

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE WESTERN DISTRICT OF TENNESSEE
EASTERN DIVISION

IN RE:

LARRY MATTINGLY and
CAROL MATTINGLY,

Debtors.

RICHARD CARVER and
THANA LEONARD,

Plaintiffs,

v.

CAROL MATTINGLY,

Defendant.

BK #89-10316-WHB
Chapter 7

Adversary Proceeding
No. 89-0120

MEMORANDUM OPINION AND ORDER
REGARDING COMPLAINT TO DETERMINE
DISCHARGEABILITY OF DEBT
PURSUANT TO 11 U.S.C. §523(a)(4)

This core proceeding¹ is before the Court on the plaintiffs' complaint to determine the dischargeability of a debt they contend arises out of the debtor-defendant's breach of her fiduciary duty to the plaintiffs' mother.

At issue is whether the debtor-defendant may be held responsible for an obligation of her husband's failed business when that obligation is the result of her investment of the plaintiffs' mother's funds in that business pursuant to her authority under a power of attorney.

¹ 28 U.S.C. §157(b)(2)(I).

The following constitutes findings of fact and conclusions of law pursuant to Bankruptcy Rule 7052.

FACTUAL FINDINGS

The record reflects that the debtors filed their voluntary bankruptcy petition for Chapter 7 relief on February 21, 1989. From 1975 until that time, Mr. Mattingly was the owner and operator of a business known as Big Sandy Development Company located in Big Sandy, Tennessee. His father, Dan Mattingly, was president. In addition, Mr. Mattingly owned and operated a real estate sales business in Big Sandy known as Harbor Town Sales. As its name suggests, Big Sandy Development Company was in the business of real estate development, specifically, the development of Kentucky Lake frontage real estate.

Mrs. Mattingly, the defendant here, testified that she worked as a secretary but drew no salary in the real estate office of Big Sandy Development Company during her husband's operation of the business. She drew no salary and had no ownership interest in the business, however.

During the same time that her husband operated the development and real estate sales business, Mrs. Mattingly became "good friends" with her neighbor and "aunt by marriage," Marguerite Hanson. (5/30/90 Testimony of Mrs. Mattingly) Mrs. Hanson, who is now deceased, was the mother of Thana Leonard and Richard Carver, the plaintiffs here. Both of Mrs. Hanson's children resided outside of Big Sandy, Tennessee and as her age advanced, her health began to fail and Mrs. Mattingly assumed responsibility for her care.

According to Mrs. Mattingly's testimony, in 1980 Mrs. Hanson gave her a power of attorney in case she became ill and needed someone to take care of her business affairs. Mrs. Hanson's attorney prepared the power of attorney.

Because of Mrs. Hanson's failing health, it became necessary for her to arrange to sell her house in Big Sandy in 1985 and move to an apartment in Jackson, Tennessee. Consequently, she executed a second power of attorney in favor of Mrs. Mattingly on April 6 of that year so that Mrs. Mattingly could arrange such a sale. The power of attorney is a "durable" one under Tennessee law and authorizes Mrs. Mattingly "to attend to all business affairs which I [Mrs. Hanson] may have which involves my property, both real and personal." (Tr. Ex. 1); Tenn. Code Annot. §34-6-102.

The home sold for \$60,000.00 cash. According to Mrs. Mattingly, part of these proceeds were used to help pay for Mrs. Hanson's escalating care expenses, as by this time, she was undergoing dialysis three times a week.

Mrs. Mattingly undertook to invest the balance of the house sales proceeds. She testified that she invested \$10,000.00 in passbook savings and invested the balance in certificates of deposit ("CD's"). However, Mrs. Mattingly was dissatisfied with the income from these investments and she subsequently transferred the CD funds to a mutual fund account which provided earnings of 10%. Although these earnings when added to Mrs. Hanson's pension fund income and social security were enough to "cover" Mrs. Hanson's expenses at that time, Mrs. Mattingly testified that she became increasingly concerned that the earnings would not be sufficient for Mrs. Hanson's care for an extended period of time.

Consequently, she discussed investing these funds in Big Sandy Development Co. with her husband. She ultimately agreed to invest \$30,000.00 with Big Sandy based upon her understanding that the investment would earn 15% annually.

In her deposition, Mrs. Mattingly testified that she believed the investment in Big Sandy to be a good one although she did not investigate the company's balance sheets or solvency. She testified at the hearing however, that in late 1987 it became apparent that the business "was in trouble" when a large loan commitment "fell through." On December 12, 1987, she caused Big Sandy to execute a promissory note and deed of trust in favor of Mrs. Hanson as consideration for her investment. (Tr. Ex. 2 & 3) According to Mrs. Mattingly's testimony, the security for this deed of trust consists of four lots valued at \$5,500.00 each and five lots valued at \$2,500.00 but according to the debtors' bankruptcy petition, the security only has a value of \$7,500.00. Mrs. Mattingly further testified that she did not inform Mrs. Hanson that her investment was in jeopardy although she did inform her of the note and deed of trust.

The plaintiffs here, i.e., Mrs. Hanson's son and daughter, testified that they were aware of Mrs. Mattingly's power of attorney and that she was investing Mrs. Hanson's money pursuant thereto. However, neither was aware of the investment in Big Sandy Development Co. until the business failed. It is this

investment in Big Sandy that the plaintiffs assert gives rise to a nondischargeable debt under 11 U.S.C. §523(a)(4), which excepts from discharge any debt "for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny." The plaintiffs seek a nondischargeable judgment of the amount shown as due Mrs. Hanson by Big Sandy, i.e., \$31,141.94 plus accrued interest, costs and fees. The burden of proving that this debt may be excepted from the debtor's discharge rests with the plaintiffs. In re Wheeler, 101 B.R. 39, 44 (Bankr. N.D. Ind. 1989).

Given that the plaintiffs' complaint is based upon allegations that the debtor breached her fiduciary duties to their mother, the threshold issue for determination is whether the debtor was acting in a fiduciary capacity. It is well settled that for purposes of §523(a)(4), such a determination is a matter of federal law although state law may be considered. In re Kern, 98 B.R. 321, 323 (Bankr. S.D. Ohio 1989); In re Wheeler, 101 B.R. 39, 45. This is due to the fact that exceptions from discharge are to be construed narrowly in favor of the debtor and often, state law provides a broad definition of "fiduciary" which may encompass ordinary commercial debtor-creditor or principal-agent relationships. In fact, it has been held in this state that the term "fiduciary capacity" as it is used in §523(a)(4) "is not as broad a term as under state law." In re Hays, 31 B.R. 285 (Bankr. E.D. Tenn. 1983).

Thus, the question becomes what, under federal law, constitutes a fiduciary relationship. A majority of the courts considering this question agree that a fiduciary relationship is primarily evidenced by an express or technical trust relationship which exists or existed prior to the act creating the debt and without reference thereto. In re Interstate Agency, Inc., 760 F. 2d 121, 124 (6th Cir. 1985) (interpreting §17(a)(4) of the Bankruptcy Act); In re McQueen, 102 B.R. 120, 124 (Bankr. S.D. Ohio 1989); see also, Davis v. Aetna Acceptance Co., 293 U.S. 328, 55 S. Ct. 151, 79 L. Ed. 393 (1934). Consequently, constructive, resulting, or implied trusts do not give rise to the type of fiduciary relationship contemplated by §523(a)(4). In re Schneider, 99 B.R. 974 (9th Cir. BAP 1989). Rather, as a general rule, §523(a)(4) is only applicable to "express or technical trusts created by agreement between the parties to impose a trust relationship." In re Gans, 75 B.R. 474, 489 (Bankr. S.D.N.Y. 1987). Moreover, the money or property on which the alleged

fiduciary "debt is based must have been entrusted to the debtor-fiduciary . . . Typically, this means that there was a 'clear intention' by the parties to create a definable trust res." Id. at 490 (Emphasis in original) "Ultimately, the 'key element' implicit in the existence of a fiduciary relationship is the 'intent to create a trust relationship rather than a contractual relationship.'" Id. citing In re Schultz, 46 B.R. 880, 885 (Bankr. D. Nev. 1985); In re Levitan, 46 B.R. 380, 384 (Bankr. E.D.N.Y. 1985). See also, In re Schneider, 99 B.R. 974 (9th Cir. BAP 1989).

In the case at bar, the relationship between Mrs. Hanson and the debtor is evidenced by the agreement appointing the debtor as her "attorney in fact" as well as the debtor's testimony to the effect that Mrs. Hanson knew that the debtor was investing the proceeds from the sale of Mrs. Hanson's house for her. The language of the power of attorney (Tr. Ex. 1) gave broad powers and responsibilities to Mrs. Mattingly. Clearly, these factors establish the parties' intent for Mrs. Mattingly to be entrusted with the funds and thus to create a trust relationship. From these factors, the Court is satisfied that a fiduciary relationship did in fact exist between Mrs. Hanson and the debtor.

Having reached this conclusion, the remaining determination is whether the debtor breached this fiduciary relationship by at least "defalcation" of funds. In its Interstate Agency opinion, the Sixth Circuit adopted the definition of "defalcation . . . as encompassing embezzlement, the misappropriation of trust funds held in any fiduciary capacity, and the failure to properly account for such funds." 760 F. 2d at 125; see also In re Kern, 98 B.R. 321, 323. Thus, proof of defalcation does not require evidence of any intentional wrong by the debtor. It need only be shown that the debtor has failed to account for money received while acting in a fiduciary capacity. Whether the failure to account is the result of negligence, ignorance, or an innocent default is of no relevance, the key factor being the failure to account. In re Gans, 75 B.R. 474, 490-491; In re Kern, 98 B.R. 321, 324; In re Guy, 101 B.R. 961, 985 (Bankr. N.D. Ind. 1988).

It is undisputed in the case at bar that the debtor has failed to account for \$31,141.94 entrusted to her by Mrs. Hanson. In addition, it has been determined that this failure to account is the result of the debtor's handling of the funds while in a fiduciary capacity. It follows then that this debt of \$31,141.94 is

nondischargeable as one which results from "defalcation while acting in a fiduciary capacity." 11 U.S.C. §523(a)(4)

From the above findings and conclusions, it is **HEREBY ORDERED** that the debt of \$31,141.94 owed to the estate of Marguerite Hanson is excepted from the general discharge available to Mrs. Mattingly. Accordingly, the plaintiffs are granted relief from the stay and authority to pursue their foreclosure remedies pursuant to the deed of trust. (Tr. Ex. 3)

FURTHER, since the promissory note (Tr. Ex. 2) was signed by Mrs. Mattingly as a lender but in her capacity as power of attorney for Mrs. Hanson, it is obvious that Mrs. Mattingly was aware of the note's provisions for interest at the rate of 13% and for recovery of all costs and attorneys fees. Therefore, the Court having concluded that the underlying debt is excepted from discharge, the plaintiffs are entitled to a nondischargeable judgment for the \$31,141.94 balance due on the note, plus contractual interest, cost of this adversary proceeding and reasonable attorney's fees. Interest shall be calculated from August 24, 1987 (the last date of a principal payment, Tr. Ex. 4); however, credit must be given for the fact that some interest payments were accrued thereafter by Big Sandy Development Company at 15% rather than the 13% contractual rate. (See Tr. Ex. 4)

If the parties are unable to agree on reasonable fees for the plaintiffs' attorney, Mr. Butler shall file an affidavit with his detailed time, rate and expenses and the Court will set a hearing to determine those fees.

SO ORDERED this 26th day of July, 1990.

WILLIAM HOUSTON BROWN
UNITED STATES BANKRUPTCY JUDGE

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