IN THE UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF ARKANSAS
FAYETTEVILLE DIVISION

IN RE: NORMAN LEE and TRENA MARIE WARD, Debtors

No. 5:08-bk-73555
Ch. 7

SAMUEL ARMES, AS GUARDIAN OF THE ESTATE OF DORTHA ARMES **PLAINTIFF**

vs. **No. 5:08-ap-7194**

NORMAN WARD **DEFENDANT**

ORDER GRANTING SUMMARY JUDGMENT

Before the Court is a motion for summary judgment with attachments, brief in support, and statement of undisputed material facts that were filed by the plaintiff, Samuel Armes [Armes], on March 5, 2009, relating to the plaintiff's complaint to determine the dischargeability of a debt pursuant to 11 U.S.C. § 523(a)(4).[1] The defendant/debtor, Norman Ward, responded to the motion for summary judgment on March 24, 2009, but did not file a separate statement of the material facts to which he contends a genuine issue exists to be tried. The plaintiff replied to the debtor's response on April 13, 2009. For the reasons stated below, the Court finds there are no remaining issues of material fact relating to the plaintiff's § 523(a)(4) cause of action and grants the motion for summary judgment.

Jurisdiction

The Court has jurisdiction over this matter under 28 U.S.C. § 1334 and 28 U.S.C. § 157, and it is a core proceeding under 28 U.S.C. § 157(b)(2)(I). The following opinion

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[1] The plaintiff's Complaint to Determine Dischargeability of Certain Debts alleges two causes of action: § 523(a)(4) and § 523(a)(6). In his Plaintiff's Motion For Summary Judgment, the plaintiff specifically prays for an order granting his motion for summary judgment pursuant only to § 523(a)(4).

constitutes findings of fact and conclusions of law in accordance with Federal Rule of Bankruptcy Procedure 7052.

Background

On August 15, 2005, Armes was appointed guardian of the person and estate of Dortha Armes, his mother, and it is in this capacity that he filed this adversary proceeding. On October 28, 2005, Armes filed a complaint against Norman Ward, the debtor, in the Circuit Court of Washington County, alleging that Ward breached his fiduciary duty as the holder of a durable power of attorney for Dortha Armes by converting Dortha Armes's property. The state court heard the complaint on October 11, 2006, with both parties being present and represented by counsel. On October 31, 2006, the state court issued its order finding that Ward breached his fiduciary duty to Dortha Armes and was unjustly enriched. The court also found Ward was in a confidential relationship with Dortha Armes and committed conversion of her property. As a result of the court's findings, it awarded Armes, as guardian of the estate, compensatory damages in the amount of $53,058.12 and punitive damages in the amount of $5000.00. No appeal was taken from the court's order.

On September 5, 2008, Ward filed a chapter 7 voluntary petition. Armes filed the present adversary proceeding on December 2, 2008, which the debtor answered on December 17, 2008. On March 5, 2009, Armes filed his Plaintiff's Motion For Summary Judgment, Plaintiff's Brief in Support of Motion For Summary Judgment, and Plaintiff's Statement of Undisputed Material Facts as to Which No Genuine Issue Exists to be Tried. On March 24, the debtor responded to Armes's motion for summary judgment, but did not controvert Armes's statement of undisputed facts in a separate pleading. In his Response to Motion For Summary Judgment, the debtor "denies that there are no issues of genuine material fact insofar as of the Judgment amount, which is alleged to be nondischargeable." By this statement, the Court believes the debtor is disputing either the amount of debt the plaintiff is asking the Court to determine nondischargeable under 11 U.S.C. § 523(a)(4) pursuant to a state court judgment, or the actual amount of

damages as determined by the state court. In his Brief in Support of Response to Motion For Summary Judgment, the debtor states, "the Defendant does not dispute the judgment. The Defendant objects to non-dischargeable [sic] due to payment and credits, including those paid through this case."

Summary Judgment

Federal Rule of Bankruptcy Procedure 7056 provides that Federal Rule of Civil Procedure 56 applies in adversary proceedings. Rule 56 states that summary judgment shall be rendered "if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law." Fed. R. Civ. P. 56(c). The burden is on the movant to establish the absence of material fact and identify portions of pleadings, depositions, answers to interrogatories, admissions on file, and affidavits that demonstrate the absence of a genuine issue of material fact. *Celotex Corp. v. Catrett*, 477 U.S. 317, 323 (1986). The burden then shifts to the non-moving party, who must "go beyond the pleadings" and by his or her own affidavits, depositions, answers to interrogatories, and/or admissions on file, designate specific facts to demonstrate that there is a genuine issue for trial. *Id*. at 324. The non-moving party is not required to present a defense to an insufficient presentation of facts by the moving party. *Pioneer Bank and Trust v. Cameron* (*In re Cameron*), no. 08-5007, 2008 WL 5169513, at *2 (Bankr. D.S.D.).

When ruling on a summary judgment motion, the Court must view the facts in the light most favorable to the non-moving party and allow that party the benefit of all reasonable inferences to be drawn from the evidence. *Ferguson v. Cape Girardeau Cty*., 88 F.3d 647, 650 (8th Cir. 1996). In this case, the Court has before it Armes's statement of undisputed material facts, which the debtor did not controvert. Consequently, Armes's statement of undisputed material facts are deemed admitted.

Collateral Estoppel

The doctrine of collateral estoppel precludes a court from conducting further proceedings on issues that have been litigated and ruled upon previously. *Fisher v. Scarborough* (*In re Scarborough*), 171 F.3d 638, 641 (8th Cir. 1999). The appropriate standard of proof under § 523 for dischargeability exceptions in the code is the ordinary preponderance of the evidence standard. *Grogan v. Garner*, 498 U.S. 279, 291 (1991). According to the Supreme Court, "if nondischargeability must be proved only by a preponderance of the evidence, all creditors who have secured fraud judgments, the elements of which are the same as those of the fraud discharge exception [in bankruptcy], will be exempt from discharge under collateral estoppel principles." *Id.* at 285. Therefore, if the elements required under § 523 have been proved in state court, the Court must grant Armes's motion for summary judgment. In determining whether the state court judgment is entitled to preclusive effect, the Court must apply the law of Arkansas. *Scarborough*, 171 F.3d at 641 (stating that the court must look to the substantive law of the forum state in applying collateral estoppel). In Arkansas, there are four elements required to establish collateral estoppel: "(1) the issue sought to be precluded must be the same as that involved in the prior litigation; (2) that issue must have been actually litigated; (3) the issue must have been determined by a valid and final judgment; and (4) the determination must have been essential to the judgment." *Riverdale Dev. Co. v. Ruffin Bldg. Sys., Inc.*, 146 S.W.3d 852, 855 (Ark. 2004).

(1) Issue Must be the Same

Armes argues that the judgment awarded to Armes in state court in the amount of $58,058.12 is exempt from discharge under § 523(a)(4). Under this section, a discharge is not available to a debtor for any debts "for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny." 11 U.S.C. § 523(a)(4). To prevail, Armes must establish that the state court trial satisfied the following two elements: (1) that a fiduciary relationship existed between Armes and the debtor, and (2) that the debtor committed fraud or defalcation in the course of that fiduciary relationship. *Jafarpour v. Shahrokhi* (*In re Shahrokhi*), 266 B.R. 702, 707 (B.A.P. 8th Cir. 2001).

Fiduciary Relationship

Under the first element of § 523(a)(4), Armes must prove by a preponderance of the evidence that the debtor was in a fiduciary relationship with Armes. In paragraph 14 of his statement of undisputed material facts, Armes states, in reference to the state court trial: "The Court also found: 'No one disputes that in June, on June 25, 2003, that a durable power of attorney was given to Mr. Norman Ward that was received into evidence as defendant's exhibit 2.'" In paragraph 16 of his statement of undisputed material facts, Armes states, again in reference to the state court trial: "Based on the undisputed and disputed testimony, the Court found and ordered as follows: 'The Court finds that Mr. Ward, in conjunction with his wife--but again, we've got to recognize he had the power of attorney; he knew what was going on--that he breached his fiduciary duty to Mrs. [Dortha] Armes, and as a result of that, he has been unjustly enriched. . . .'" Under Arkansas law, "[a] person who holds power of attorney is an agent, and it has long been recognized that a fiduciary relationship exists between principal and agent in respect to matters within the scope of the agency." *Dent v. Wright*, 909 S.W.2d 302, 204 (Ark. 1995). If Arkansas law applied, a fiduciary relationship would have been established based on the state court's findings. However, the determination of a fiduciary relationship under § 523(a)(4) is a question of federal law, not state law. *Tudor Oaks Ltd. P'ship v. Cochrane* (*In re Cochrane*), 124 F.3d 978, 984 (8th Cir. 1997).

The federal law relating to § 523(a)(4) is clear and well established: "'[t]he fiduciary relationship must be one arising from an express or technical trust that was imposed before and without reference to the wrongdoing that caused the debt.'" *Id*. (quoting *Lewis v. Scott*, 97 F.3d 1182, 1185 (9th Cir. 1996)); *see also Barclays Am./Bus. Credit, Inc. v. Long* (*In re Long*), 774 F.2d 875, 878 (8th Cir. 1985)(citing *Davis v. Aetna Acceptance Co.*, 293 U.S. 329 (1934)). Although the fiduciary duty created by a durable power of attorney creates an agency relationship, it does not necessarily give rise to the fiduciary capacity required by § 523(a)(4). *Valley Mem'l Homes v. Hrabik* (*In re Hrabik*), 330 B.R. 765, 773 (Bankr. D.N.D. 2005)(citing *Bast v. Johnson* (*In re Johnson*), 174 B.R. 537, 541 (Bankr. W.D. Mo. 1994)). However, in addition to an express or

technical trust, a court may look to the substance of a particular transaction to determine whether a debtor can be a fiduciary under a durable power of attorney or whether the agency relationship is primarily contractual. *Hunter v. Philpott*, 373 F.3d 873, 876 (8th Cir. 2004); *see also Long*, 774 F.2d at 878-79; *Hrabik*, 330 B.R. at 773 ("if a debtor has a sufficiently elevated level of fiduciary duty, section 523(a)(4) may apply to an agency relationship"); *Johnson*, 174 B.R. at 542 (same).

Cases within the Eighth Circuit are replete with examples that elevate a relationship to the fiduciary capacity required under § 523(a)(4). For example:

- One party is incapable of monitoring the other's behavior. *Hrabik*, 330 B.R. at 773.

- The power of attorney stated that it was to be exercised solely for the benefit of the principal. *Cameron*, 2008 WL 5169513 at *4; *Hrabik*, 330 B.R. at 773; *Rech v. Burgess* (*In re Burgess*), 106 B.R. 612, 620 (Bankr. D. Neb. 1989).

- The power of attorney delineated what specific property or actions were covered. *Cameron*, 2008 WL 5169513 at *4.

- There was no expectation or understanding that the power of attorney holder's actions would be monitored by the principal, usually due to age or infirmity. *Cameron*, 2008 WL 5169513 at *4.

- The fiduciary relationship arose from the power of attorney, not from a resulting constructive trust. *Cameron*, 2008 WL 5169513 at *4.

- The principal intended to give up the management of her business affairs, and did not play an active role in the management. *Burgess*, 106 B.R. at 620.

In this instance, after reviewing the plaintiff's statement of undisputed material facts and the certified copies of the state court transcript and pleadings that were attached to the plaintiff's motion for summary judgment, the Court finds that the debtor acted in a fiduciary capacity within the scope of § 523(a)(4). Specifically, Dortha Armes and the debtor entered into a Durable Power of Attorney on June 25, 2003, which was filed of record on December 7, 2004. Dortha Armes was the sole principal to the agreement. The power of attorney allowed the debtor, *inter alia*, to "request, ask, demand, sue for,

recover, collect, receive, and hold and possess all such sums of money, debts, dues, commercial paper, checks, drafts, accounts, deposits, annuities, pension, and retirement benefits, insurance benefits and proceeds, property, tangible or intangible property and property rights and demands whatsoever . . . ." (Pl's. Mot. Summ. J. Ex. A at 157, ¶ 2.) The power of attorney further stated, "[i]n addition to the powers herein, this power of attorney is given in anticipation of possible infirmity resulting from injury, old age, senility, blindness, disease or other related similar cause as a means of providing for my care and for the care of my holdings and property . . . ." (Pl's. Mot. Summ. J. Ex. A at 157, ¶ 9.) The state court judge found that the debtor was in a "confidential relationship" with Dortha Armes. (Pl's. Mot. Summ. J. Ex. B, ¶ 2.) Finally, the power of attorney was entered into prior to the damages suffered by Dortha Armes. For these reasons, the Court finds that the first element required under § 523(a)(4) has been met.

Fraud or Defalcation

Under the second element of § 523(a)(4), Armes must prove by a preponderance of the evidence that the debtor committed fraud or defalcation in the course of that fiduciary relationship. Defalcation is defined as the "'misappropriation of trust funds or money held in any fiduciary capacity; [the] failure to properly account for such funds.'" *Cochrane*, 124 F.3d at 984 (quoting *Lewis v. Scott*, 97 F.3d 1182, 1186 (9th Cir. 1996)). Fraud is defined as "'any deceit, artifice, trick or design involving direct and active operation of the mind, used to circumvent and cheat another--something said, done or omitted with the design of perpetuating what is know to be a cheat or deception.'" *Merchants Nat'l Bank v. Moen* (*In re Moen*), 238 B.R. 785, 790-91 (B.A.P. 8th Cir. 1999)(quoting *RecoverEdge L.P. v. Pentecost*, 44 F.3d 1284, 1293 (5th Cir. 1995)).

In this instance, the state court judge found that the debtor converted $53,058.12 belonging to Dortha Armes. In announcing his reasoning for awarding punitive damages, the judge stated that "having made the findings of fact that I have and the conclusions of law, it is the Court's conclusion that to the extent damages have been awarded, there was absolutely no legal justification for Mr. and Mrs. Ward to consider this 53-thousand-plus

dollars as their own and to not return it to Ms. Armes or her representative." In paragraph 15 of his statement of undisputed material facts, Armes states, in reference to the state court trial: "As to the disputed testimony, the Court found that Mr. Ward: 'Has provided no accounting of what he did with that [Mrs. Armes'] money under his fiduciary duties as a power of attorney.'" As stated earlier, the debtor did not controvert Armes's statement of undisputed material facts. Accordingly, the Court finds that the second element required under § 523(a)(4) has also been met.

Having found the elements of § 523(a)(4) have been met, the Court also finds that Armes has also met the first required element of collateral estoppel--that the issue sought to be precluded must be the same as that involved in the prior litigation.

(2) Actually Litigated

The second element of collateral estoppel is that the issue must have been actually litigated. According to the plaintiff's statement of undisputed material facts, Armes filed a complaint in the state court on October 28, 2005; that complaint was heard by the court on October 11, 2006; and both parties appeared. Accordingly, the Court finds that Armes has met the second element of collateral estoppel.

(3) Valid and Final Judgment

The third element is that the issue must have been determined by a valid and final judgment. The plaintiff attached a certified copy of the judgment that was entered in the state court action and filed for record on October 31, 2006. (Pl's. Mot. Summ. J. Ex. B, ¶ 2.) According to the plaintiff's statement of undisputed material facts, and supported by a certified copy of the state court docket (Pl's. Mot. Summ. J. Ex. D), no appeal was taken from the state court judgment. Consequently, the Court finds that Armes has met the third element of collateral estoppel.

(4) Essential to the Judgment

Finally, the fourth element is that the determination that the debtor committed fraud or

defalcation in the course of his fiduciary relationship was essential to the judgment. In the state court case, the determination of both compensatory and punitive damages was based upon the debtor's breach of his fiduciary duty to Dortha Armes. Even though the finding of a fiduciary relationship under § 523(a)(4) is based on federal law and is a higher standard than what is required under Arkansas law, as stated above, the Court finds that in this instance a fiduciary relationship did exist. Accordingly, the Court finds that the determination that the debtor committed fraud or defalcation in the course of his fiduciary relationship was essential to the judgment entered in state court. Ergo, the Court finds that Armes has met the fourth element of collateral estoppel and is entitled to the entry of an order granting his motion for summary judgment.

Conclusion

For the reasons stated above, the Court grants Armes's motion for summary judgment and finds that the debt to Armes, as guardian of the estate of Dortha Armes, in the amount of $58,058.12, plus costs in the amount of $145.00, less any amounts previously paid in satisfaction of the judgment, is excepted from discharge in the debtor's bankruptcy case pursuant to § 523(a)(4). As stated in the state court order, post-judgment interest shall be paid at the rate of 8% per annum from October 31, 2006, the date of the judgment.

IT IS SO ORDERED.

May 8, 2009
DATE

Ben Barry
BEN T. BARRY
UNITED STATES BANKRUPTCY JUDGE

cc: Rick Woods, attorney for Samuel Armes
J. Robin Pace, attorney for the debtor
William M. Clark Jr., chapter 7 trustee