IN THE UNITED STATES BANKRUPTCY COURT

FOR THE DISTRICT OF ARIZONA

In re DIEGO MENDOZA TORRES and JEANNE MARIE TORRES, Debtor.	Chapter 7 Case No.11-bk-12641-SSC Adv. No. 11-ap-1081 (Not for Publication- Electronic Docketing ONLY)
EVA MYERS, Plaintiff, v. DIEGO MENDOZA TORRES and JEANNE MARIE TORRES, Defendants.	MEMORANDUM DECISION

I. INTRODUCTION

Diego Mendoza Torres and Jeanne Marie Torres, the Debtors ("Debtors"), filed their Chapter 11 bankruptcy petition on May 2, 2011. Eva Myers, the former sister-in-law of the Debtors and the Plaintiff herein ("Plaintiff," "Eva Myers") filed her Complaint on June 15, 2011. In her Complaint, the Plaintiff seeks entry of a nondischargeable judgment against the Debtors, as defendants ("Debtors" or "Defendants") pursuant to 11 U.S.C. § 523. On August 4, 2011, the Debtors filed a motion for summary judgment ("Motion"), which was fully briefed by the

parties.[1] On October 20, 2011, the Court held oral argument on the Motion. At the conclusion of the hearing, the Court took the matter under advisement.

In this Memorandum Decision, the Court has now set forth its findings of fact and conclusions of law pursuant to Rule 7052 of the Rules of Bankruptcy Procedure. The issues addressed herein constitute a core proceeding over which this Court has jurisdiction. 28 U.S.C. §§ 1334(b) and 157(b) (West 2011).

II. FACTUAL BACKGROUND

The Debtors formed Sender Holdings, LLC ("Sender") in March 2006 to acquire, develop, and sell real property located in Clay Springs, AZ. Sender acquired fifteen acres located at 4908 and 4934 Elk Trail, Clay Springs, AZ 85293 (collectively the "Elk Trail Property"), and approximately twenty-three acres known as Lots A through E of Pulp Mill (the "Pulp Mill Property"). The Debtors originally purchased the properties in their own names and then transferred them to Sender. They funded the purchases with their personal funds, borrowed funds from their personal line of credit and from their wholly-owned company, Prime Development & Investment, LLC ("Prime").

John and Eva Myers ("Myers") agreed to invest, and did invest, the sum of $145,000 for the purpose of acquiring the Elk Trail Property. Eva Myers, the Plaintiff, is the ex-wife of John Myers. Mr. Myers is the brother of Debtor Jeanne Torres. On March 22, 2006, Diego Torres, acting as member and manager of Sender and the Myers, executed a Profit Sharing Agreement ("Agreement") in connection with the acquisition of the Elk Trail Property. Pursuant to the Agreement, Sender agreed to pay the Myers a monthly preferred return of at least $1,200 (or 10% of the outstanding investment principal), to repay the principal investment upon the sale of the Property, and to pay the Myers 5% of any net profits generated from the sale of the Property. The Myers' investment was partially used to reimburse the Debtors for the acquisition

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1.The Plaintiff filed a response on September 15, 2011, and the Debtors filed a reply on October 6, 2011.

cost of the Elk Trail Property. The Debtors purchased the Elk Trail Property for $188,500. Although the Property had been appraised for $245,000, the Debtors did not seek a profit when they transferred it to Sender. Rather, they sought a return of their $188,500.

The Pulp Mill Property was purchased in July 2006 for approximately $287,500. The Debtors obtained permanent financing on the Pulp Mill Property from M&I Bank on August 8, 2006. The proceeds from that financing, $184,434.41, were partially used to reimburse the Debtors and/or Prime for the acquisition of the Pulp Mill Property. On August 29, 2006, the Debtors transferred the Pulp Mill Property to Sender, and waited to receive the rest of their acquisition cost from Sender.

The Debtors, either directly or through their companies, also caused various funds to be advanced to or for the benefit of Sender for various purposes, including property improvements (such as for a well, grading, and drainage), surveys, soil tests, transactional costs, legal costs, property tax payments, debt service to M&I Bank, and payments to the Myers pursuant to the Agreement. The Debtors oversaw the development and sale of Sender's properties without charging or collecting from Sender any management or development fees.

From March to May 2007, Sender sold 11 acres of the Elk Trail Property for $248,900. During that time, Sender also sold Lot A of the Pulp Mill Property for $109,900.

The parties dispute whether Plaintiff knew of the sales at the time they were made. Mr. Myers claims that he knew of the sales and that he and Eva Myers were willing to wait to get their investment back until the last of the Elk Trail Property was sold.

Between March and July 2007, Sender transferred funds to or for the benefit of the Debtors and Prime. During this time, the Debtors and Prime also transferred funds to Sender. The net amount of transfers to the Debtors and/or Prime during 2007 was $153,144.57. In May 2007, Sender transferred $20,000 to 4T Properties, LLC. From July 19, 2007, and for the next two and a half years or more, Sender continued to receive, and was a net recipient of, funds from the Debtors and Prime totaling more than $62,000.

The parties dispute whether Sender was insolvent at the time of, or became insolvent as a result of, the transfers to the Debtors, Prime, and/or 4T. However, Sender paid its debts as they became due throughout 2007, 2008, and the first part of 2009. Further, the value of Sender's assets exceeded its liabilities during that time. Sender had remaining real property assets, including four acres of the Elk Trail Property and 18.3 acres of the Pulp Mill Property, and had cash and notes receivable totaling more than $29,000.

The parties agreed in March 2008 to reduce the monthly preferred return payment to Myers, with the unpaid portion to be added to the investment amount and included in the final payment.

Sender did not, however, pay back the principal amount of the Myers' investment, although Sender continued to make monthly preferred return payments to Myers until April 2010. Sender anticipated that Myers would be repaid from the sale of its remaining real property. The remaining property had a book value of $322,315.10. Sender's only liabilities were an encumbrance on the Pulp Mill Property totaling $172,317.84 and the Myers' investment of $145,000.

In December 2009, the remaining Pulp Mill Property was foreclosed upon. The Debtors and/or Prime continued to cause funds to be advanced to Sender, including funds for payments to Myers through February 2010 for April 2010. In April 2010, Sender notified Myers that it was discontinuing the payments. Thereafter, Sender offered to transfer to Myers the remaining Elk Trail Property, which had been listed for sale in 2008 at $104,800. Plaintiff claims this offer was based upon a full settlement of all claims.

At oral argument on the Debtors' Motion for Summary Judgment, the Court inquired, several times, of Plaintiff's counsel whether he wished to amend the Complaint to set forth a claim for fraud under Section 523(a)(2)(A) or set forth a claim under some other provision of Section 523. However, counsel declined the Court's suggestion concerning a possible amendment of the Complaint, requesting that the Court rule on the Motion solely on the

Plaintiff's claim that her debt was nondischargeable under Section 523(a)(4).[2]

III. DISCUSSION

The Plaintiff requests that its debt be excepted from discharge pursuant to 11 U.S.C. § 523. Specifically, the Plaintiff argues that under the terms of the Agreement, an express trust was created, which created a fiduciary relationship between the parties. Therefore, it appears that the Plaintiff seeks a nondischargeability determination under § 523(a)(4). In their Motion for Summary Judgment, the Debtors seek a determination that they were not fiduciaries for purposes of § 523, and thus the Plaintiff does not have a nondischargeable claim.

The Court finds that based upon the facts presented and Ninth Circuit authority, an express trust was not created by the Agreement, and therefore, the parties' relationship did not rise to the fiduciary level contemplated in 11 U.S.C. § 523(a)(4). Therefore, the Court finds that the Plaintiff's debt is discharged.

A. STANDARD FOR SUMMARY JUDGMENT

A motion for summary judgment should be granted if the movant has shown that there are no genuine issues of material fact and the movant is entitled to judgment as a matter of law. Fed. R. Bankr. P. 7056(c). Ruling on a motion for summary judgment necessarily implicates that substantive evidentiary standard of proof which would apply at trial. Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 252 (1986). A material fact is genuine if the evidence is such that a reasonable jury could return a verdict in favor of the non-moving party. Id. Procedurally, "the proponent of a summary judgment motion bears a heavy burden to show that there are no disputed facts warranting disposition of the case on the law without trial." In re Aquaslide 'N' Dive Corp., 85 B.R. 545, 547 (9th Cir. BAP 1987). Once that burden has been met, "the opponent must affirmatively show that a material issue of fact remains in dispute." Frederick S.

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2. Plaintiff's counsel stated that there was no factual basis to assert any claims predicated on fraud against the Debtors.

Wyle P.C. v. Texaco, Inc., 764 F.2d 604, 608 (9th Cir. 1985).

The opponent may not assert the existence of some alleged factual dispute between the parties. Liberty Lobby, 477 U.S. 242 at 252. Instead, to demonstrate that a genuine factual issue exists, the objector must produce affidavits which are based on personal knowledge, and the facts set forth therein must be admissible in evidence. Aquaslide, 85 B.R. at 547. In addition, summary judgment must be used with care and restraint, Hutchinson v. United States, 677 F.2d 1322, 1325 (9th Cir. 1982), and is reviewed in the light most favorable to the non-moving party. Hifai v. Shell Oil Co., 704 F.2d 1425, 1428 (9th Cir. 1983).

B. PLAINTIFF DOES NOT HAVE A NONDISCHARGEABLE DEBT AGAINT THE DEBTORS FOR FRAUD OR DEFALCATION WHILE ACTING IN A FIDUCIARY CAPACITY UNDER 11 U.S.C. §523(a)(4).

Section 523(a)(4) provides that an individual debtor is not discharged from any debt "for fraud or defalcation while acting in a fiduciary capacity, embezzlement or larceny." In the Ninth Circuit, to prevail on a complaint under this Subsection, the creditor must establish three elements: (1) an express trust;[3] (2) that the debt was caused by fraud or defalcation; and (3) that the debtor was a fiduciary to the creditor at the time the debt was created. In re Jacks, 266 B.R. 728 (9th Cir. BAP 2001); In re Bigelow, 271 B.R. 178 (9th Cir. BAP 2001).

The question of whether a fiduciary relationship exists for purposes of § 523(a)(4) is one of federal law. In re Cantrell, 329 F.3d 1119, 1125 (9th Cir. 2003); Ragsdale v. Haller, 780 F.2d 794, 795 (9th Cir. 1986). When determining the fiduciary relationship issue, the courts should consult state law. Id. The broad-based, general definition of fiduciary is not applicable in the context of an exception to discharge under § 523(a)(4). In re Lewis, 97 F.3d 1182, 1185 (9th Cir. 1996). Not all fiduciary capacities or relationships recognized by state law will be

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3. The express trust must be created prior to, and separate from, any alleged wrongdoing. *See* In re Lewis, 97 F.3d 1182, 1185 (9th Cir. 1996), citing (Ragsdale, 780 F.2d at 795). [T]he fiduciary relationship must be one arising from an express or technical trust that was imposed before and without reference to the wrongdoing that caused the debt." Id.

found sufficient for Section 523(a)(4) purposes. Cantrell at 1125-26. In this matter, all actions between the parties occurred in Arizona. Therefore, the Court should consult Arizona law concerning the fiduciary relationships created. In re Stanifer, 236 B.R. 709 (9th Cir. 1999); In re Chavez, 430 B.R. 890 (Bankr. D. Ariz. 2010).

Under § 523(a)(4), the Ninth Circuit requires that a debtor must have been a trustee, in the strict or narrow sense, through an express or technical trust. Banks v. Gill Distribution Centers, Inc., 263 F.3d 862 (9th Cir. 2001). Whether a fiduciary is the trustee of an express trust depends on state law, and an express trust may be imposed by common law. In re Lewis, 97 F.3d 1182, 1185-86 (9th Cir. 1996) (holding that Arizona case law imposes an express trust on partners). Therefore, a debtor will be deemed a fiduciary if state law creates an express or technical trust relationship which imposes trustee status upon the Debtor. In re Munton, 352 B.R. 707 (9th Cir. BAP 2006). A general fiduciary duty of confidence, trust, loyalty, and good fath is insufficient to establish a relationship for purposes of nondischargeability. In re Tallant, 207 B.R. 923 (Bankr. E.D. Cal 1997) aff'd in part, rev'd in part on other grounds, 218 B.R. 58 (9th Cir. BAP 1998); In re Young, 91 F.3d 1367 (10th Cir. 1996).

In the Profit Sharing Agreement ("Agreement") entered into between Sender Holdings, LLC and the Myers on March 28, 2006, the recitals note that the company is acquiring real property, the "Elk Trails Property," and the Investor (the Myers) desire to provide capital to the company to "facilitate the acquisition, and management of the property."[4] Pursuant to the Agreement, the Myers agree to deliver $145,000 to the Sender for the acquisition of the property. Sender agrees to 'adhere to the highest level of business practices and prudence in the acquisition and management of the property."[5] The Agreement calls for a "Preferred Return" whereby in exchange for the investment, the Myers are to be paid a 10% preferred annual return

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4. See Docket No. 17; Exhibit D.

5. See Docket Entry No. 17; Exhibit D, § 2 of the Agreement.

of the investment.[6] The Preferred Return is to be paid no less frequently than in equal monthly payments of $1,208.33. The Agreement specifically provides that the parties are not to be considered "joint ventures, partners, or agents of each other."[7] The Plaintiff apparently does not dispute, at least at this time, said statement in the Agreement.[8]

Contrary to the assertions of the Plaintiff, the language in the Agreement does not create a express trust for § 523(a)(4) purposes. An express trust is created by an agreement between two parties to impose a trust relationship. The elements of an express trust are: (1) sufficient words to create a trust; (2) a definite subject; and (3) identifiable trust res. In re Stanifer, 236 B.R. 709 (9th Cir. 1999). There is no language in the Agreement which indicates an intent to create a trust relationship. The language in the Agreement is clear that the Plaintiff was an "Investor" in the "Company." Pursuant to this relationship, the Plaintiff anticipated and did get a significant financial return on her investment.

Language in the Agreement which purports to hold Sender to the "highest level of business practices" is insufficient to create at trust relationship. The "broad general definition of fiduciary - a relationship involving confidence, trust and good faith- is inapplicable in the dischargeability context." In re Chavez, 430 B.R. 890, 894 (Bankr. D. Ariz. 2010) (citing In re Short, 818 F.2d 693, 695 (9th Cir. 1987)). While Arizona law recognizes that certain individuals, such as partners, corporate directors, and agents stand in a fiduciary capacity, the Agreement specifically disavows the creation of such a relationship. In addition, the Plaintiff has failed to provide any evidence that the parties intended to create a trust relationship instead of a contractual relationship. This intent to create a trust relationship is a key element in determining the existence of an express trust. In re Chavez, 430 B.R. 890, (Bankr. D. Ariz 2010) (citing In re

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6. See Docket Entry No. 17; Exhibit D, § 3 of the Agreement.

7. See Docket Entry No. 17; Exhibit D, § 9 of the Agreement.

8. The Plaintiff states in her Response that she is not prepared to assert that she was a partner of Sender Holdings. *See* Response, Docket Entry No. 16, p. 8, fn 3.

Pedrazzini, 644 F.2d 756 (9th Cir. 1981)). Therefore, the Court concludes that the Plaintiff has failed to provide evidence of an express or statutory trust for § 523(a)(4) purposes.

Moreover, as set forth by Ninth Circuit case law, the determination under § 523(a)(4) is strict and also requires a definable trust res. In re Chavez, 430 B.R. 890 (Bankr. D. Ariz. 2010); In re Bigelow, 271 B.R. 178 (9th Cir. BAP 2001). In this case, the Court concludes that the Plaintiff provided the Debtors with investment funds, not trust funds. At no point were the Debtors requested to hold and manage funds on behalf of the Plaintiff. Therefore, since there were no trust funds involved in the Debtors' relationship with the Plaintiff, the Court is unable to find that a fiduciary relationship was created within the narrow meaning of § 523(a)(4).

The Agreement establishing the relationship between the Plaintiff and Debtors did not create an express trust. As noted above, the Plaintiff has failed to show several critical elements of an express trust. The loss of the Plaintiff's investment is unfortunate. However, the loss of the investment, perhaps like many others, is tied to market conditions which occurred in Arizona that no one could foresee or contemplate. The Plaintiff chose to invest in a company that was engaged in real estate development. Most investments bear a certain amount of risk, but investing in Arizona real estate may carry more than an average amount of risk.

IV. CONCLUSION

Based upon the foregoing, the Court concludes that there are no genuine issues of material fact. Therefore, the Debtors' Motion for Summary Judgment is GRANTED. The Court shall execute an order incorporating this Decision.

DATED this 5th day of December, 2011.

Honorable Sarah Sharer Curley
United States Bankruptcy Judge