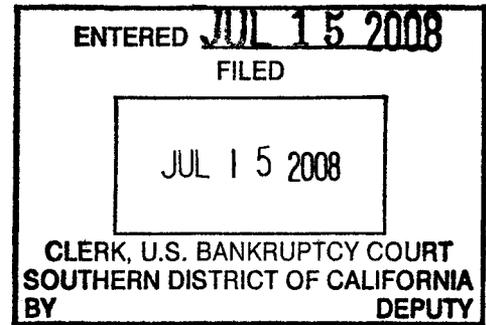


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WRITTEN DECISION – [NOT] FOR PUBLICATION



UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF CALIFORNIA

In re:

Joseph Francis Kelley and
Shirley Susan Kelley,

Debtors.

Alicia Dwyer,

Plaintiff,

v.

Joseph Francis Kelley and
Shirley Susan Kelley

Defendants.

) Bankruptcy No. 07-01152-LT

) Adversary No. 07-90263

) MEMORANDUM DECISION

This Memorandum Decision follows trial in Adversary Proceeding No. 07-90263 (the "Dischargeability Action".) Alicia Dwyer initiated the Dischargeability Action by filing a Complaint to Determine Dischargeability of Debt against debtors Joseph Francis Kelley and Shirley Susan Kelley (collectively, "Debtors") that requests a judicial determination that her entire claim against Debtors is non-dischargeable under 11 U.S.C. §§ 523(a)(4) and 523(a)(2)(A). Stated simply, Ms. Dwyer asserts that the Debtors acted as

1 her fiduciaries in connection with a real estate transaction, committed fraud by improperly
2 utilizing her credit card in the real estate transaction and then failing to reimburse her for the
3 charges, and thereby caused her damages that should be excepted from discharge.

4
5 This is a core proceeding over which this Court has jurisdiction under 28 U.S.C.
6 § 157(b)(2)(I) and pursuant to 28 U.S.C. § 1334 and 11 U.S.C. § 523.¹ This Memorandum
7 Decision constitutes the Court's findings of fact and conclusions of law, pursuant to
8 Rule 7052 of the Federal Rules of Bankruptcy Procedure.

9
10 **FINDINGS OF FACT**

11
12 **I. Ms. Dwyer Signs The Listing Agreement And Retains Century 21 As**
13 **Broker And Mr. Kelley As Agent To Sell The Property.**

14
15 a. It is undisputed that on or about September 8, 2002, Ms. Dwyer
16 executed a Residential Listing Agreement (the "Listing Agreement") by which she retained
17 Century 21 1st Choice ("Century 21") to assist her as real estate broker in connection with
18 the sale of real property located at 3074 Holly Rd., Alpine, California (the "Property").

19 Ex. 1.

20
21 b. Earlier in 2002, Ms. Dwyer obtained the financing necessary to acquire
22 the Property, while her mother provided the down payment. Ms. Dwyer held title to the
23 Property on September 8, 2002, but prior to the close of escrow quit-claimed the Property to
24 her mother. Upon close of escrow, Ms. Dwyer's mother recovered her investment, and the

25
26 ¹ Hereinafter, references to code sections refer to Title 11 of the United States Codes, also referred
27 to as the "Bankruptcy Code", unless otherwise specified. References to the transcript of the trial in
28 this matter, docket #29, are abbreviated "Tr." References to the Declarations of Alicia Dwyer,
Joseph Kelley, and Shirley Kelley that were introduced into evidence at the Trial are referred to in
abbreviated form hereafter as "Dwyer Decl.", "Mr. Kelley Decl.", and "Mrs. Kelley Decl.",
respectively.

1 Property secured lender received payment in full. Ms. Dwyer did not receive any profit
2 from sale of the Property. Tr. 106:9-25; 107:1-4; Ex. 25.

3
4 c. The Listing Agreement specified those expenses that Ms. Dwyer
5 agreed at that time to pay: \$550.00 for a physical inspection and \$250.00 for a virtual tour.
6 Ms. Dwyer did not agree to pay advertising costs in the Listing Agreement. Ex. 1.

7
8 d. The Listing Agreement provided for a six percent commission to
9 Century 21. Ex. 1; Tr. 8:14-17.

10
11 **2. Mr. Kelley Acted As A Real Estate Agent For And Fiduciary To**
12 **Ms. Dwyer, While Mrs. Kelley Acted As A Non-Fiduciary Support Person.**

13
14 a. Mr. Kelley prepared and signed the Listing Agreement for Century 21
15 as "Agent," acted as Ms. Dwyer's realtor, listed the Property for sale, and represented
16 Century 21 in the sale of the Property (the "Property Sale"). Dwyer Decl. ¶¶2-4; Tr. 5:21-22
17 and 25; 6:1; 8:1-13; 64:10-25; 65:1.

18
19 b. Mr. Kelley acknowledged and the Court finds that he was a realtor and
20 a real estate salesman and agent for and associate licensee of Century 21 and that, as a
21 result, he owed fiduciary duties to sellers such as Ms. Dwyer including a duty of utmost
22 loyalty, a duty of fair treatment, a duty not to defraud or deceive, and a duty to put the
23 client's interest above his own. Tr. 5:8-9 and 17-18; 6:21-25; 7:1-22.

24
25 c. Mrs. Kelley was a "realtor's helper" and not a licensed real estate agent.
26 During the period of the listing, she participated in numerous conversations with Ms. Dwyer
27 and acted as a member of Mr. Kelley's staff. Mrs. Kelley Decl. ¶1; Tr. 22:6-7; 71:16-17;
28 72:11-12.

1 **3. Mr. Kelley Obtained Use Of Ms. Dwyer's Credit Card Based On An**
2 **Agreement To Reimburse Her For All Expenses Charged.**

3
4 a. At Mr. Kelley's request and subsequent to the signing of the Listing
5 Agreement, Ms. Dwyer authorized use of her credit card (the "Credit Card") by Mr. Kelley
6 for purposes of marketing the Property, and, in particular, to purchase advertising. Dwyer
7 Decl. ¶6; Tr. 8:18-20, 9:15-25, 10:1-2.

8
9 b. The beginning balance on the Credit Card prior to any charges related
10 to the Property was \$4,780.24. Ms. Dwyer made additional use of the Credit Card for
11 purchases unrelated to the Property from October 8, 2002 to February 13, 2003. Ex. 2
12 (November 2002 and March 2003 Statements)

13
14 c. Mr. Kelley required Ms. Dwyer to sign a written authorization for use
15 of the Credit Card. Neither party introduced a copy of the alleged authorization into
16 evidence, as Mr. Kelley claims to have lost his copy. Tr.9:23-25; 10:1-19; 11:3-6 and 14-
17 17.

18
19 d. The form Ms. Dwyer executed to allow credit card use was not
20 standard at Century 21, but was Mr. Kelley's own form. Tr. 11:3-10.

21
22 e. A representative of Century 21 told Ms. Dwyer that "Mr. Kelley should
23 not have done that" in response to Ms. Dwyer's post-sale inquires regarding use of the
24 Credit Card. Dwyer Decl. ¶7. The Court acknowledges that this testimony is hearsay, but it
25 was admitted into evidence without any objection by Debtors. Further, it is supported by
26 Mr. Kelley's admission that the form utilized was his and not a Century 21 form. Tr. 11:3-
27 10.

28

1 f. Mr. Kelley and Ms. Dwyer agreed upon guidelines for use of the Credit
2 Card. Mr. Kelley never had physical possession of the Credit Card, but, instead, utilized the
3 written authorization to use the Credit Card with vendors. Mr. Kelley Decl. ¶6; Tr. 49:15-
4 20.

5
6 g. Ms. Dwyer received the Credit Card statements and was thus aware of
7 Credit Card use during the course of the Property Sale. Tr. 100:22-25; 101:1-2.

8
9 h. Ms. Dwyer understood that all advertising costs charged to the Credit
10 Card were to be "reimbursed" to her upon close of the escrow for the Property Sale.
11 Mr. Kelley conceded that he agreed to reimburse some expenses, but was not specific as to
12 the percentage or type of any expenses not subject to reimbursement. Dwyer Decl. ¶ 6;
13 Tr. 9:17-25; 10:1-25; 11:1-2; 12:15-16; 119:2-7. As noted above, Mr. Kelley failed to
14 produce a copy of the authorization agreement signed by Ms. Dwyer or a copy of the form
15 of the agreement. Given the clear testimony that the form utilized was Mr. Kelley's, this is
16 puzzling and certainly suggests that the document Ms. Dwyer signed contains nothing
17 supportive of Mr. Kelley's position. The Court finds Ms. Dwyer to be the more credible
18 witness on this point. Her testimony on this point was clear and consistent. Mr. Kelley's
19 vague suggestion that there were certain items where he did not agree to reimbursement –
20 but that he cannot remember the details – is not credible. His demeanor on the witness stand
21 during this portion of his testimony also supports the Court's conclusion that Mr. Kelley was
22 not being candid on this point. Thus, the Court finds that Mr. Kelley obtained use of the
23 Credit Card by agreeing to fully reimburse Ms. Dwyer for all Credit Card charges he
24 initiated.

25
26 i. The testimony was unclear regarding Ms. Dwyer's instructions
27 regarding Credit Card use while the Property was in escrow. Mr. Kelley testified that
28

1 Ms. Dwyer authorized continued use of the Credit Card while escrow was pending. The
2 Court finds this evidence credible. Tr. 133:8-25; 134:1-19. Dwyer Decl. ¶9.

3
4 **4. Escrow Closed, Mr. Kelley And Century 21 Received Commissions, But**
5 **Ms. Dwyer Was Not Paid.**

6
7 a. Escrow was opened on the Property Sale in October or November of
8 2002. Escrow closed on March 5, 2003. Ex. 25; Tr. 14:22-25; 15:1-3.

9
10 b. When escrow closed on the Property Sale, Ms. Dwyer was not
11 reimbursed for the Credit Card charges Mr. Kelley initiated. Mr. Kelley testified that: "it
12 was my understanding that those reimbursements were complete", but he provided no
13 explanation for this assumption. He now acknowledges that she is unpaid. During the post-
14 escrow period and at various times thereafter Mr. Kelley directly or indirectly through
15 Mrs. Kelley promised to pay Ms. Dwyer back. While he failed to do so or to take sufficient
16 steps to obtain reimbursement, Mr. Kelley also believed that an amicable resolution could
17 be reached. Dwyer Decl. ¶12; Tr. 17:11-25; 18:1-9; 23:15-25; 24:1-25; 25:1-25; 26:1-22.

18
19 c. In connection with this closing, the total sales commission² was
20 \$33,600.00, and Mr. Kelley received approximately \$6,000.00 as his commission from
21 Century 21. Tr. 8:14-17; 55:24-25; 56:1; Ex. 25.

22
23
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26
27 ² The parties submitted no evidence as to whether the sale involved a cooperating broker as agent
28 for the buyer, therefore, it was not established whether Century 21 received the full 6% or a lesser
portion based on a split with a buyer's agent.

1 **5. All Charges To The Credit Card Authorized By Mr. Kelley, Including**
2 **Post-Escrow Charges, Relate To The Property.**

3
4 a. Ms. Dwyer testified that after close of escrow, Debtors used the Credit
5 Card "for all sorts of things that had nothing to do with [the Property], and which were
6 never authorized by [her]." Mr. Kelley denied any use of the Credit Card after the close of
7 escrow, but acknowledged that the vendors continued to use it inappropriately. Mr. Kelley
8 insisted that all charges on the Credit Card initiated by him relate to the Property Sale.
9 Dwyer Decl. ¶ 13; Mr. Kelley Decl. ¶ 7. Tr. 14:8-10; 16:12-25; 17:1-10; 18:15-19; 19:1-25;
10 27:24-25; 28:1 and 10-25; 29:1-25; 30:1-5. The Court finds no evidence that Mr. Kelley
11 used the Credit Card for purposes unrelated to the Property Sale or expressly authorized
12 continued use after escrow closed.

13
14 b. The charges to the Credit Card related to the Property Sale total
15 \$11,243.75. Dwyer Decl. ¶ 16.

16
17 **6. Ms. Dwyer Continued To Press For Reimbursement, And The Debtors**
18 **Continued To Promise Payment.**

19
20 a. After Escrow closed, Plaintiff spoke with Debtors at least once per
21 month making Debtors aware of the unpaid Property Sale related Credit Card charges and
22 the accruing interest charges, late fees, and over-limit fees related thereto. These calls were
23 with Mrs. Kelley who consistently affirmed that Ms. Dwyer would be repaid. Dwyer Decl.
24 ¶21; Tr. 121:23-25; 122:1-18; 123:10-21.

25
26 b. Ms. Dwyer was not employed during the post-escrow closing period
27 and did not have money to pay the Credit Card bill for several months. Thus, she incurred
28

1 \$390.00 in late charges. Debtors repeatedly promised to reimburse her for these late
2 charges. Dwyer Decl. ¶¶ 18 and 20; Ex. 4.

3
4 c. Beginning in February 2003, Ms. Dwyer also incurred over limit
5 charges as a result of the Property Sale related charges. These charges totaled \$647.00.
6 Debtors repeatedly promised to reimburse her for these charges. Dwyer Decl. ¶¶ 18 and 20;
7 Ex. 4.

8
9 d. Ms. Dwyer called the businesses charging the Credit Card and advised
10 them not to allow the Debtors further use of the Credit Card and, at her request, the Debtors
11 sent letters dated in March and April of 2003 requesting that the businesses stop use of the
12 Credit Card. Dwyer Decl. ¶ 23; Tr. 99:17-25; 100:1-14; Ex. 8, 9, 10 and 11.

13
14 **7. Ms. Dwyer Requests And Obtains A Promissory Note As Evidence Of**
15 **The Reimbursement Obligation.**

16
17 a. Approximately 15 months after close of the Property Sale, Ms. Dwyer
18 contacted Mr. Kelley and requested that he execute a promissory note. Mr. Kelley alleges
19 that Ms. Dwyer requested a note in an amount that would show Ms. Dwyer's father that she
20 was an astute manager of her real-estate transactions. Mr. Kelley alleges that Ms. Dwyer
21 was having difficulties with her father over the expenses associated with the Property Sale,
22 and she wanted a tax deduction for the expenses. He also suggests that Ms. Dwyer offered
23 additional real estate transactions as an inducement to signing of the note. Ms. Dwyer
24 specifically denies these explanations by Debtors. Mr. Kelley Decl. ¶9, 4:10-15. Dwyer
25 Decl. 8:5-11. Tr. 30:25; 31:1-25; 32:1-8. The Court does not find Mr. Kelley's testimony
26 credible to the extent he suggests that he signed a note without any belief that it evidenced
27 an obligation he owed to Ms. Dwyer. Mr. Kelley agreed to reimburse her for these charges
28

1 when he obtained use of the Credit Card, and Debtors consistently agreed to repayment
2 thereafter.

3
4 b. Eventually, Debtors executed and delivered a Promissory Note dated
5 May 8, 2004 (the "Note").

6
7 c. Ms. Dwyer "guestimated" the principal amount of the Note. It included
8 the amounts Debtors charged in relation to the Property Sale, \$11,243.75, and interest, late
9 charges, and over balance fees charged to the Credit Card from November 2002 to the Note
10 date in the amount of \$8,602.74. The principal amount also included the estimated
11 additional interest Ms. Dwyer "guestimated" she would incur prior to payment in full of the
12 Note. Tr. 117:3-25; 118:1-12.

13
14 d. The Note did not accrue interest and included an attorneys' fee
15 provision. Ex. 12.

16
17 e. Mrs. Kelley also signed the Note, although Ms. Dwyer never requested
18 her to do so. Plf. Trial Brief filed March 12, 2008 (Plf. Brief #1) 2:9-10.

19
20 f. Ms. Dwyer paid the Credit Card balance in full on or about July 1,
21 2004. She utilized the proceeds of another loan to make this payment. She testified that she
22 has incurred liability for substantial additional interest charges thereafter, but she provided
23 no evidence regarding either the applicable interest rate or the amount of post Credit Card
24 payoff interest. Tr. 118:9-12; 119:13-24.

1 **8. When Debtors Failed To Pay The Note, Ms. Dwyer Initiated A Civil**
2 **Action And Obtained A Default Judgment.**

3
4 a. Ms. Dwyer initiated a state court action against Debtors in 2005 to
5 collect on the Note and obtained a default judgment against Debtors in April 2006 for the
6 full amount of the Note plus attorney's fees and court costs. Ms. Dwyer sought an
7 assignment of Mr. Kelley's commissions and pursued a judgment debtor exam, but all
8 collection efforts were halted when Debtors filed their bankruptcy petition in March of
9 2007. Dwyer Decl. ¶28 *et seq.*

10
11 b. During the course of the state court action, the Debtors did not dispute
12 that they owed money to Ms. Dwyer. In particular, they did not claim that they signed the
13 Note to appease Ms. Dwyer's father, to facilitate tax benefits, or to gain future business.
14 Tr. 34-38; 40:5-7; 42:2-13.

15
16 c. The Debtors first raised this defense in connection with the
17 Dischargeability Action. Tr. 42:24-25; 43:1-4.

18
19 d. Debtors' schedules list Ms. Dwyer's claim as undisputed. They also
20 evidence significant financial distress unrelated to Ms. Dwyer's claim including total
21 unsecured claims in the amount of \$356,143.00 and medical claims of over \$160,000.00.

1 While it is true that Mrs. Kelley also executed the Note, the record is unclear as to
2 why she took this step. Certainly, there is no evidence or legal authority that establishes that
3 this fact, in and of itself, is sufficient to constitute her a fiduciary to Ms. Dwyer. As a result,
4 Ms. Dwyer's claims under section 523(a)(4) fail as to Mrs. Kelley.

5
6 **2. Mr. Kelley Owed A Fiduciary Duty To Ms. Dwyer.**

7
8 Ms. Dwyer engaged Century 21 as a real estate broker for the Property Sale.
9 Mr. Kelley signed the Listing Agreement as "Agent" for Century 21, listed the Property, and
10 at all relevant times acted as Century 21's representative and Ms. Dwyer's agent in
11 connection with the Property Sale. At trial, Mr. Kelley acknowledged a fiduciary obligation
12 to Ms. Kelley as a result of this status.

13
14 Notwithstanding this admission, Mr. Kelley's counsel argued at trial that by virtue of
15 Ms. Dwyer's contract with Century 21, the fiduciary duty owed to Ms. Dwyer was actually
16 that of Century 21 – not Mr. Kelley. Mr. Kelley's argument is not well taken.

17
18 California Civil Code Section 2079.13 provides clear authority that Mr. Kelley owed
19 a fiduciary duty to Ms. Dwyer even if Century 21 was the broker. Mr. Kelley appears to
20 have acted as an associate licensee, as that term is defined under California law, in
21 connection with the Property Sale. Under California law, an "associate licensee" is a person
22 who is licensed as a real estate broker or sales person and who is either licensed under a
23 broker or has entered into a written contract with a broker to act as the broker's agent in
24 connection with acts requiring a real estate license and to function under the broker's
25 supervision in the capacity of an associate licensee. Cal. Civ. Code § 2079.13. As an
26 associate agent of Century 21, Mr. Kelley's duty to Ms. Dwyer was equivalent to the duty
27 owed by Century 21 as section 2079.13 further provides that:
28

1 When an associate licensee owes a duty to any principal or to
2 any buyer or seller who is not a principal, in a real estate
3 transaction, that duty is equivalent to the duty owed to that party
4 by the broker for whom the associate licensee functions.

4 *Id.*

6 Thus, whether Mr. Kelley functioned as a broker, agent, or, as seems most probable,
7 an associate licensee of Century 21, he owed the same duty to Ms. Dwyer as did Century 21,
8 as the broker. California law is also clear that the duty owed by any broker, agent or
9 associate agent/licensee is a fiduciary duty. *See, Thompson v. Rodriguez (In re Rodriguez)*,
10 196 B.R. 537, 539 (N.D. Cal. 1996); *Woolsey v. Edwards (In re Woolsey)*, 117 B.R. 524,
11 529 (9th B.A.P. 1989); *Rattray v. Scudder*, 28 Cal. 2d 214, 222-223 (1946); *Warren v.*
12 *Hildegard Merrill*, 143 Cal. 4th 96, 109 (2006).

14 Given Mr. Kelley's acknowledgment that he acted as Ms. Dwyer's fiduciary and that
15 he understood the duties imposed on him by this fiduciary relationship and the clarity of
16 California law on this topic, any argument that Mr. Kelley was not Ms. Dwyer's fiduciary is
17 frivolous. Mr. Kelley functioned as a fiduciary to Ms. Dwyer and owed her obligations of
18 loyalty, candor, and fair treatment. As a fiduciary he also undertook a duty to put her
19 interests first. There is no question that as a matter of both law and fact Mr. Kelley acted as
20 a fiduciary to Ms. Dwyer.

22 **3. Ms. Dwyer's Agreement To Allow Use Of Her Credit Card By**
23 **Mr. Kelley, Her Fiduciary, Established The Requisite Existence Of A Trust Res.**

25 In order for the Court to find defalcation by a fiduciary under section 523(a)(4), the
26 facts must establish more than status as a fiduciary and breach of a general fiduciary
27 obligation imposed by state law. *Evans v. Pollard (In re Evans)*, 161 B.R. 474, 477 (9th Cir.
28 BAP. 1993). The Bankruptcy Code requires that an "express trust" exist. Such a trust is

1 defined as a: "fiduciary relationship with respect to property subjecting the person by whom
2 the title to the property is held to equitable duties to deal with the property for the benefit of
3 another person" *Id.* at 478. Thus, the requirement of a trust relationship is established
4 when a trust res – money or property – is entrusted to the debtor/fiduciary.

5
6 A real estate broker may be placed into the role of a fiduciary under a technical or
7 express trust with respect to funds held by a broker on behalf of a client. Cal. Bus. & Prof.
8 Code 10145. *See e.g. In re Currin*, 55 B.R. 928, 933 (Bankr.D.Colo.1985). In this case,
9 Ms. Dwyer entrusted her credit card to Mr. Kelley. This act created the trust res as to which
10 fraud or defalcation could occur. When Ms. Dwyer provided Credit Card authorization to
11 Mr. Kelley, she allowed him to utilize her credit and to incur debt in her name. The Court
12 sees no reasonable basis to distinguish between the control over a specific monetary deposit
13 in a case like *Currin* and control over the ability to obtain specific funds through use of the
14 Credit Card. *See also e.g. Stevens v. Briles (In re Briles)*, 228 B.R. 462, 466-467 (Bankr.
15 S.D. Cal. 1998) (trust deed constitutes trust res for section 523(a)(4) purposes); *Berry v.*
16 *Mullin (In re Mullin)*, 91 B.R. 175, 177 (Bankr. S.D. Fla. 1988) (disputed escrow proceeds
17 constitute trust res for section 523(a)(4) purposes). In all such cases, the fiduciary exerts
18 control over his principal's asset and, thus, has an obligation to use the asset properly and to
19 account fully for all such use.

20
21 **4. Ms. Dwyer's Claim Against Mr. Kelley Was Caused, In Part, By**
22 **Defalcation In Connection With A Trust Res, Her Credit Card.**

23
24 Finally, for a claim to be non-dischargeable under section 523(a)(4), the debtor
25 fiduciary must commit an act of fraud or defalcation in regard to the trust res. Once
26 Ms. Dwyer establishes a fiduciary relationship and the existence of a trust res, the duty
27 shifts to Mr. Kelley to provide a full accounting; *i.e.* to show that he acted consistent with
28 his fiduciary duty in connection with any use of the trust res. *In re Niles*, 106 F.3d at 1462.

1 The evidence indicates that Mr. Kelley committed defalcation of his fiduciary duty in his
2 handling of the Credit Card.

3
4 In *Niles*, the Ninth Circuit agreed with the bankruptcy court's findings that some of
5 the fiduciary's actions fell under section 523(a)(4), but some did not. In the first instance,
6 the Court agreed that the fiduciary's retention of rental income that belonged to the trust
7 created a non-dischargeable debt as a result of defalcation under section 523(a)(4). *Id.* In
8 contrast, the Court found that the fiduciary's failure to repay loans made by the trust
9 beneficiary from non-trust assets was not a defalcation under section 523(a)(4) that resulted
10 in a non-dischargeable obligation. *Id.* at 1463. In this second instance, the funds at issue
11 were not part of a trust res over which the fiduciary had control. *Id.* at 1462-1463.

12
13 Here, the situation is more akin to the wrongful retention of trust assets. Ms. Dwyer
14 entrusted Mr. Kelley, her fiduciary, with the Credit Card – thus, he controlled how it was
15 used and the amount of credit charged thereon. Further, and more importantly, his use of
16 the Credit Card fell squarely within the four corners of his fiduciary relationship with
17 Ms. Dwyer – he obtained this use not as an arm's length borrower, but as a real estate agent
18 for use in a real estate transaction in connection with which he owed a fiduciary duty. He
19 violated that duty –by not reimbursing Ms. Dwyer, by making sure that both Century 21 and
20 he obtained a full commission from escrow while failing to obtain any reimbursement of the
21 Credit Card charges from escrow, and by allowing post-escrow close misuse of the Credit
22 Card for which he failed to obtain repayment. The Credit Card created a trust res, and a
23 claim based on damages resulting from Mr. Kelley's total failure to reimburse Ms. Dwyer as
24 promised in connection with this trust res use is non-dischargeable.

25
26 Defalcation as a fiduciary does not require intent and can be found even if the
27 fiduciary's actions are merely negligent or otherwise constitute innocent defaults. *Western*
28 *Surety Co. v. Meek (In re Meek)*, 25 B.R. 58, 60 (Bankr. D. Ore. 1982). Mr. Kelley's failure

1 to properly account to Ms. Dwyer for the Credit Card use by providing reimbursement as
2 and when promised, or even to assist Ms. Dwyer in presenting a claim to the escrow,
3 constitutes defalcation as a fiduciary. The Court does not find that Mr. Kelley had active
4 intent to defraud. Instead, it finds that he failed to make an appropriate escrow demand on
5 her behalf, failed to make any payment personally, failed to cause Century 21 to make
6 payment, and failed to obtain reimbursement when the vendors he selected misused the
7 Credit Card. These failures appear to arise from negligence and inattention rather than
8 intent, but, as intent is not required, negligence or inattention suffice, particularly where
9 Mr. Kelley took great care to make sure that Century 21 and he were paid in full.

10
11 Mr. Kelley obtained use of the Credit Card which provided a significant benefit to
12 him and/or to Century 21. In so doing he had an obligation to account fully and completely
13 to Ms. Dwyer for all use of the Credit Card. He failed to do so and the debt directly
14 resulting from this defalcation is non-dischargeable.³

15
16 **B. Intent And Fraud Cannot Be Found In The Facts Of This Case.**

17
18 While the Court finds this debt non-dischargeable as to Mr. Kelley for defalcation
19 while acting as a fiduciary pursuant to section 523(a)(4), the Court does not find the debt
20 non-dischargeable under section 523(a)(2)(A) as to either of the Debtors. Under
21 section 523(a)(2)(A) there is no shifting of the burden of proof to the debtor at any time.
22 Instead, the plaintiff must prove all elements of the claim by a preponderance of the
23 evidence. *Grogan v. Garner*, 498 U.S. 279, 290 (1991). Ms. Dwyer failed to present
24 evidence to support her allegations that the Debtors committed fraud by misuse of the Credit
25 Card, non-reimbursement for the charges to the Credit Card, or entry into and/or failure to
26 repay the Note.

27
28 ³ Ms. Dwyer also suggests that post-escrow Mr. Kelley was using her card for improper purposes. However the evidence does not support Ms. Dwyer on this point.

1 To prevail under section 523(a)(2)(A), a creditor is required to prove that: "(1) the
2 debtor made representations; (2) he knew the representations to be false at the time they
3 were made; (3) the representations were made with the intention and purpose of deceiving
4 the creditor; (4) the creditor relied on the representations; and (5) the creditor sustained the
5 alleged loss and damage as the proximate result of the representations having been made."
6 *Hayhoe v. Cole (In re Cole)*, 226 B.R. 647, 654 (9th Cir. BAP 1998) [(citing, among others,
7 *Ben. Pension Plan v. Kirsh (In re Kirsh)*, 973 F.2d 1454, 1457 (9th Cir. 1992)]. The Court
8 must also bear in mind that "exceptions to discharge [should] be construed narrowly and in
9 favor of the debtor." *AT&T Universal Card Services v. Pham (In re Pham)*, 250 B.R. 93, 97
10 (9th Cir. BAP 1999).

11
12 At trial, Ms. Dwyer failed to present any evidence to support a claim that the Debtors
13 misrepresented the proposed uses of the Credit Card and intentionally used it for
14 undisclosed purposes. It is undisputed that the parties agreed the Credit Card was to be used
15 for expenses associated with the Property Sale. The Court finds that Debtors did not
16 authorize use of the Credit Card for any other purpose.

17
18 Ms. Dwyer offered Exhibit 3 into evidence as her summary of a total of "82 wrongful
19 usages" of the Credit Card. Dwyer Decl. 3:22-28. Asked to specifically identify the
20 charges that did not pertain to the Property, Ms. Dwyer testified that she had no knowledge
21 that any of the 82 charges were unrelated to the Property. When pressed, Ms. Dwyer
22 acknowledged that she considered all uses of the Credit Card to have been wrongful because
23 she was never repaid for such uses. The Court cannot agree that mere failure to reimburse
24 constitutes intentional misuse by the Debtors.

25
26 The Court also determines that there is no evidence from which a reasonable
27 conclusion can be drawn that the Debtors intentionally misled Ms. Dwyer into believing that
28 she would be reimbursed. The Court concludes from the evidence that the Debtors' failure

1 to reimburse Ms. Dwyer was the result of Debtors' failure to provide explanation and
2 oversight during the escrow process, failure to appropriately follow up with and/or to
3 appropriately supervise vendors, and other acts of negligence and inadvertent oversight.
4 This conclusion is supported by the entirety of the evidence and in particular by the
5 consistent testimony that Debtors promptly acknowledged an obligation to repay
6 Ms. Dwyer. This acknowledgement is not consistent with the actions of a party bent on
7 fraud.

8
9 Finally, in Plaintiff's trial brief (Plf. Brief #1, 2:20-25) and in Closing Argument by
10 counsel, Ms. Dwyer argues that the Debtors' "continued" their fraud by repeated promises
11 to reimburse Ms. Dwyer, execution of the Note, non-payment of the Note, and then
12 collection stalling tactics that culminated in filing this bankruptcy case. As discussed
13 earlier, the Court finds no evidence that the Debtors acted fraudulently with respect to the
14 use of the Credit Card or the failure to reimburse Ms. Dwyer at closing. As a threshold
15 matter, no fraud existed to be continued.

16
17 Nor has Ms. Dwyer introduced evidence from which this Court could reasonably
18 infer that the Debtors prepared and executed the Note as part of a new scheme to defraud
19 Ms. Dwyer. In viewing the totality of the evidence and the circumstances, it is evident to
20 the Court that the Debtors acknowledged an obligation to repay Ms. Dwyer, but sought to
21 delay repayment – presumably until they could find the money to do so. However, there is
22 no evidence that they did more than promise to pay in the future and to execute the Note
23 when requested to do so by Ms. Dwyer. Further, the Court found Mr. Kelley credible in his
24 testimony that during the relevant periods prior to the bankruptcy filing he believed that an
25 amicable resolution was possible. Nothing the Debtors did or said establishes a total lack of
26 intention to repay the obligation to Ms. Dwyer at the time of the execution of the Note.⁴

27
28 ⁴ "[A] cause of action for fraud will exist under 11 U.S.C. § 523(a)(2)(A) when a debtor makes promises of future action which, at the time they were made, he had no intention of fulfilling."

1 Similarly, the Debtors' failure to defend against the state court collection action does
2 not support a fraud claim.⁵ This failure is consistent with their constant acknowledgement
3 of liability. Further, it is hard to imagine what defense could have been offered under these
4 facts. Finally, at all relevant times, including after entry of the default judgment, the
5 Debtors continued to discuss methods for an "amicable" resolution. Eventually, however,
6 their financial condition in total – not simply the pressure of this claim – required the filing
7 of a bankruptcy.⁶

8
9 Based on the foregoing, the Court finds that Ms. Dwyer fails to meet her burden of
10 proof and fails to establish that any portion of her claim is non-dischargeable as a result of
11 fraud.

12
13 **C. Ms. Dwyer Is Entitled To A Non-Dischargeable Debt In An Amount Less Than**
14 **The Full State Court Judgment.**

15
16 Having determined that a claim in some amount is non-dischargeable under
17 section 523(a)(4), the Court must now examine the specific amounts at issue to determine
18 whether they are all non-dischargeable. The Court concludes that Ms. Dwyer's claim is
19 non-dischargeable only to the limited extent set forth below.

20
21
22 *Bank of Louisiana v. Bercier (In re Bercier)*, 934 F.2d 689, 692 (5th Cir. 1991). Here, the Court
23 finds there is no evidence from which to conclude that Debtors lacked the intent to fulfill their
24 promise to pay. Even if there were such evidence, Ms. Dwyer has offered no evidence of damages
25 that could have been directly and proximately caused by entry into the Note. In fact, Ms. Dwyer
26 testified that the Note amount was primarily an estimated amount of her existing damages at the
27 time the Note was signed.

28
⁵ On a collateral issue, the Court notes, without finding, that the Debtors may not have actually
received the state court complaint within sufficient time to avoid the default judgment.

⁶ Plaintiff's argument that the bankruptcy filing constituted part of the fraud is likewise non-
persuasive. The Court takes judicial notice of the schedules filed by the Kelleys in the bankruptcy
case, which were not challenged by the Plaintiff, and which included unsecured claims totaling
\$356,143. The scheduled claims include over \$160,000 in medical claims.

1 **1. Ms. Dwyer's Entire Claim On Account Of Property Sale Related Credit**
2 **Card Charges Is Non-dischargeable.**

3
4 The total amount of Property Sale related Credit Card charges, \$11,243.75, is non-
5 dischargeable. Mr. Kelley agreed to repay this amount when he obtained use of the Credit
6 Card. Failure to do so was a defalcation of his fiduciary duty to Ms. Dwyer in relation to his
7 use of this Trust Res.

8
9 **2. Ms. Dwyer's Claim On Account Of Credit Card Interest Is Only Partially**
10 **Non-dischargeable.**

11
12 Credit Card interest is not non-dischargeable in full. Ms. Dwyer included in her
13 calculation all interest accruing on her Credit Card balances from November 2002 forward.
14 This claim is inappropriately inflated to the extent Ms. Dwyer used the Credit Card before
15 and thereafter to charge amounts for her own benefit which remained unpaid. At the time
16 Mr. Kelley began use of the Credit Card, it already had a balance owing of \$4,780.24.
17 Thereafter, Ms. Dwyer charged additional amounts for a total of \$7,561.15 in Credit Card
18 charges having nothing to do with the Property Sale. Interest on these amounts is unrelated
19 to Mr. Kelley's defalcation as a fiduciary.

20
21 Ms. Dwyer must provide a calculation regarding the appropriate amount of interest as
22 the Court will not conduct this mathematical inquiry without input from the parties. **The**
23 **Court will allow Ms. Dwyer ten business days hereafter (or such additional time as**
24 **hereafter granted by this Court, if extension of time is reasonably necessary) to supply**
25 **an appropriate interest calculation based solely on evidence already before the Court.**⁷

26
27 ⁷ In the event Plaintiff fails to file and serve the requested calculations, judgment will be entered in
28 the amount otherwise set forth herein based on this Court's conclusion that Plaintiff has failed to
meet her burden of proof with respect to the interest component of her claim.

1 In conducting this analysis, Ms. Dwyer should calculate interest accruing on each Credit
2 Card advance made pursuant to the authorization given to Mr. Kelley. This analysis should
3 take into account the number of days that each particular charge remained outstanding until
4 payment of the Credit Card balance in full and should calculate interest over that time
5 period at the correct finance charge. As the finance charge changed at least three times, the
6 analysis for each charge must be broken down with specificity. Ms. Dwyer should file and
7 serve a declaration setting forth her analysis and, in particular, showing the method for
8 calculation. All analysis must be based exclusively on the Credit Card statements
9 previously introduced into evidence. Mr. Kelley will thereafter have ten business days to
10 provide any rebuttal calculations.

11
12 For purposes of this calculation Ms. Dwyer is entitled to the assumption that the
13 payments she made during the relevant time period reduced amounts she personally
14 authorized on the Credit Card only, as the total of such payments is less than the total of her
15 personal charges.

16
17 After receiving the analysis from the parties, the Court will issue a supplemental
18 Memorandum Decision advising the parties of the exact amount of the non-dischargeable
19 judgment in this case.

20
21 **3. Ms. Dwyer's Claim On Account Of Credit Card Late Charges Is**
22 **Dischargeable.**

23
24 Ms. Dwyer's claim on account of Credit Card late charges is dischargeable. Her clear
25 testimony was that she had no money to pay the Credit Card. Thus, she was unable to pay
26 even the minimum payment for 10 months and, as a result, accrued a late payment charge of
27 \$39.00 for each of those months. Mr. Kelley's actions did not cause Ms. Dwyer's financial
28

1 problems and were not the basis for these charges. The unpaid balance on the Credit Card
2 included amounts Ms. Dwyer charged on her own behalf. Because she had no ability to
3 pay, she would have accrued late payment charges notwithstanding any act by Mr. Kelley.
4 As these charges are not the result of Mr. Kelley's defalcation these charges are
5 dischargeable.

6
7 **4. Ms. Dwyer's Claim On Account of Credit Card Over Limit Fees Is Non-**
8 **dischargeable.**

9
10 The Court concludes that Ms. Dwyer's claim for over limit fees is non-dischargeable.
11 The majority of the charges accrued on the Credit Card are charges related to the Property
12 Sale. Indeed, Ms. Dwyer's charges on the Credit Card are limited and she began accruing
13 "over the limit fees" immediately prior to the close of escrow and, thereafter, when she
14 reasonably believed that payment in full would be immediately forthcoming. As a result,
15 the Court concludes that the over the limit fees were caused by Mr. Kelley's defalcation in
16 his fiduciary duty in connection with the Credit Card and properly should be non-
17 dischargeable.

18
19 **5. Ms. Dwyer's Claim On Account of Other Note Principal Is Dischargeable.**

20
21 Ms. Dwyer "guestimated" the total amount of damage to her in suggesting
22 \$23,000.00 as the principal amount of the Note. It included a guess as to the amount of
23 interest expense Ms. Dwyer would incur from the time of signing the Note until payment in
24 full.⁸ The problem with Ms. Dwyer's estimation is that it is totally lacking in any
25 evidentiary support – and she bears the burden of proof on this issue. Thus, the Court

26
27 ⁸ Interest at the time the Note was signed was actually \$6,384.29. One month after the Note was
28 signed Ms. Kelley paid off the Credit Card. As noted above, not all this amount is non-
dischargeable.

1 determines that additional amounts of estimated interest included in the principal balance of
2 the Note are dischargeable. The Court cannot tie this guestimate to Mr. Kelley's defalcation
3 as a fiduciary. The fact that he signed the Note is not dispositive, and Ms. Dwyer supplied
4 no evidence that these amounts equate to actual damages attributable to Mr. Kelley. The
5 Court is aware that such charges exist – Ms. Dwyer paid off the Credit Card with a new loan
6 – but there is not a shred of evidence as to the amount of the interest that has accrued on this
7 loan. As Ms. Dwyer failed to meet her burden of proof as to this category of damages, such
8 amounts will not be deemed non-dischargeable.⁹

9
10 **6. Pre-Judgment Interest On The Non-dischargeable Portion Of Ms.**
11 **Dwyer's Claim Is Not Appropriate.**

12
13 Plaintiff requests prejudgment interest on the total guestimated \$23,000.00 face
14 amount of the Note from August 7, 2004, the due date of the Note, through judgment."[T]he
15 award of prejudgment interest in a case under federal law is a matter left to the sound
16 discretion of the trial court. Awards of prejudgment interest are governed by considerations
17 of fairness and are awarded when it is necessary to make the wronged party whole."
18 *Acequia, Inc. v. Clinton (In re Acequia, Inc.)*, 34 F.3d 800, 818 (9th Cir. 1994) (citing
19 *Purcell v. United States*, 1 F.3d 932, 942-43 (9th Cir. 1993) (quotation omitted)).

20
21 As set forth earlier in this Memorandum Decision, Ms. Dwyer is entitled to a non-
22 dischargeable claim for Credit Card interest she has incurred on the Property related Credit
23 Card charges. Similarly, she would have been entitled to a non-dischargeable claim in the
24 amount of interest she incurred on the loan she obtained to pay off the non-dischargeable
25 Credit Card charges but for her total failure to advance evidence from which the Court could

26
27 ⁹ Inclusion of such interest also raises some interesting usury issues that the Court does not address
28 given its determination that Ms. Dwyer fails to meet her burden of proof to this alleged area of
damages.

1 determine this amount. She is not entitled, however, to pre-judgment interest, as this is not a
2 situation where such interest is necessary or appropriate to fully and appropriately
3 compensate Ms. Dwyer. It is Mr. Kelley's use of Ms. Dwyer's credit that is at issue, not the
4 use of her funds. Ms. Dwyer is entitled to recovery of damages caused by the defalcation,
5 not to a profit on the use of her credit. This is a key distinction that Plaintiff's argument for
6 prejudgment interest overlooks.

7
8 Ms. Dwyer relies on the Ninth Circuit's decision in *In re Niles* to support her claim
9 for an award of prejudgment interest under California Civil Code Section 3287(a).¹⁰ Plf.
10 Brief #2 4:5-13. In *Niles*, the non-dischargeable debt arose from a defalcation by a
11 fiduciary under California state law. 106 F.3d at 1463. The bankruptcy court found that the
12 debtor/fiduciary/real estate agent committed a defalcation by mishandling a property
13 management account entrusted to her by the plaintiff. *Id.* at 1458-59. In short, the fiduciary
14 collected rents that belonged to the plaintiff and kept or used the money herself, depriving
15 the plaintiff of the use of the funds (and any earnings from the funds). *Id.* The Circuit
16 Court found that "[b]y failing altogether to rule on the request for interest, the bankruptcy
17 Court did not properly exercise its discretion." *Id.* at 1463. The Circuit Court further held
18 that the plaintiff was entitled to prejudgment interest on the funds received by the fiduciary
19 for plaintiff's benefit for which the fiduciary had not accounted, because they were amounts
20 certain as of a particular day. *Id.* Prejudgment interest was necessary and appropriate in
21 *Niles*, as it compensated the plaintiff for an inability to use funds and to recover interest
22 thereon.

23
24 The facts here are distinguishable from those in *Niles*. Mr. Kelley did not divert
25 funds that should have been paid over to Ms. Dwyer. Rather, the financial impact on

26
27 ¹⁰ California Civil Code section 3287(a) provides that prejudgment interest is awardable where a
28 person "is entitled to recover damages certain, or capable of being made certain by calculation" as
of a particular day.

1 Ms. Dwyer of Mr. Kelley's defalcation was the increase of her obligations under the Credit
2 Card, and then under her home loan (when she substituted one form of debt for another).
3 The non-dischargeable judgment, by inclusion of the amount of interest incurred on the
4 Credit Card, will make Ms. Dwyer as whole as reasonably possible without necessitating
5 that the Court improperly "guestimate" the interest charged on Ms. Dwyer's home loan. As
6 Mr. Kelley's defalcation did not deprive Ms. Dwyer of any use of her own funds, however,
7 the Court finds no basis upon which to award Ms. Dwyer prejudgment interest.¹¹

8
9 **7. Ms. Dwyer Is Not Entitled To A Non-Dischargeable Claim for Attorneys'**
10 **Fees.**

11
12 Ms. Dwyer seeks to have the attorney's fees awarded in her default judgment and the
13 attorney's fees incurred in litigating the Dischargeability Action determined to be non-
14 dischargeable. "A prevailing creditor in a non-dischargeability proceeding is entitled to
15 contractual attorney's fees under state law if the bankruptcy court adjudicates a contract
16 action in connection with the bankruptcy court proceeding." *AT&T Universal Card*
17 *Services v. Pham (In re Pham)*, 250 B.R. at 96, 99 (9th Cir. BAP 2000) (*citations omitted*).

18
19 Ms. Dwyer's attorney's fees argument is premised on the grounds that "[i]n
20 perpetrating fraud on Plaintiff, and breaching fiduciary duties to her, Defendants executed
21 the Note in favor of Plaintiff." Plf. Brief #2, 2:21-23. The Note contains an attorney's fees
22 provision that states that "[i]n the event this note shall be in Default, and placed with an
23 attorney for collection, then the undersigned agree to pay all reasonable attorney's fees and
24 costs of collection." *Id.* 2:28, 3:1. Ms. Dwyer's argument, therefore, is that the presence of
25 this attorney's fees provision in the Note entitles Ms. Dwyer to the finding of non-
26 dischargeability of any related attorney's fees. This Court disagrees.

27
28 ¹¹ No prejudgment interest was included in the Default Judgment issued by the State Court on the basic breach of contract action.

1 In *Pham*, the Bankruptcy Appellate Panel remanded a bankruptcy court judgment
2 denying AT&T's request for attorney's fees in connection with credit card debt, and
3 required that the bankruptcy court determine whether, under California law, the underlying
4 credit card agreement supported an award of attorney's fees in a fraud action based on the
5 credit card agreement. The *Pham* Panel noted that if the credit card agreement allowed for
6 fee recovery any such amounts would be non-dischargeable as the fraud claim arose out of
7 that contract.

8
9 The Supreme Court's decision in *Cohen v. De La Cruz*, 523 U.S. 213 (1998)
10 similarly upheld a finding of a non-dischargeable debt under section 523(a)(2)(A) that
11 included treble damages and attorney's fees. The creditors in *Cohen* initiated the action and
12 obtained the order underlying their claim under the New Jersey Consumer Fraud Act, a
13 statute which provided for recovery of attorney's fees. In the subsequent bankruptcy, the
14 creditors sought and obtained a determination that the entire award was non-dischargeable –
15 including the award of attorneys' fees arising under the statute forming the basis for the
16 non-dischargeable claim. The Supreme Court noted that section 523(a)(2)(A): "prevents the
17 discharge of all liability arising from fraud, and that an award of treble damages [and
18 statutory attorney's fees] therefore falls within the scope of the exception." 523 U.S. at 215.

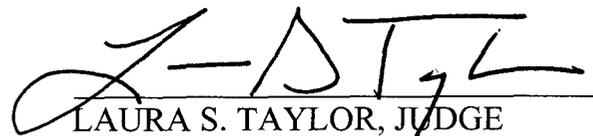
19
20 Ms. Dwyer's authority does not support her argument that her attorneys' fees claims
21 are non-dischargeable. In *Pham* and *Cohen*, the attorney fee claims arose directly out of the
22 contract and statute that formed the basis for the non-dischargeable claim. Here the non-
23 dischargeable claim arises from Mr. Kelley's defalcation as a fiduciary. There is no
24 contractual basis for the claim that includes an attorney fee provision and no statute
25 expressly allowing for recovery of fees in such a situation. The fact that the Note contains
26 an attorneys' fee provision is inapposite. The Note was created after the events establishing
27 a non-dischargeable claim took place, and Ms. Dwyer's right to a non-dischargeable claim
28 is not based on the Note. Thus, the provisions in the Note, including the attorney's fees

1 provision, are not the basis for this Court's non-dischargeability determination, and
2 Ms. Kelley's attorneys' fees claims, thus, are dischargeable.

3
4 **CONCLUSION**

5
6 Ms. Dwyer is entitled to a Non-Dischargeable Judgment against Mr. Kelley under
7 11 U.S.C. § 523(a)(4) in an amount equal to \$11,890.75 plus a portion of the Credit Card
8 interest. The Court will advise as to the total amount of the Non-Dischargeable Judgment
9 after it reviews the interest rate calculations submitted by the parties. The Court concludes
10 that the Dischargeability Action fails as to Ms. Dwyer's claims against Mr. Kelley under
11 11 U.S.C. § 523(a)(2)(A) and fails as to Mrs. Kelley in its entirety.

12
13 DATED: July 15, 2008

14 
15 LAURA S. TAYLOR, JUDGE
16 United States Bankruptcy Court
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