U.S. BANKRUPTCY COURT

FOR THE DISTRICT OF ARIZONA

In re **ANTHONY CLYDE CRUZ and CARMELA DOMAINE QUITUGUA,** **Debtors.**	In Chapter 7 proceedings Case No.: 10-271 Adversary No. 10-644
FRANK MANOLIO and DEBORAH CROSS, **Plaintiffs,** v. **ANTHONY CLYDE CRUZ and CARMELA DOMAINE QUITUGUA**, **Defendants.**	**MEMORANDUM DECISION RE DISCHARGEABILITY**

"I have no documents to supply."
Testimony of Anthony Quitugua, April 25, 2011

I. Nature of the Case

Does money invested by the Plaintiffs into Debtor Anthony Quitugua's single member limited liability company become nondischargeable debt in the Debtors' personal bankruptcy? It does as to Mr. Quitugua and the Debtors' community because Mr. Quitugua provides no accounting of his personal or limited liability company's finances and the Plaintiffs have shown that he, both individually and through his LLC,

obtained money from the Plaintiffs fraudulently under § 523(a)(2)(A) and embezzled money invested under § 532(a)(4). It does not as to Ms. Quitugua individually because the Plaintiffs have not shown that she participated in the fraud or embezzlement.

II. Facts

Frank Manolio and Anthony C. Quitugua met in Fall 2005. Football and real estate formed their common bond: Mr. Manolio is a high school football coach and has a real estate license; Mr. Quitugua was also a real estate agent[1] and claimed he played football at Louisiana State. Soon after meeting, they began discussing possible investments in the booming Phoenix real estate market.

Based on their discussions, Frank Manolio and Deborah Cross[2] invested $99,000 ("Investments")[3] with Quitugua & Associates, LLC ("Q&A") for the purpose of purchasing, rehabilitating, and reselling real estate. As the Plaintiffs understood the Investments, Mr. Quitugua would find undervalued property, fix it up, sell it quickly at 85-95% of value, and they would all realize a quick profit. Plaintiffs claim that Mr. Quitugua told them that he would return their $99,000 whenever they asked.

The Investments are memorialized by separate joint venture agreements between Frank Manolio and Quitugua & Associates, LLC ("JVA1") and Deborah Cross and Quitugua & Associates, ("JVA2") (JVA1 and JVA2 collectively "JVAs"). Under the JVAs, when properties were sold profits would be split between Q&A (60%) and the Defendants (40%). JVA1 contains addendums to include the purchase of these properties:

1. 1701 East Colter Street, Unit 204, Phoenix, Arizona;
2. 1701 East Colter Street, Unit 203, Phoenix, Arizona;
3. 1701 East Colter Street, Unit 184, Phoenix, Arizona;
4. 1701 East Colter Street, Unit 182, Phoenix, Arizona; and
5. 7631 N. 19th Drive, Phoenix, Arizona.

JVA2 contains an addendum which includes the following property: 6900 East Princess Drive, Unit #1180, Phoenix, Arizona which was never purchased (the properties listed in JVA1 and JVA2 collectively "Properties"). Mr. Manolio testified that, prior to investing,

[1] Mr. Quitugua's real estate license has now been suspended.
[2] Mr. Manolio and Ms. Cross are married. Veronica Manolio, Plaintiffs' attorney, is Mr. Manolio's daughter.
[3] The Debtors do not contest that the Plaintiffs invested $99,000.

he visited the various properties personally to decide if they were good investments. Based on his visits and the representations of Mr. Quitugua, the Plaintiffs made the Investments in August and October of 2005.

In early 2006, the Plaintiffs started to become nervous about the status of the Investments so Mr. Manolio began keeping a log. His log reveals repeated phone calls to Mr. Quitugua and others with Q&A asking about the Investments. Mr. Quitugua or others associated with Q&A repeatedly promised repayment at some point in the near future despite the fact that most calls came after Q&A already sold the Properties. Obviously, this repayment never came. By Summer 2007, the Plaintiffs had had enough, sued in state court, and in 2010 filed the adversary proceeding currently before this Court.

Throughout the course of the two lawsuits, the Plaintiffs repeatedly requested Q&A or personal business records that the Debtors never provided. Mr. Quitugua excuses the lack of production by blaming his former landlord for locking him and Q&A out of his office for non-payment. The lockout, argues Mr. Quitugua, restricted access to all his personal and business documents. Thus, in pretrial documents the Debtors have repeatedly stated that they have no documents to support their defense:

> Defendants' Initial Disclosure Statement, August 9, 2010:
>
> > Defendants hereby set forth their initial disclosures pursuant to Rule 26(a)(1) of the Federal Rules of Civil Procedure.
> > * * *
> > **2. A copy or description by category and location of all documents in Defendants' possession, custody or control which may be used to support the defense of this adversary case.**
> >
> > There are no documents in Defendants possession, custody or control.
>
> Plaintiffs' First Request for Production to Defendants, February 7, 2011:
>
> > Please produce the following:
> >
> > 1. Any and all Business/Corporate Records of Quitugua & Associates, LLC including:
> > * * *
> >
> > 2. Any and all records of Anthony C. Quitugua and Carmella D. Quitugua for the time period of 2005:
> > * * *

6. Any and all documentation or proof to substantiate Defendants' defense.

Response to Plaintiffs' First Request for Production to Defendants, March 4, 2011:

1. Defendants are not in possession of any of the requested documentation. Defendants [sic] books and records, along with those of Quitugua and Associates, Inc. [sic] were seized by a landlord after a lock out of its business space.

* * *

2. Defendants respond as follow:

a. None.
b. None exist.
c. None exist.
d. None.
e. 2005-2007 tax returns are no longer in Defendants possession.
f. 2005-2007 tax returns are no longer in Defendants possession.
g. None

* * *

6. None other than has been listed by the Plaintiffs.

This position continued throughout the trial where Mr. Quitugua repeatedly testified that he lacks documentary support for his testimony due to his lack of records. Mr. Quitugua's persistent claim of missing records is undermined by Ms. Quitugua's testimony that she has copies of their income tax returns – one of the documents requested by the Plaintiffs.

Because the Debtors provided no documents, the Plaintiffs and the Court must rely on documents in the public record and possessed by the Plaintiffs as the only evidence of the purchase and sale of the Properties. These documents reveal the following:

<u>1701 E Colter St. # 203</u>

Investment:	$12,000
Purchase Date:	September 2005
Seller:	Montecito Camelback
Buyer:	Q&A
Price:	$203,506.00
Sale Date:	February 2006
Seller:	Q&A
Buyer:	Lindsey Powers
Price	$350,000.00

1701 E Colter St. # 204

Investment:	$12,000
Purchase Date:	September 2005
Seller:	Montecito Camelback
Buyer:	Q&A
Price:	$203,506
Sale Date:	June 2006
Seller:	Q&A
Buyer:	TRA Lynn Hartman
Price:	$350,000

1701 E Colter St. # 184

Investment:	$12,000
Purchase Date:	September 2005
Seller:	Montecito Camelback
Buyer:	Q&A
Price:	$198,656
Sale Date:	June 2006
Seller:	Q&A
Buyer:	Maximillian Valera
Price:	$350,000

1701 E Colter St. # 182 ("Unit #182")

Investment:	$12,000
Purchase Date:	September 2005
Seller:	Montecito Camelback
Buyer:	Q&A
Price:	$198,656
Sale Date:	December 2005
Seller:	Q&A
Buyer:	Brandon Whitehead
Price:	$349,000

7631 N19th Drive

Investment:	$21,000
Purchase Date:	September 9, 2005
Trustor:	Q&A
Beneficiary:	Active Finance
Obligation Secured:	$96,750
Sale Date:	December 2005
Seller:	Q&A
Buyer	Nichole Stuart
Sale Price	$139,000

6900 E Princess Dr #1180

Investment:	$30,000

No evidence it was ever purchased.

These documents show that the Properties generated a profit of $636,926 to which, under the terms of the JVAs, the Plaintiffs were entitled to 40% or $254,770.40. The Plaintiffs did not receive $254,770.40, but instead received $17,600: $4,800 for unit 203; $4,800

for unit 204; $4,800 for Unit 184; and $3,200 for North 19th Drive leaving them $237,170.40 short of the sums called for under the JVAs.

Mr. Quitugua testified to ever-changing reasons why the Plaintiffs were not paid, including that: 1) he has no idea what, if any, profits there were on the sale of these units due to the lack of records; 2) the units sold generated a profit of between $25,000-$30,000, but that he has no documents to support his numbers; and 3) again with no documentation – the Plaintiffs' calculations do not account for costs of the sale including construction and carrying costs as high as 18% per month.

III. Analysis

Under §523(a)(2)(A) a debt is not dischargeable "for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by -- false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition." This case is unusual because the Plaintiffs entered into the JVAs with Q&A, not the Debtors, but ask the Court to find the debt nondischargeable against the Debtors. To do so, the Plaintiffs allege that Mr. Quitugua, the sole member of Q&A, ignored corporate formalities and thus they can pierce Q&A's company veil.

A. Piercing the Corporate Veil

Whether veil piercing of an LLC is an available remedy in Arizona is an open question. As one commentator has put it:

> The Arizona statutes do not expressly impose liability on members under an alter-ego or "piercing the veil theory." It is reasonable to anticipate, however, that a court would apply these theories to impose personal liability on the members of an LLC in appropriate circumstances. Presumably, the court would apply rules analogous to those applied to corporations and their shareholders in these circumstances.

Terrance W. Thompson, 6 *Ariz. Prac., Corporate Practice* § 12:62. Though LLC's are analogous to corporations, the Arizona District Court, in interpreting Utah's LLC statutes, observed that piercing the veil of an LLC is more difficult because "LLCs are more informal and flexible institutions than corporations, and that the failure to meet

rigid requirements should not defeat an LLC's status." *TFH Properties, LLC v MCM Development, LLC*, 2010 WL 2720843, *6 (D. Ariz. July 9, 2010) (not reported). But, an LLC cannot be used "as an impenetrable wall, behind which members can hide from all creditors. We decline defendants' efforts to transform 'limited liability' companies into 'zero liability' entities." *Id.* This Court synthesizes the two pronouncements and will apply Arizona's corporate laws regarding piercing the company veil, with due regard that an LLC is an entity requiring less formality than a corporation.

In Arizona, "corporate status will not be lightly disregarded." *Keams v. Tempe Technical Institute, Inc.*, 993 F. Supp 714, 723 (D.Ariz. 1997). The fact that a corporation, or in this case LLC, is a one-man operation does not mean "the corporation is the alter ego of that one man." *Ize Nantan Bagowa, Ltd. v. Scalia*, 577 P.2d 725, 728 (Ariz. App. 1978). "[C]ourts will pierce a corporate veil and impose personal liability if the business is conducted on a personal rather than a corporate basis, and if the business was established without an adequate financial basis." *Keams*, 993 F. Supp. at 723 (citing *Ize Nantan Bagowa*, 577 P.2d at 728). However, the "corporate fiction will be disregarded when the corporation is the alter ego or business conduit of a person, and when to observe the corporation would work an injustice. The alter ego status is said to exist when there is such a unity of interest and ownership that the separate personalities of the corporation and the owners cease to exist." *Ize Nathan Bagowa* 577 P.2d at 728; *see also U.S. v. Everett*, 2008 WL 3843831, *2 (D. Ariz. Aug 14, 2008) (not reported).

The evidence (and lack thereof) shows that Q&A was the business conduit of Mr. Quitugua and recognition of Q&A as a separate entity would be an injustice. The Plaintiffs undisputedly gave Q&A $99,000. What happened to the $99,000 is unknown. Why? Because Mr. Quitugua provides no paper trail for the Investments.

Over years of discovery requests, Mr. Quitugua has repeatedly claimed that he has no Q&A or personal business records because of a landlord lockout. This excuse strains credibility. Mr. Quitugua provides no evidence of the lockout, nor of attempts to recover documents from the landlord, nor of efforts to recover documents from others involved

with Q&A. Mr. Quitugua is treating this matter as if he lost a store receipt needed to return a blender. Instead, this is a fight over a one hundred thousand dollar investment that generated a documented six hundred thirty six thousand dollar profit. Some documentation must exist which the Debtors, at best, chose not to try to find or, at worst, chose not to disclose. Much as *TFH Properties* declined "defendants' efforts to transform 'limited liability' companies into 'zero liability' entities" this Court will decline the Debtors' attempts to turn LLCs from informal and flexible institutions into illusory and anarchic institutions.

Evidence of Mr. Quitugua's use of Q&A as a personal conduit is shown by his treatment of Unit #182. According to the documents available, Q&A purchased Unit #182 in September 2005 for $198,656, $12,000 of which came from Mr. Manolio, and sold it in December 2005 for $349,000 to Brandon Whitehead – Mr. Quitugua's nephew. Mr. Whitehead testified that could not afford the condo, yet he signed a document showing him as the purchaser. He signed the document because Mr. Quitugua promised to pay the mortgage and paid Mr. Whitehead $5,000 to sign the document. Mr. Whitehead never lived in the property. Eventually, Unit #182 was transferred to Mr. Quitugua's father-in-law, loans were taken out, and ultimately Unit #182 was foreclosed upon. Instead of treating Unit #182 as an investment of Q&A and the Plaintiffs, Mr. Quitugua treated it as his personal investment vehicle. In short, the evidence is sufficient to pierce the veil and Plaintiffs can proceed against the Debtors personally.

B. Nondischargeability

To prevail in a §523(a)(2) action, the creditor "must establish: (1) a misrepresentation of fact by the debtor, (2) that the debtor knew at the time to be false, (3) that the debtor made with the intention of deceiving the creditor, (4) upon which the creditor relied, and (5) that was the proximate cause of damage to the creditor." *In re Cossu*, 410 F.3d 591, 596 (9th Cir. 2005); *See also In re Sabban*, 384 B.R. 1, 5 (9th Cir. BAP 2008). "The creditor bears the burden of proof to establish all five of these elements by a preponderance of the evidence." *In re Weinberg*, 410 B.R. 19, 35 (9th Cir. BAP

1991). "[F]raudulent intent may be established by circumstantial evidence, or by inferences drawn from a course of conduct." *In re Devers*, 759 F.2d 751, 753-54 (9th Cir. 1985.) "[I]n determining whether the debtor had no intention to perform, a court may look to all the surrounding facts and circumstances." *In re Barrack*, 217 B.R. 598, 607 (9th Cir. BAP 1998). Elements (1), (2) and (3), when read together, mean that a creditor must establish "evidence, that a debtor knowingly made a false representation, either express or implied, with the intent of deceiving the creditor." *In re Brown*, 217 B.R. 857, 861 (Bankr. S.D. Cal 1998).

Here, the Court concludes that Mr. Quitugua falsely stated that he would invest the Plaintiffs money into specific real estate investments and split the profits. He made these statements with the intention to deceive the Plaintiffs and knowing them to be false. The Court heard testimony from Marilyn Hinrichs wherein she recounted how Mr. Quitugua encouraged her to make an investment, promised the same result, but again returned little of her money with no explanation of where it went. Mr. Quitugua's story is that he was not the money man, stating instead that Malcolm Vallero played that role. This is not credible in light of the totality of the evidence; at best for Mr. Quitagua, this testimony tends to show that he both didn't have, and didn't care to have, knowledge of where money was being invested or what profits could be made off of each project. The lack of documentation only solidifies this conclusion. In short, the facts and circumstances of this case show a pattern of intentional deceit by Mr. Quitugua.

The Plaintiffs relied on the representations made by Mr. Quitugua. Mr. Manolio inspected each of the Properties before investing. As a result of the inspections and Mr. Quitugua's promise that the Investments would be made into the Properties, the Plaintiffs invested $99,000. The $99,000 is now gone with no credible explanation of where the money went. But for Mr. Quituigua's promise to invest their money in the Properties, the Plaintiffs would not have made the Investments. Mr. Quitugua is the proximate cause for the damages to the Plaintiffs.

In addition to fraud, the Plaintiffs claim embezzlement under § 532(a)(4). Embezzlement for purposes of §523(a)(4) is defined by federal law. *In re Wada*, 210 B.R. 572, 576 (9th Cir. BAP 1997). Under §523(a)(4), embezzlement "requires three elements: (1) property rightfully in the possession of a nonowner; (2) nonowner's appropriation of the property to a use other than which [it] was entrusted; and (3) circumstances indicating fraud." *In re Littleton*, 942 F.2d 551, 556 (9th Cir. 1991) (quotations omitted). The first element is shown as each party agrees that the Plaintiff's gave Mr. Quitugua $99,000 to invest in the Properties. As described above, circumstances indicating fraud by Mr. Quitugua have been shown: thus, the third element is satisfied.

What then of the second element? Under the JVAs, after expenses and costs were paid, the parties agreed to split the net proceeds. Instead of the split, as summarized by Mr. Quitugua's counsel during closing arguments, once the Properties were sold the money stayed in Q&A. In other words, the proceeds were used for a purpose other than which it was entrusted, thereby triggering liability under section 523(a)(4).

C. Liability of Ms. Quitugua

The Plaintiffs have not shown fraud by Ms. Quitugua. "Fraudulent intent will not be presumed … however, it may be proven inferentially." *In re Oliphant*, 221 B.R. 506, 511 (Bankr. D. Ariz. 1998). To show § 523 nondischargeeability "Plaintiff must show culpable conduct or fraudulent intent on the part of the 'innocent' spouse in order for the debt to be nondischargeable in the 'innocent' spouse's bankruptcy." *Id.* "[K]nowledge itself may be inferred where the facts and circumstances are so egregious that denial of knowledge is simply not credible." *Id.* Here, the Plaintiffs have not shown intent on behalf of Ms. Quitugua. Further, though the Plaintiffs believe otherwise, the facts and circumstances of this case are not so egregious as to deny discharge to Ms. Quitugua's sole and separate property.

D. Attorneys' Fees

Under the American Rule, "'the prevailing litigant is ordinarily not entitled to collect a reasonable attorneys' fee from the loser.'" *Travelers. and Sur. Co. of America v.*

Pac. Gas and Elec. Co., 549 U.S. 443, 1203 (2007) (quoting *Alyeska Pipeline Service Co. v. Wilderness Society*, 421 U.S. 240, 247 (1975). Here, the Plaintiffs cite no direct statutory authority to award attorneys fees but rather urge the Court to make an award in its discretion under 11 U.S.C. §105(a). The Court does not believe it has the discretion to award fees in this case. To the extent that it does have the discretion to do so, it declines.

IV. Conclusion

The Plaintiffs have pierced the veil between Mr. Quitugua and Q&A. The Plaintiffs have established fraud and embezzlement under §§523(a)(2)(A) and (4). The Plaintiffs have established that damages of $237,170. No attorneys' fees are awarded. These damages are nondischargeable as to Mr. Quitugua and the community assets of the Debtors. Counsel for Plaintiffs is to upload a form of order.

Dated: September 26, 2011

CHARLES G. CASE II
UNITED STATES BANKRUPTCY JUDGE

COPY of the foregoing mailed by the BNC and/or
sent by auto-generated mail to:

All interested parties