UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF GEORGIA
GAINESVILLE DIVISION

IN RE:	:	
	:	CASE NO. G11-24718-REB
DEWARD LAMAR ALLEN and PEGGY SUE ALLEN,	:	
	:	
Debtors.	:	
	:	
	:	
	:	
DAVID KEYS and KENNETH LOWMAN,	:	ADVERSARY PROCEEDING NO. 12-2047
	:	
Plaintiffs,	:	
	:	
v.	:	CHAPTER 7
	:	
DEWARD LAMAR ALLEN and PEGGY SUE ALLEN,	:	
	:	
Defendants.	:	JUDGE BRIZENDINE
	:	

ORDER

Before the Court is the complaint of Plaintiffs named above as filed on March 30, 2012. In their complaint against Defendant-Debtors, as affirmed through subsequent pleadings and statements to the Court through counsel, Plaintiffs seek a denial of Debtors' discharge under 11 U.S.C. § 727(a)(4)(A) for knowingly making false oaths, and under Section 727(a)(5) for failing to explain satisfactorily certain losses and deficiencies of assets. In addition, Plaintiffs seek a determination that certain indebtedness owed to them by Debtors be excepted from their discharge herein and held nondischargeable under Section 523(a)(2)(A) and/or Section 523(a)(4). Finally, Plaintiffs pray for relief in the form of equity through the enforcement of a certain restitution

agreement under O.C.G.A. § 24-1-3, and declaration that an equitable lien exists in their favor. By Order entered on March 19, 2013, this Court denied Plaintiffs' motion for summary judgment on grounds including the failure to establish fraudulent intent. This matter came on for trial on September 11, 2013 as continued to September 12, 2013. Based upon the Court's evaluation of the documentary evidence and testimony presented, as well as its review of the parties' arguments and applicable legal authority, the Court finds and concludes as follows.

Plaintiffs' claim arises out of their contributions of "labor, materials, and sweat" to what they refer to as a partnership venture named Mountain Falls Properties, LLC, as formed by an oral agreement with Debtor Lamar Allen. Together, these persons created this entity for the purpose of constructing and developing residential properties. Under their agreement, Plaintiffs would build and finish homes, while Debtors would develop and manage the projects and handle the finances.[1] Plaintiffs allege that late in 1988, they became aware of certain financial problems with the business. An audit of the checkbook records revealed that the Debtors had allegedly misappropriated certain funds of the venture, using them for the construction of their personal home, to purchase appliances, and to pay their personal bills without Plaintiffs' knowledge. Plaintiffs contend they were denied their one-third share of the profits as a result of Debtors' pattern of fraud, theft, misrepresentation, embezzlement, and deception in diverting profits of the business for their own uses.

Plaintiffs further allege that upon confronting Debtors, they were told that Debtors were "having a hard time" and that they desired to make restitution to avoid criminal charges, imposition of a lien on their property, and loss of their home. Debtors have denied these allegations and any

[1] Debtor Peggy Sue Allen also participated in the handling of the affairs of this entity.

wrongdoing, and contend they agreed to restitution in a compromised amount because they could justify some of the charges. The parties dispute whether records supporting same were fully made available. Eventually, the parties entered into a Reimbursement Agreement [sic] dated October 6, 2008 in which Debtors pledged the proceeds of a certain loan to pay each Plaintiff the sum of $89,986.07.[2] *See* Plaintiff's Trial Exhibit "C." Debtors did not repay the amount as agreed after obtaining the loan, and Plaintiffs assert Debtors never intended to do so.

Plaintiffs filed a civil suit for fraud and damages in the Superior Court of Lumpkin County, Georgia (Civil Action File No. #09-CV-805-LA), and obtained a judgment, filed on October 10, 2010 in which the court held that the Agreement constituted an enforceable contract under applicable state law. *See* Order and Summary Judgment, attached as Exhibit "B" to Plaintiffs' Complaint. The state court also entered a subsequent order finding Debtors in willful contempt for failure to comply with various orders of that court as entered in connection with the Plaintiffs' efforts to enforce the judgment. Debtors filed this Chapter 7 bankruptcy case on November 15, 2011.[3]

* * * *

While the Bankruptcy Code offers honest debtors the opportunity of a "fresh start" through the discharge of certain debt, in return, debtors must present themselves and their circumstances in a truthful and accurate manner. Section 727(a)(4)(A) provides that "[t]he court shall grant the debtor a discharge, unless...the debtor knowingly and fraudulently, in or in connection with the

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[2] Plaintiffs claim, and Debtors dispute, that this Agreement constitutes an equitable lien.

[3] As noted by Plaintiffs, Debtors also filed a case in this Court under Chapter 13 on August 12, 2011, which was dismissed on November 18, 2011, and styled *In re Deward Lamar Allen and Peggy Sue Allen*, Case No. 11-23327-REB.

case—made a false oath or account." The purpose of this provision is to insure that sufficient facts are available to all persons interested in the administration of the bankruptcy estate without requiring investigations or examinations to discover whether the information provided is true. And so "'[t]he entire thrust of an objection to discharge because of a false oath or account is to prevent knowing fraud or perjury in the bankruptcy case.'" *Fogal Legware of Switzerland, Inc. v. Wills (In re Wills)*, 243 B.R. 58, 63 (9th Cir. BAP 1999), *citing* William L. Norton, Jr., NORTON BANKRUPTCY LAW AND PRACTICE 2D § 74.11 (1997). A plaintiff objecting to discharge under this subsection bears the burden of proof and must make out his case by a preponderance of the evidence. *See The Cadle Co. v. Taras (In re Taras)*, _ B.R. _, 2005 WL 6487202 (Bankr. N.D.Ga. Aug. 19, 2005).

Two elements that must be established to deny a debtor's discharge under § 727(a)(4)(A): first, the debtor's oath or account must have been knowingly and fraudulently made; and second, it must be related to a material fact. *Swicegood v. Ginn*, 924 F.2d 230 (11th Cir. 1991). Typically, omissions from a debtor's schedules constitute a false oath, and actual fraudulent intent in such a case may be inferred from the totality of the circumstances surrounding the debtor's case. *See Ingersoll v. Kriseman (In re Ingersoll)*, 124 B.R. 116, 123 (M.D.Fla. 1991). Further, reckless indifference to the truth is sufficient to prove fraudulent intent, and a cumulative effect may arise supporting an inference of such intent to deceive from a demonstrated pattern of omissions. *Taras, supra,* at * 4. Courts analyze whether the alleged omissions are part of a scheme to retain assets for a debtor's benefit at the expense of creditors through their nondisclosure.

Plaintiffs allege that Debtors made conflicting claims regarding their assets and liabilities in this Chapter 7 case and their prior Chapter 13 case, which they deny. Specifically, Plaintiffs

contest statements pertaining to Debtors' income and their characterization of the debt owed Plaintiffs. During the trial, the Court heard statements regarding a reverse mortgage and the manner of listing of the state court judgment in their schedules, and ruled in favor of Debtors' motion to dismiss with respect to this allegation of the complaint. Plaintiffs' counsel referred to Debtors' false oath or account on the status of the business and taking the money from the other two partners, and the fact that Debtors 'whittled down' from $400,000.00, the amount reported in an audit (as discussed hereafter), to the lesser sum shown in the Reimbursement Agreement. Yet, Plaintiffs did not show how same related to inaccuracies in Debtors' schedules, statement of financial affairs, or other filings with the Court in this case, and their intent in regard thereto.[4] Based on the evidence of record and the testimony and statements of counsel as then presented, the Court finds that Plaintiffs failed to carry their burden of proof on this issue and offered no evidence to support their claim for relief under Section 727(a)(4)(A). For the reasons as stated on the record, which are incorporated herein under Fed.R.Bankr.P. 7052, this count is dismissed.

Next, with respect to Section 727(a)(5), a debtor's discharge may be denied when a debtor fails to offer a satisfactory explanation of a loss of assets. First, the objecting creditor must show a discrepancy between property as listed in the schedules as compared with other financial documents tending to show the existence of an asset before the bankruptcy filing. At that point,

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[4] Debtors' Schedule D in this Chapter 7 case reflects that each Plaintiff holds a judgment lien for $91,000.00. In their prior Chapter 13 case (11-23327-REB), Debtors listed David Keys in their Schedule D as holding a judgment lien in the total amount of $180,000.00. The Court was unable to reconcile these figures with the allegation in Plaintiffs' Statement of Material Undisputed Facts, paragraph 11, that Debtors listed each Plaintiff as being owed $180,000.00. (Docket Entry No. 12, filed on October 15, 2012.) In addition, Plaintiffs alleged, but did not prove, discrepancies made with fraudulent intent regarding their income and asset value in their prior Chapter 13 case and the present case.

the burden shifts to the debtor to explain what happened to the property in question and why it is not reflected in the schedules, subject to the Court's review of credibility and whether such explanation is convincing. *See Hawley v. Cement Indus., Inc. (In re Hawley)*, 51 F.3d 246 (11th Cir. 1995); *Chalik v. Moorefield (In re Chalik)*, 748 F.2d 616 (11th Cir. 1984).

Again, during the trial, the Court ruled in favor of Debtors' motion to dismiss with respect to this allegation of the complaint. Based on the evidence of record and the testimony and statements of counsel as then presented, the Court finds that Plaintiffs failed to carry their burden of proof on this issue and offered no evidence to support their claim for relief under Section 727(a)(5). Specific items were not brought to Debtors' attention for them to explain at trial so that the Court could observe witness demeanor and assess credibility. For the reasons as stated on the record, which are incorporated herein under Fed.R.Bankr.P. 7052, this count is dismissed.

* * * *

The Court next addresses Plaintiffs' allegations under Section 523(a)(2)(A).[5] As discussed above, Plaintiffs appear to have focused their claim here on the Reimbursement Agreement as upheld by the state court. The Court first observes that as stated in its prior Order denying summary judgment, the Court was not able to identify which transaction serves as the basis of Plaintiffs' specific claims under Section 523(a). Plaintiffs see both the original business arrangement and subsequent Reimbursement Agreement as vital to the circumstances surrounding their loss, especially insofar as they allege both events fit within an overall pattern of fraud on the part of Debtors. The Court, however, could not discern whether their specific allegations were

[5] At the conclusion of Plaintiffs' presentation of their case, Debtors also moved to dismiss Plaintiffs' claims under 11 U.S.C. § 523(a)(2)(A) as well as 11 U.S.C. § 523(a)(4).

intended to address the original partnership venture/LLC contribution, the Reimbursement Agreement, or both for purposes of its analysis under Section 523(a)(2) and (a)(4).[6]

Through later pleadings and statements offered during the trial, it became clearer to the Court that Plaintiffs were attempting to center their claims on the Reimbursement Agreement as enforced by the state court, and, therefore, that the obligation set forth in that Agreement should be excepted from discharge herein under the Bankruptcy Code sections cited.[7] Plaintiff Kenneth Lowman did allow, however, that although the obligation as set forth in the Reimbursement Agreement was the basis for the state court litigation, and that the judgment they obtained is what they are attempting to collect, "if they had to go to court, they would want it all."[8]

To succeed under Section 523(a)(2)(A), Plaintiffs must prove facts showing that Debtors "committed positive or actual fraud involving moral turpitude or intentional wrongdoing."[9]

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[6] For instance, while the Section 523(a)(2) claim seems directed toward the Reimbursement Agreement, the Section 523(a)(4) claim seems to address the original business agreement.

[7] In addition, as this Court concluded in its Order of March 19, 2013, the summary judgment order of the state court, while entering judgment in favor of Plaintiffs in the total sum of $179,972.14 based on the Reimbursement Agreement, does not contain sufficient findings of fact to establish each element of Section 523(a)(2) and Section 523(a)(4), respectively. At the trial, it also became obvious that Plaintiffs' claims under Section 727(a) seemed to relate more to these events than any specifically alleged intentional improprieties in Debtors' bankruptcy schedules.

[8] On cross examination, Mr. Lowman admitted the Agreement states "[a]ny errors in these amounts on either side that may arise between now and the time of the settlement shall be corrected at settlement," and so he might have received less than $89,986.07 as set forth therein, but still expected to receive something. Plaintiff's Trial Exhibit "C." He also testified that Debtors thanked him for not liening their home.

[9] *Bracciodieta v. Raccuglia (In re Raccuglia)*, 464 B.R. 477, 485 (Bankr. N.D.Ga. 2011). Section 523(a)(2)(A) provides in pertinent part as follows:

> (a) A discharge under section 727...does not discharge an individual debtor from any debt—

Plaintiffs need to establish that Debtors obtained money, property, or credit from Plaintiffs: (1) by false representation, pretense, or fraud; (2) knowingly made or committed; (3) that occurred with the intent to deceive Plaintiffs or to induce their acting on same; (4) upon which Plaintiffs actually and justifiably relied; and (5) that Plaintiffs suffered damages, injury, or loss as a result thereof. *HSSM # 7 Ltd. Pshp. v. Bilzerian (In re Bilzerian)*, 100 F.3d 886, 892 (11th Cir. 1996); *Sterling Factors, Inc. v. Whelan (In re Whelan)*, 245 B.R. 698, 705-06 (N.D.Ga. 2000); *Lusk v. Williams (In re Williams)*, 282 B.R. 267, 272 (Bankr. N.D.Ga. 2002). Legal or constructive fraud, which involves an act contrary to a legal or equitable duty that has a tendency to deceive, yet not originating in an actual deceitful design, is insufficient. *See Agricredit Acceptance Corp. v. Gosnell (In re Gosnell)*, 151 B.R. 608, 611 (Bankr. S.D.Fla. 1992); *see also Burroughs v. Pashi (In re Pashi)*, 88 B.R. 456, 458 (Bankr. N.D.Ga. 1988).[10]

At trial, Plaintiff David Keys testified that their business had started to slow down and that he was thinking about closing it and dividing everything. After meeting with Debtors to go over

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> (2) for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by -
>
> (A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition ....

11 U.S.C. § 523(a)(2)(A). Exceptions to discharge are narrowly construed and must be proven by a preponderance of the evidence. *See Terkune v. Houser (In re Houser)*, 458 B.R. 771, 776 (Bankr. N.D.Ga. 2011); *see also Grogan v. Garner*, 498 U.S. 279, 291, 111 S.Ct. 654, 661, 112 L.Ed.2d 755 (1991); *League v. Graham (In re Graham)*, 191 B.R. 489, 493 (Bankr. N.D.Ga. 1996); *accord City Bank & Trust Co. v. Vann (In re Vann)*, 67 F.3d 277 (11th Cir. 1995).

[10] Reckless disregard for the truth or falsity of a statement can also supply the necessary basis for a determination of nondischargeability under this provision in the proper circumstances. *Birmingham Trust Nat'l Bank v. Case*, 755 F.2d 1474, 1476 (11th Cir. 1985), *superseded on other grounds* by Pub.L.No. 98-353, 88 Stat. 333 (1984).

the situation and to see how things stood on a financial basis, however, several weeks elapsed before Debtors finally produced both checkbooks on their accounts and occurred only after Plaintiffs' repeated requests. Upon review of these records, Mr. Lowman testified that they discovered certain monies seemed to have been used to pay for work on Debtors' own home.[11] Mr. Keys stated that he asked his sister, Tina Mildred Smith, to examine the books and records of the LLC for him. Debtors did not object, but Ms. Smith insists they did not furnish the entire records. Ms. Smith completed her audit in two weeks, and testified that she found Debtors owed over $400,000.00 to Plaintiffs.

Plaintiffs confronted Debtors about what happened to all the money since they knew the LLC was not broke and they had not been paid. Mr. Lowman also testified that Peggy Sue Allen told him at one point that the entity was about to go bankrupt. She later testified that this entity owed no debt and they had decided to turn the LLC over to Plaintiffs. Ms. Allen vigorously disputes Ms. Smith's findings.

Following the audit, the parties entered into the Reimbursement Agreement dated October 6, 2008 and drafted by Ms. Allen. Keys testified that they all agreed on the payment amounts referenced therein. In the Agreement, Debtors agreed to pay Plaintiffs the total amount of $179,972.14 ($89,986.07 to each Plaintiff). *See* Plaintiff's Trial Exhibit "C." *See also* note 7 herein. By its terms, the Agreement contains no specific admissions of liability. Mr. Lowman stated that he was "satisfied" with the Agreement because he knew Debtors were broke and could

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[11] During his testimony, Lamar Allen stated that each Plaintiff had been paid the sum of $20,000.00 from profit on the first house they built, and so he paid himself his part in materials for his home as later monies came into the business. Ms. Allen corroborated this understanding that the monies used were Mr. Allen's share.

not pay the whole amount. According to him, the intent was to settle the matter and close the LLC, as opposed to winding up "with five men fussing in court."

Tina Smith also testified that Plaintiffs and Mr. Allen agreed on the figure therein stated, although in her opinion, this amount was less than what was actually taken by Debtors. Ms. Smith was present when this Agreement was signed, and described it as a second agreement. She further testified that she heard Debtors say they "didn't realize [the amount of the discrepancy] was so high" and that they "were going to make it right." She heard such statements as an admission and thought the matter was resolved.

As collateral for the compromised debt, Debtors pledged proceeds from a loan to be secured by their home. Both Plaintiffs testified that the purpose of the Agreement was to avoid a liening of Debtors' property by Plaintiffs so they could get a reverse mortgage and pay Plaintiffs what they owed. Debtors obtained the loan, but never performed their obligation under this Agreement. Plaintiffs contend, they never intended to do so, which Debtors deny.

Ms. Allen testified that it was she who called in Ms. Smith to prove to Mr. Keys that "they had nothing to hide," but that Ms. Smith excluded her from her review until Ms. Smith arrived at her figure and made her accusation. Ms. Smith, she stated, would not allow her to explain where the money had gone. Ms. Allen also recalled complaints from Plaintiffs over funds spent, in her view, to correct mistakes made by the LLC in its building projects.

Ms. Allen testified that the Reimbursement Agreement contained Ms. Smith's figures and that Debtors hoped to retain an unbiased professional to go over the books. This accounts for the

statement in the Agreement concerning the possibility of errors.[12] She changed a paper prepared by Ms. Smith that she described as a demand, and typed up the Reimbursement Agreement to provide that the numbers were not correct and would change. When asked by Plaintiffs' counsel, "did you intend to pay it?" she responded that they intended to get the final numbers, which were nothing like the amount Ms. Smith reported missing. Ms. Allen discounted Ms. Smith's figure of $400,000.00 because the houses they were building could not support such profit numbers. In signing the Agreement, Debtors did not intend to pay what they saw as an incorrect amount.[13]

As mentioned, Plaintiffs argue that Debtors never intended to honor the Reimbursement Agreement, which constitutes fraud. Upon careful review of the record, the Court concludes that Plaintiffs have not introduced sufficient evidence to carry their burden of proof on this issue. The record does not support a finding that Debtors obtained money from Plaintiffs by knowingly and fraudulently, and with intent to deceive, inducing Plaintiffs to act or forebear from acting, through a misrepresentation or artifice, upon which Plaintiffs actually and justifiably relied, in entering into the Reimbursement Agreement, by which Plaintiffs suffered damages. It is not clear from the

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[12] As mentioned above in note 7, the Agreement contains a stipulation stating that "[a]ny errors in these amounts on either side that may arise between now and the time of the settlement shall be corrected at settlement." Plaintiff's Trial Exhibit "C." Arguably, the vagueness of such an essential term could seem fatal to whether the parties ever reached a shared understanding on this point. The state court, however, must have concluded that the parties had in fact reached such a sufficiently mutual understanding that an amount was due to render the agreement enforceable.

[13] Mr. Allen also testified that with respect to the Agreement, he never intended to pay the amount stated therein consistent with the note placed at the bottom of the Agreement, and hoped an accountant or someone with experience in the construction industry could review this matter and get a true figure. Plaintiffs never directly testified concerning this point.

In addition, Ms. Allen stated that the reverse mortgage was not related to the Reimbursement Agreement, and that since they had a construction loan they did not agree with counsel's quote from Plaintiffs' statements of fact that they had used $359,947.00 for their personal use.

evidence whether or not Plaintiffs knew that Debtors did not view the Agreement as containing the final payment figure, but the stipulation contained therein tends to suggest that the parties at least contemplated a further settlement could alter their arrangement. In sum, it appears that Debtors did agree to pay something and that they breached this agreement, but such action in and of itself does not establish fraud.

In addition, the Court appreciates the testimony offered by Tina Smith, and the passion with which she demonstrated her conviction that Debtors misapplied over four hundred thousand dollars of partnership funds based on her audit of certain bank records and other financial documents.[14] For purposes of Section 523(a)(2)(A), however, along with proof of intent, further evidence is needed documenting more precisely what funds came into Debtors' possession and what they spent for their personal use to the exclusion of, and concealment from, Plaintiffs.

As discussed above, Plaintiffs may have sought to apply Section 523(a)(2)(A) to their original agreement in forming the LLC. At the close of evidence, the Court observed that the state court had already addressed this matter and found that a debt is owed as a matter of contract—not fraud. In their brief, Plaintiffs assert that a nondischargeable debt does not become dischargeable solely because the parties enter into a settlement agreement. *See Pennsylvania Mut. Cas. Ins. Co. v. Barnes (In re Barnes)*, 317 B.R. 187, 190 n. 3 (Bankr. M.D.Ga. 2004), citing *Greenberg v. Schools*, 711 F.2d 152, 156 (11th Cir. 1983); *see also Tower Oak, Inc. v. Selmonosky (In re Selmonosky)*, 204 B.R. 820, 829 n. 13 (Bankr. N.D.Ga. 1996).

This Court agrees that neither a settlement agreement nor its breach acts to change the underlying character of the original debt solely into one of contract, if, for instance, as alleged here,

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[14] Plaintiffs did not introduce these business records into evidence.

same arose as a result of fraud. But, in this case, the settlement agreement was in fact the subject of later litigation, when it was construed and enforced through a state court order and judgment on the grounds therein stated.

Again, the Court acknowledges that whereas collateral estoppel may prevent the relitigation of findings of fact by a prior court ruling, *res judicata* does not apply to prevent this Court from looking behind a state court order to examine the overall character of a disputed obligation for purposes of determining dischargeability.[15] In presenting the issue of enforcing the Reimbursement Agreement to the state court, however, Plaintiffs seemingly limited their remedy to one of contract, admittedly, perhaps, based on the nature of Debtors challenges thereto, but that is the sole basis on which the state court framed its analysis and entered its ruling that Debtors had breached the contract. *See* Order and Summary Judgment, attached as Exhibit "B" to Plaintiffs' Complaint.

As a matter of comity, therefore, this Court believes it has some responsibility to accept that ruling on the terms offered. In other words, at no time, at least as it appears from the state court's order, did Plaintiffs seek enforcement on grounds that the obligation represented in the Reimbursement Agreement resulted from fraud, or that Debtors failure to pay the amount owed was a continuation of fraudulent activity regarding same.

In any event, looking behind the circumstances giving rise to the entry of the state court's order, or even if the Court construed same as not limiting the scope of Plaintiffs' claims as arising in connection the original events addressed in the Reimbursement Agreement such that the fraud claim survived, the Court concludes that Plaintiffs have not presented sufficient evidence to carry

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[15] *Accord Dunn v. Whyte (In re Whyte)*, 487 B.R. 578, 585-86 (Bankr. N.D.Ga. 2013) (discussing legal effect of election of remedies under state law, and confirming responsibility of federal bankruptcy court to decide issues of dischargeability of debt under Section 523(a)(2)(A)).

their burden of proof on this issue. Plaintiffs have presented no evidence that in entering the original agreement forming the LLC, that Debtors committed actions in violation of Section 523(a)(2)(A) to the detriment of Plaintiffs. The Court understands that Debtors appear to owe Plaintiffs a sum of money based on their alleged mismanagement of certain monies coming into the LLC accounts. But, without more proof, their indebtedness based on the state court's order, while it may amount to a breach of Debtors' promise to pay and make the situation right, and is no doubt unfortunate and frustrating for Plaintiffs, does not rise to the level of fraud based on the record presented.[16]

* * * *

Next, the Court addresses Plaintiffs' allegations under Section 523(a)(4). Pursuant to this subsection, debts arising from "fraud or defalcation while acting in a fiduciary capacity" are nondischargeable, though "this exception is a narrow one" in terms of deciding who qualifies as a fiduciary within the meaning of this statutory provision. *Guerra v. Fernandez–Rocha (In re Fernandez–Rocha),* 451 F.3d 813, 816 (11th Cir. 2006), citing *Quaif v. Johnson (In re Quaif),* 4 F.3d 950, 953 (11th Cir. 1993); *see also Hawkins v. Thomas (In re Thomas),* 478 B.R. 468 (Bankr. N.D.Ga. 2012). The high standard required to prove the existence of a proper fiduciary relationship serves the Bankruptcy Code policy favoring the granting of a discharge. Once a debtor is identified as a fiduciary or trustee, however, a lesser standard of knowledge or intent is required to support a finding of defalcation as compared to and distinguished from fraud, embezzlement, or larceny,

[16] Again, while the statements of Tina Smith are most certainly probative, they are not finally conclusive in terms of the standard for proving Debtors fraudulent intent in entering into the agreement(s) at issue as opposed to their conduct operating under the agreement(s). The necessary fraud must exist at the time the agreement is made—it is not enough under Section 523(a)(2)(A) that a debtor subsequently acts in a fraudulent manner under an otherwise valid agreement.

which are also referenced in Section 523(a)(4) and are intentional torts.[17]

As noted above, it must first be shown that Debtors acted as a fiduciary under an express or technical trust. *See Quaif*, 4 F.3d at 953.[18] Plaintiffs, therefore, need to prove that such a trust relationship existed prior to the commission of the allegedly wrongful acts, as distinguished from a trust *ex maleficio* that the law imposes as a result of such actions and which give rise to the debt at issue. *See Blashke v. Standard (In re Standard)*, 123 B.R. 444, 453-54 (Bankr. N.D.Ga. 1991). In this case, Plaintiffs and Debtors were members of a partnership venture or LLC. In *Standard*, however, the court concluded that although certain Georgia statutes impose a fiduciary duty on a general partner or described certain relationships in terms of confidentiality, they do not create an express or technical trust as required by Section 523(a)(4). 123 B.R. at 454-55 (construing O.C.G.A. § 14-8-21(a) and O.C.G.A. § 23-2-58).

The Court finds this analysis persuasive in the present case. Members of a partnership venture or LLC undoubtedly share a special relationship under state law and there are good reasons for imposing a fiduciary duty among them. Proper adherence to decades of consistently restrictive federal bankruptcy law interpretation, including the Supreme Court, however, requires that the

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[17] As recently held by the United States Supreme Court, "defalcation" under this provision refers to "a culpable state of mind requirement" that includes "knowledge of, or gross recklessness in respect to, the improper nature of the relevant fiduciary behavior." *Bullock v. BankChampaign, N.A.*, _ U.S. _ , 133 S.Ct. 1754, 1756, 185 L.Ed.2d 922 (2013). Fraud for purposes of this discharge exception refers to intentional deceit. *See generally BellSouth Telecomm., Inc. v. Panjwany (In re Panjwany)*, _ B.R. _ , 2005 WL 6490600 (Bankr. N.D.Ga. Feb. 9, 2005).

[18] Either applicable nonbankruptcy law must clearly and expressly impose trust-like duties on the parties, or the operating agreement between them must evidence a clear intent to do so. *See generally Fernandez-Rocha*, 451 F.3d 813.

fiduciary relationship addressed in this exception be demonstrated by evidence of an express trust.[19]

Hence, in order for members of partnership venture or LLC to owe fiduciary duties to one another within the meaning of 11 U.S.C. § 523(a)(4), the Court concludes that additional facts establishing the existence of such an express or technical trust are needed. *See Schreibman v. Zanetti-Gierke (In re Zanetti-Gierke)*, 212 B.R. 375, 380-81 (Bankr. D.Kan. 1997). Here, however, the Court finds that Plaintiffs have not proven such facts.[20] To conclude otherwise solely because they are members of the LLC, without further evidence that Debtors were fiduciaries within the meaning of Section 523(a)(4), would essentially mean that all business partners are fiduciaries under this subsection and thereby improperly expand such provision beyond its intended scope. *Accord Standard*, 123 B.R. at 455-56. Thus, on this count, the Court rules in favor of Debtors and against Plaintiffs.

Finally, debts arising from embezzlement may also be excepted from discharge under Section 523(a)(4). To establish an entitlement to relief under this provision, Plaintiffs must prove by a preponderance of the evidence that Debtors misappropriated property of another as entrusted to them for their own benefit with fraudulent intent. Moreover, Plaintiffs must establish "fraud in fact, involving moral turpitude or intentional wrong" as opposed to implied fraud, showing that Debtors (or one of them) acted to convert or steal the partnership profits in question. *See Chenaille*

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[19] *See Standard*, 123 B.R. at 455-56; *Angelle v. Reed (In re Angelle)*, 610 F.2d 1335, 1341 n. 12 (5th Cir. 1980).

[20] Likewise, this Court concludes that notwithstanding the ruling of the Georgia Court of Appeals that "partners owe fiduciary duties directly to one another, including a duty to act in the 'utmost good faith'" under O.C.G.A. § 23-2-58, this case does not hold that a partner relationship in Georgia creates an express or technical trust. *See Hendry v. Wells*, 286 Ga.App. 774, 650 S.E.2d 338 (2007).

v. Palilla (In re Palilla), 493 B.R. 248, 252 (Bankr. D.Colo. 2013).[21] Here, Plaintiffs must show, for instance, that Debtor(s) deposited the funds at issue, to which Plaintiffs were entitled as their share of the profits, into an account accessible only to Debtors for which they could offer no explanation or purpose, but instead diverted them to their own personal use. *See Humphries v. Martinez (In re Martinez)*, 410 B.R. 847, 852 (Bankr. W.D.Mo. 2008) (cites omitted).[22]

During the trial, the Court observed the witnesses and their demeanor during examination and assessed their credibility especially in view of Debtors' denial of fraud. While Plaintiffs have mounted substantial circumstantial evidence, the Court finds that they have failed to carry their burden of proof in terms of embezzlement or even larceny.[23] As noted above, neither the checks nor the deposit records are in evidence. It is not clear to what extent Debtor was authorized to use LLC monies and how and whether they exceeded same, especially given Mr. Allen's testimony that Plaintiffs had received certain payments and he sought to pay himself his share.

In addition, Plaintiffs claim that the Reimbursement Agreement itself is an admission of theft and embezzlement. Again, neither the Agreement nor the state court order enforcing same contain any statements or findings of fact that could be construed as an admission of these specific

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[21] The Court observes that it has been held because one cannot embezzle one's own property, a partner cannot embezzle partnership property. *Hardesty v. Johnson,* 126 B.R. 343, 346 (Bankr. E.D.Mo. 1991); *see also Weigand v. Chwat (In re Chwat)*, 203 B.R. 242, 248 (Bankr. E.D.Va. 1996).

[22] With regard to embezzlement, Debtor did file an affidavit in response denying that either he or his wife misappropriated funds, thus creating a fact issue.

[23] For bankruptcy purposes, larceny means "the fraudulent and wrongful taking and carrying away of property of another with intent to convert it to the taker's use and with intent to permanently deprive the owner of such property." *DiCrispino v. Adams (In re Adams)*, 348 B.R. 368, 373 (Bankr. E.D.La. 2005), quoting *The Cadle Co. v. Hartman (In re Hartman)*, 254 B.R. 669, 674 (Bankr. E.D.Pa. 2000).

allegations. An agreement to make restitution may be based on breach of contract as well as being derived from an allegation of fraud, and to succeed on their claim herein, Plaintiffs must prove the latter.[24]

It is apparent that Debtors used LLC funds in a way that even they seemed to acknowledge they owed something to Plaintiffs. But, the record does not support the conclusion that they acted with a fraudulent intent in doing so to establish either embezzlement or larceny under the legal standard of Section 523(a)(4).

* * * *

Based upon a review of the evidence presented and testimony of record, as well as the arguments of the parties, the Court enters the above findings of fact and conclusions of law and, accordingly, it is

ORDERED that the objection of Plaintiffs named above to the discharge of Defendant-Debtors herein under 11 U.S.C. § 727(a)(4)(A) and 11 U.S.C. § 727(a)(5) be, and the same hereby

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[24] As mentioned in note 2 above, Plaintiffs further argue that Debtors' pledge to make restitution constitutes an equitable lien because the funds allegedly stolen can be traced to payments for materials and labor in connection with the building of their home. Plaintiffs did not present evidence showing such tracing, and whether or not Debtors were forthcoming with any evidence probative of such issue, it is Plaintiffs' burden to collect that evidence and introduce it at trial, or seek the Court's assistance in enforcing discovery requests.

On a related note, Plaintiffs have also contended that Debtors' failure to respond to the statement of undisputed facts as part of their motion for summary judgment constitutes binding admissions. *See* Plaintiffs' Response Brief to Defendants' Brief, filed on October 9, 2013 (Docket Entry No. 33); *see also* Local Rule BLR (N.D.Ga.) 7056-1(a)(2). The Court finds these statements, though perhaps not all of them, were directly controverted at the summary judgment stage, and are more in the nature of evidentiary admissions that may be controverted or explained at trial as opposed to binding judicial admissions. *See e.g. Kasbee v. Huntington Nat'l Bank (In re Kasbee)*, 466 B.R. 719, 723-24 (Bankr. W.D.Pa. 2010). In any event, at most they show Debtors used LLC funds, but they also show that Plaintiffs received $55,000.00 each. Moreover, at trial Debtors did actively dispute the claim that they misappropriated funds in the amount of $359,947.00.

is, **denied** on both grounds; and, it is

FURTHER ORDERED that the award of damages in the sum of $179,972.14 plus costs against Debtors and in favor of Plaintiffs, as set forth in the Order and Summary Judgment entered by the Superior Court of Lumpkin County, Georgia (Civil Action File No. #09-CV-805-LA), and filed on October 10, 2010 in which the court held that the Reimbursement Agreement between these parties dated October 6, 2008 constitutes an enforceable contract under Georgia law be, and the same hereby is, **dischargeable** and the dischargeability of same is **not** excepted from Debtors' discharge herein under either 11 U.S.C. § 523(a)(2)(A) or 11 U.S.C. § 523(a)(4). It is

FURTHER ORDERED that all other remaining claims for relief herein are **denied**. It is

FURTHER ORDERED that judgment will be granted contemporaneously herewith in favor of Defendant-Debtors and against Plaintiffs.

The Clerk is directed to serve a copy of this Order upon counsel for Plaintiffs, counsel for Defendant-Debtors, the Chapter 7 Trustee, and the United States Trustee.

IT IS SO ORDERED.

At Atlanta, Georgia this 25th day of October, 2013.

ROBERT E. BRIZENDINE
UNITED STATES BANKRUPTCY JUDGE