defendant filed the above-captioned Chapter 7 case,
18 and Plaintiff timely commenced the above-captioned adversary
19 proceeding.

20 **LEGAL STANDARD**

21 The Bankruptcy Code is designed to give the honest but
22 unfortunate debtor a fresh start in bankruptcy; thus,
23 exceptions to discharge should be construed strictly against
24 the creditor and liberally in favor of the debtor. Landsdowne
25 v. Cox (In re Cox), 41 F.3d 1294, 1297 (9th Cir. 1994). A
26 creditor must show that the debtor engaged in "blameworthy"
27 conduct in order to successfully except a debt from discharge.
28 In re Anderson, 181 B.R. 943, 948 (Bankr. D. Minn. 1995).

1 A debt may not be discharged if it was obtained by "false
2 pretenses, a false representation, or actual fraud." 11 U.S.C.
3 § 523(a)(2)(A). Although the Bankruptcy Code does not
4 expressly define those terms, the United States Supreme Court
5 has held that the terms "carry the acquired meaning of terms of
6 art. They are common law terms, and ... in the case of 'actual
7 fraud,' ... they imply elements that the common law has defined
8 them to include." Field v. Mans, 516 U.S. 59, 69 (1995). The
9 purposes of section 523(a)(2) include preventing a debtor from
10 retaining the benefits of property obtained by fraudulent means
11 and ensuring that the relief intended for honest debtors does
12 not go to dishonest debtors. Turtle Rock Meadows Homeowners
13 Ass'n v. Slyman (In re Slyman), 234 F.3d 1081, 1085 (9th Cir.
14 2000) (citation omitted).

15 To prevail on a claim under section 523(a)(2)(A), a
16 creditor must establish: (1) a misrepresentation, fraudulent
17 omission or deceptive conduct by the debtor; (2) knowledge of
18 the falsity or deceptiveness of his statement or conduct; (3)
19 an intent to deceive; (4) justifiable reliance by the creditor
20 on the debtor's statement or conduct; and (5) damage to the
21 creditor proximately caused by his or her reliance on the
22 debtor's statement or conduct. Id. The creditor bears the
23 burden of establishing each of these elements by a
24 preponderance of the evidence. Id.

25 Plaintiff claims that Defendant made two intentional
26 misrepresentations of fact to induce him to invest in S&H.
27 Specifically, Plaintiff claims: (1) Defendant misstated how
28 Plaintiff's investment money would be used as originally

1 indicated in the Prospectus; and (2) Defendant misrepresented
2 to Plaintiff that S&H was in full compliance with the CSTL when
3 in fact it was not. The Court will address each alleged
4 misrepresentation using the Slyman elements listed above.

5 **ANALYSIS**

6 A. The Prospectus.

7 Plaintiff contends that the "investment opportunity"
8 described in the Prospectus misled him into believing that his
9 money would be used for marketing, to "ramp up [S&H's]
10 operation in Cuba," and to support "day-to-day operations" when
11 instead it was used to fund the China Trip. The Court finds
12 that, while the Prospectus itself was a misrepresentation and
13 that Defendant ultimately had knowledge of its falsity, he did
14 not intentionally deceive Plaintiff nor could Plaintiff have
15 justifiably relied on Defendant's misrepresentation.

16 The third of the five Slyman elements requires that a
17 plaintiff prove that a defendant intentionally deceived the
18 plaintiff. See Slyman, 234 F.3d at 1085. Because it is nearly
19 impossible to prove an intent to deceive by direct evidence,
20 "[a] court may infer fraudulent intent from various kinds of
21 circumstantial evidence." Edelson v. Commissioner, 829 F.2d
22 828, 832 (9th Cir. 1987); Gertsch v. Johnson & Johnson, Fin
23 Corp. (In re Gertsch) 237 B.R. 160, 167-68 (B.A.P. 9th Cir.
24 1999). The court may look at "the totality of the
25 circumstances and the conduct of the person accused" in order
26 to make an inference of fraudulent intent. In re Ormsby, 591
27 F.3d 119, 1206 (9th Cir. 2010).

1 The Court finds that Defendant did not have the intent to
2 deceive because he was forthcoming with Plaintiff about S&H's
3 financial difficulties, particularly with regard to the China
4 Trip. Defendant created the Prospectus in January 2009 and by
5 the time that he and Plaintiff met, S&H's financial situation
6 had worsened to the point that it did not have enough money to
7 fund the China Trip. Plaintiff testified that Defendant
8 informed him of this problem in May, 2009 and also informed him
9 that his \$250,000 would be used to cover the expenses
10 associated with the China Trip. Additionally, the Resolution
11 explicitly states that Plaintiff's investment was meant to
12 resolve the cash shortfalls associated with the China Trip.
13 Reading the Prospectus in isolation and contrasting the alleged
14 "investment opportunities" it describes with the fact that
15 Plaintiff's money actually went to cover the China Trip might
16 lead one to believe that Defendant intentionally deceived
17 Plaintiff. However, after considering the "totality of the
18 circumstances" and Defendant's honesty regarding the true
19 purpose the \$250,000 investment, Plaintiff fails to show by a
20 preponderance of the evidence that Defendant acted with the
21 intent to deceive him. See id.

22 In order to prevail under section 523(a)(2)(A), a
23 plaintiff must also prove that he or she justifiably relied on
24 the defendant's misrepresentations or actions. See Slyman, 234
25 F.3d at 1085. Based on the totality of the evidence, the Court
26 finds that Plaintiff did not in fact rely on the
27 misrepresentations contained in the Prospectus.

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1 After the May 2009 meeting in which Defendant informed
2 Plaintiff of S&H's inability to pay for the China Trip,
3 Plaintiff was aware that his investment would cover that trip
4 and not the items identified under the "investment opportunity"
5 in the Prospectus. Further, Plaintiff concedes that he drafted
6 the Resolution in haste so that he could transfer the funds
7 immediately to fund the China Trip. Additionally, Plaintiff
8 included a clause in the Resolution specifying that one of its
9 purposes was to "allow for the prompt resolution" of the China
10 Trip's cash shortfalls. By contrast, Plaintiff makes no
11 mention of any of the other items identified under "investment
12 opportunities" found in the Prospectus in the Resolution. For
13 these reasons the Court finds that Plaintiff did not rely on
14 the Prospectus.

15 B. S&H's compliance with the CSTL.

16 Plaintiff asserts that Defendant induced him to invest in
17 S&H by representing to him that S&H was fully in compliance
18 with the CSTL and other applicable laws governing its services
19 when in fact it was not. Defendant does not dispute that he
20 was in violation of section 17550.15. By completing and
21 submitting the Attestation, which requires sellers of travel to
22 verify their compliance with section 17550.15, Defendant made a
23 misrepresentation to the world at large, including Plaintiff,
24 that S&H was in compliance with the CSTL. Nonetheless,
25 Plaintiff has not proven by a preponderance of the evidence
26 that Defendant had knowledge of the falsity of his
27 representation, that Defendant intended to deceive Plaintiff,
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1 or that Plaintiff justifiably relied on Defendant's
2 misrepresentation.

3 In order to prevail under the second element of the Slyman
4 test, a plaintiff must prove that the defendant had "knowledge
5 of the falsity or deceptiveness of his statement or conduct."
6 In re Slyman, 234 F.3d at 1085. Knowledge may be proven "by
7 circumstantial evidence and inferred from the [defendant's]
8 course of conduct." In re Ortenzo Hayes, 315 B.R. 579, 587
9 (Bankr. C.D. Cal. 2004). A defendant can be charged with
10 knowledge even if he does not have actual knowledge of the
11 falsity of his statements but instead by showing a "reckless
12 disregard for its truth." In re Gertsch, 237 B.R. at 167. The
13 Court finds that Defendant neither knew of the falsity of his
14 assertion that he was in compliance with the CSTL nor did he
15 display a reckless disregard for its truth.

16 Defendant acquired S&H in 2002 after it had been in
17 operation for over 40 years and after it had been acting in
18 violation of the CSTL by not keeping customer deposits in
19 separate trust accounts for approximately seven years.
20 Defendant continued the practices of the previous owners and
21 kept only one operating account for the company. While
22 Defendant was careless for having annually filled out the
23 Attestation without understanding its contents, the Court does
24 not find him reckless. Further, the Court deems credible
25 Defendant's testimony that he had no actual knowledge that he
26 was in violation of the CSTL until Plaintiff brought it to his
27 attention. In sum, the Court finds that Plaintiff failed to
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1 prove by a preponderance of the evidence that Defendant had
2 knowledge of the falsity of his representation.

3 Next, in order to satisfy the third element of the Slyman
4 test, Plaintiff must prove that Defendant intentionally
5 deceived him into investing in S&H by falsely representing that
6 S&H was in compliance with California law. See In re Slyman,
7 234 F.3d at 1085. (See discussion above.) The Court finds
8 that Defendant did not intentionally deceive Plaintiff.

9 Defendant was forthcoming about S&H's financial
10 difficulties and explicitly told Plaintiff that S&H did not
11 have enough money to fund the China Trip. Had Defendant tried
12 to intentionally deceive Plaintiff, it is unlikely that he
13 would have been so honest about the cash shortage for the China
14 Trip. Likewise, Defendant was forthcoming with all of S&H's
15 documentation regarding its finances when requested by
16 Plaintiff. For these reasons, the Court finds that Defendant
17 did not intentionally deceive Plaintiff.

18 In order to prevail on the fourth element of the Slyman
19 test, a plaintiff must prove that he or she justifiably relied
20 on the defendant's misrepresentations. See In re Slyman, 234
21 F.3d at 1085. Justifiable reliance imputes a "subjective
22 standard [on the plaintiff] which takes into account the
23 knowledge and relationship of the parties" rather than a being
24 a standard "of the average reasonable person." In re Kirsh,
25 973 F.2d 1454, 1458 (9th Cir. 1992). Therefore, if a plaintiff
26 has "special knowledge, experience and competence he may not be
27 permitted to rely on representations that an ordinary person
28 would properly accept." Id. (citation omitted).

1 While an ordinary plaintiff is not expected to investigate
2 the accuracy of a defendant's statements, if "under the
3 circumstances ... the facts should be apparent to one of
4 [plaintiff's] knowledge" and "should serve as a warning that he
5 is being deceived ... he is required to make an investigation
6 of his own." Field, 516 U.S. at 71 (quotation omitted).
7 Further, a plaintiff is "required to use his senses, and cannot
8 recover if he *blindly relies* upon a misrepresentation" had he
9 been able to discover its falsity upon "a cursory examination
10 or investigation." Id. (emphasis added).

11 The Court finds that Plaintiff did not justifiably rely on
12 Defendant's misrepresentation that S&H was in compliance with
13 the CSTL. First, Plaintiff has decades of experience in the
14 travel industry and while he may not be a "sophisticated
15 investor," he is extremely knowledgeable about the group travel
16 industry. He knew of the CSTL requirements. Armed with his
17 substantial experience, Plaintiff should have been alarmed
18 after the May 10, 2009 meeting when he found out about S&H's
19 lack of funds to cover the China Trip. This should have been a
20 red flag, warning him that S&H might not be in compliance with
21 section 17550.15, further prompting Plaintiff to undertake a
22 more thorough investigation of S&H's finances and business
23 practices. Instead, Plaintiff hastily drafted the Resolution
24 so that the China Trip could proceed. Plaintiff clearly
25 understood what additional information he should analyze, as he
26 requested it after the fact in the Resolution. Had Plaintiff
27 required the production of these documents before investing the
28 \$250,000, he likely would have discovered that S&H was not in

1 compliance with the law. In sum, Plaintiff fails to prove that
2 he justifiably relied on Defendant's misrepresentation.

3 **CONCLUSION**

4 For the reasons discussed above, none of the debt owed to
5 Plaintiff shall be excepted from Defendants' discharge.

6 ****END OF ORDER****

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Court Service List

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