

**SEP 28 2006**

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U.S. BKCY. APP. PANEL  
OF THE NINTH CIRCUIT**

**ORDERED PUBLISHED**

**UNITED STATES BANKRUPTCY APPELLATE PANEL  
OF THE NINTH CIRCUIT**

6	In re:	)	BAP No.	SC-05-1314-SRyMa
7	PETER MUNTON,	)	Bk. No.	03-05103
8	Debtor.	)	Adv. No.	03-90314
9	_____	)		
10	T & D MORAVITS & CO.,	)		
11	Appellant,	)		
12	v.	)	<b>O P I N I O N</b>	
13	PETER MUNTON,	)		
14	Appellee.	)		
	_____	)		

Argued and Submitted by Telephone Conference  
on July 14, 2006

Filed - September 28, 2006

Appeal from the United States Bankruptcy Court  
for the Southern District of California

Honorable Peter W. Bowie, Chief Bankruptcy Judge, Presiding

Before: SMITH, RYAN<sup>1</sup>, and MARLAR, Bankruptcy Judges.

<sup>1</sup> Hon. John E. Ryan, United States Bankruptcy Judge for the  
Central District of California, sitting by designation.

1 SMITH, Bankruptcy Judge:  
2

3 An unpaid subcontractor sought to except from discharge debt  
4 incurred by debtor through the alleged breach of fiduciary duty  
5 arising from the misapplication of statutory trust funds. The  
6 bankruptcy court denied its motion for summary judgment and this  
7 appeal followed.<sup>2</sup> We REVERSE and REMAND.

8 **I. FACTS**

9 T & D Moravits & Co. ("Moravits"), a concrete subcontractor,  
10 provided materials and services to Ryan Companies US, Inc. dba  
11 Ryan Midwest Construction Co. for the construction of townhouses  
12 owned by CPWH Resident, Ltd. ("CPWH"), a Texas limited  
13 partnership. The principals of CPWH are Richard P. Richmond  
14 ("Richmond") and Peter Muntou ("Muntou" or "Debtor"). Washington  
15 Mutual Bank, F.A. ("Bank") financed the project and disbursed the  
16 loan proceeds directly to CPWH based upon invoices presented by  
17 the subcontractors. CPWH, however, failed to pay over these  
18 funds to certain subcontractors.

19 In March 2002, subcontractor Concept General Contracting,  
20 Inc. filed a suit in Texas state court against CPWH and Richmond  
21 for nonpayment. Moravits filed a petition in intervention  
22 against Muntou alleging, among other claims, that he violated the  
23 Texas Construction Trust Fund Statute<sup>3</sup> (the "state court action").  
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25 <sup>2</sup> The BAP granted leave to appeal this interlocutory order  
26 on November 29, 2005.

27 <sup>3</sup> The Texas Construction Trust Fund Statute (sometimes  
28 referred to herein as the "Texas statute") is set forth under  
Chapter 162 of the Texas Property Code.

(continued...)

1  
2           <sup>3</sup>(...continued)  
3           Section 162.001(a) provides

4                   (a) Construction payments are trust funds  
5                   under this chapter if the payments are made  
6                   to a contractor or subcontractor or to an  
7                   officer, director, or agent of a contractor  
8                   or subcontractor, under a construction  
9                   contract for the improvement of specific real  
10                   property in this state.

11           Section 162.002 states

12                   A contractor, subcontractor, or owner or an  
13                   officer, director, or agent of a contractor,  
14                   subcontractor, or owner, who receives trust  
15                   funds or who has control or direction of  
16                   trust funds, is a trustee of the trust funds.

17           Pursuant to § 162.031, the Texas statute is triggered by

18                   (a) A trustee who, intentionally or knowingly  
19                   or with intent to defraud, directly or  
20                   indirectly retains, uses, disburses, or  
21                   otherwise diverts trust funds without first  
22                   fully paying all current or past due  
23                   obligations incurred by the trustee to the  
24                   beneficiaries of the trust funds, has  
25                   misapplied the trust funds.

26           The following provisions also provide for a "safe harbor"  
27           for certain uses of these trust funds (affirmative defenses):

28                   (b) It is an affirmative defense to  
29                   prosecution or other action brought under  
30                   [s]ubsection (a) that the trust funds not  
31                   paid to the beneficiaries of the trust were  
32                   used by the trustee to pay the trustee's  
33                   actual expenses directly related to the  
34                   construction or repair of the improvement or  
35                   have been retained by the trustee, after  
36                   notice to the beneficiary who has made a  
37                   request for payment, as a result of the  
38                   trustee's reasonable belief that  
39                   the beneficiary is not entitled to such funds  
40                   or have been retained as authorized or  
41                   required by Chapter 53.

(continued...)

1 Munton did not respond to the state court action and, as a  
2 result, in May 2002, a default judgment was entered in the amount  
3 of \$168,813.31 (the "default judgment"). The default judgment  
4 provided that Munton "violated the Texas statute and breached  
5 fiduciary duties."

6 In May 2003, Munton filed a chapter 7 petition. Thereafter,  
7 Moravits timely commenced a complaint for nondischargeability  
8 pursuant to § 523(a)(4)<sup>4</sup>. Debtor answered with a general denial  
9 and pled various affirmative defenses.

10 Moravits filed a motion for summary judgment ("MSJ"),  
11 requesting that the bankruptcy court give collateral estoppel  
12 effect to the default judgment and determine the debt  
13 nondischargeable.

14 Relying heavily on the Fifth Circuit's decision in Coburn  
15 Co. of Beaumont v. Nicholas (In re Nicholas), 956 F.2d 110 (5th  
16 Cir. 1992), Debtor responded that under the Texas statute, an  
17 express trust (within the meaning of § 523(a)(4)) is only  
18 established upon specific findings that a contractor misapplied  
19

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20  
21 <sup>3</sup>(...continued)

22 (c) It is also an affirmative defense to  
23 prosecution or other action brought under  
24 Subsection (a) that the trustee paid the  
25 beneficiaries all trust funds which they are  
entitled to receive no later than 30 days  
following written notice to the trustee of  
the filing of a criminal complaint or other  
notice of a pending criminal investigation.

26 <sup>4</sup> Unless otherwise indicated, all chapter, section and rule  
27 references are to the Bankruptcy Code, 11 U.S.C. §§ 101-1330, and  
28 to the Federal Rules of Bankruptcy Procedure, Rules 1001-9036, as  
enacted and promulgated prior to the effective date (October 17,  
2005) of The Bankruptcy Abuse Prevention and Consumer Protection  
Act of 2005, Pub. L. 109-8, 119 Stat. 23 (2005).

1 funds covered under the statute. Because no such findings were  
2 made, there was no per se violation of the Texas statute, hence,  
3 the elements of § 523(a) (4) were not satisfied by the default  
4 judgment alone.

5 Moravits disputed the application of Nicholas, arguing that  
6 in Nicholas, unlike in the instant case, there were no prior  
7 state court findings that the debtor had violated the Texas  
8 statute. Moravits further argued that Ninth Circuit law, and not  
9 that of the Fifth Circuit, applied. In Nicholas, the Fifth  
10 Circuit imposed upon the plaintiff the burden of disproving the  
11 existence of affirmative defenses. Id. at 114. Specifically,  
12 the court found that because the plaintiff had failed to  
13 establish, in Texas, the absence of affirmative defenses under  
14 the Texas statute, no trust relationship existed for purposes of  
15 § 523(a) (4). Id. By contrast, in Otto v. Niles (In re Niles),  
16 106 F.3d 1456 (9th Cir. 1997), the Ninth Circuit held that the  
17 burden of establishing affirmative defenses remains with the  
18 defendant debtor.

19 The bankruptcy court agreed with Moravits that the default  
20 judgment conclusively determined that Debtor had violated the  
21 Texas statute by not paying over the funds he received from the  
22 Bank to Moravits for that purpose. In addition, the court found  
23 that the affirmative defense was not an element of a cause of  
24 action brought pursuant to the Texas statute. However, in  
25 choosing to adopt the reasoning in Nicholas, the court held that  
26 for there to be a § 523(a) (4) violation, Moravits would need to  
27 establish not only a breach of the construction trust fund  
28 provision of the Texas statute, but also a breach of § 523(a) (4).

1 In order to establish a breach of § 523(a)(4), the court  
2 indicated that Moravits would have to produce evidence which  
3 proved that Debtor was in a fiduciary relationship within the  
4 meaning of § 523(a)(4), which he breached by knowingly or  
5 purposely misapplying the loan proceeds under the Texas statute.

6 Based on its decision, the bankruptcy court granted summary  
7 adjudication in Moravits' favor as to there being a breach of the  
8 Texas statute by Debtor. However, because the court believed  
9 that a material issue still remained as to whether Debtor had the  
10 specific knowledge or intent to misapply the loan proceeds, it  
11 offered Moravits the opportunity to either advance the matter to  
12 trial on the issue of the misapplication of trust funds or to  
13 appeal the denial of summary judgment.

14 Moravits filed a notice of appeal from the denial order, and  
15 the BAP granted leave to appeal.

## 16 **II. JURISDICTION**

17 The bankruptcy court had jurisdiction under 28 U.S.C. § 1334  
18 and §§ 157(b)(1) and (b)(2)(I). We have jurisdiction under 28  
19 U.S.C. §§ 158(b)(1) and (c)(1).

## 20 **III. ISSUE**

21 Whether a default judgment, finding a violation of the Texas  
22 Construction Trust Fund Statute, is entitled to collateral  
23 estoppel effect in a § 523(a)(4) nondischargeability action.

## 24 **IV. STANDARD OF REVIEW**

25 We review a decision concerning a motion for summary  
26 judgment de novo. Consol. Marketing, Inc. v. Marvin Props., Inc.  
27 (In re Marvin Props., Inc.), 854 F.2d 1183, 1185 (9th Cir. 1988);  
28 Woodworking Enters., Inc. v. Baird (In re Baird), 114 B.R. 198,

1 201 (9th Cir. BAP 1990). The task of an appellate court in  
2 reviewing a summary judgment matter is the same as a trial court  
3 under Fed. R. Civ. P. 56<sup>5</sup>. Hifai v. Shell Oil Co., 704 F.2d  
4 1425, 1428 (9th Cir. 1983). In this case, we must determine  
5 whether the bankruptcy court correctly found that there was a  
6 genuine issue of material fact. Id.; see also Fed. R. Civ. P.  
7 56(c).

8 We also review de novo the bankruptcy court's decision on  
9 the availability of collateral estoppel. Baldwin v. Kirkpatrick  
10 (In re Baldwin), 245 B.R. 131, 134 (9th Cir. BAP 2000).

11 Whether a person is a "fiduciary" for purposes of  
12 § 523(a)(4) is a question of law also reviewed de novo. Lovell  
13 v. Stanifer (In re Stanifer), 236 B.R. 709, 713 (9th Cir. BAP  
14 1999).

## 15 V. DISCUSSION

### 16 A. Affirmative Defenses Not Raised in a Prior State Court 17 Action May Not be Asserted in a Subsequent Dischargeability 18 Proceeding

19 The doctrine of collateral estoppel, or issue preclusion,  
20 applies in dischargeability proceedings to preclude the re-  
21 litigation of state court findings relevant to dischargeability.  
22 Grogan v. Garner, 498 U.S. 279, 284 n.11 (1991). We apply the  
23 issue preclusion principles of the state from which the judgment  
24 originates. Cal-Micro, Inc. v. Cantrell (In re Cantrell), 329  
25 F.3d 1119, 1123 (9th Cir. 2003).

26 Under Texas law, issue preclusion may be applied where  
27 1) the facts sought to be litigated were fully and fairly

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28 <sup>5</sup> Fed. R. Civ. P. 56(c) is made applicable to the instant proceeding by Fed. R. Bankr. P. 7056.

1 litigated in a prior proceeding; 2) the same facts were essential  
2 to the judgment in the prior action; and 3) the parties were  
3 adversaries in the prior action. Bonniwell v. Beech Aircraft  
4 Corp., 663 S.W.2d 816, 818 (Tex. 1984). The Fifth Circuit,  
5 interpreting Texas law on the doctrine, has held that, as to  
6 default judgments, the fully and fairly litigated requirement is  
7 satisfied only where the state court has conducted an evidentiary  
8 hearing prior to the entry of the default judgment. Pancake v.  
9 Reliance Ins. Co. (In re Pancake), 106 F.3d 1242, 1244 (5th Cir.  
10 1997).

11 Without challenging the efficacy of the Fifth Circuit's  
12 interpretation, we note that under Texas law a default judgment  
13 represents an admission of the facts properly alleged in the  
14 plaintiff's petition. Stoner v. Thompson, 578 S.W.2d 679, 684-85  
15 (Tex. 1979). Moreover, a defendant must plead, prove, and secure  
16 findings of any affirmative defenses. See Woods v. William M.  
17 Mercer, Inc., 769 S.W.2d 515, 517 (Tex. 1988). When a defendant  
18 fails to answer, he provides no evidence to support any  
19 affirmative defenses. Love v. State Bar, 982 S.W.2d 939, 943  
20 (Tex. App. 1998). Therefore, a defendant who fails to answer  
21 waives any affirmative defenses. Id.; see also Stoner, 578  
22 S.W.2d at 684-85; Simon v. BancTexas Quorum, N.A., 754 S.W.2d  
23 283, 286 (Tex. App. 1988); Lakeside Leasing Corp. v. Kirkwood  
24 Atrium Office Park Phase 3, 750 S.W.2d 847, 850 (Tex. App. 1988).  
25 We, therefore, conclude that, under Texas state law, Debtor is  
26 precluded, from asserting in the dischargeability action, any  
27 affirmative defenses that could have, and should have, been  
28 raised in connection with the state court action.



1 B. The Texas Construction Trust Fund Statute Creates a  
2 Fiduciary Relationship for Purposes of § 523(a)(4)

3 Section 523(a)(4) provides that an individual debtor is not  
4 discharged from any debt "for fraud or defalcation while acting  
5 in a fiduciary capacity, embezzlement or larceny."

6 "Fiduciary capacity" is defined and governed by federal law,  
7 which narrowly restricts the term to fiduciary relationships that  
8 arise from express or technical trusts. Lee-Benner v. Gergely  
9 (In re Gergely), 110 F.3d 1448, 1450 (9th Cir. 1997) (quoting  
10 Ragsdale v. Haller, 780 F.2d 794, 796 (9th Cir. 1986)); Lewis v.  
11 Scott (In re Lewis), 97 F.3d 1182, 1185 (9th Cir. 1996). The  
12 broad general definition of a fiduciary relationship, i.e., a  
13 relationship of confidence, trust or good faith, is not relevant  
14 in the dischargeability context. Ragsdale, 780 F.2d at 796.

15 Though the definition of "fiduciary capacity" is guided by  
16 federal law, we look to state law to determine whether the  
17 requisite trust relationship exists. Id. A debtor will be  
18 deemed a fiduciary if state law creates an express or technical  
19 trust relationship which imposes trustee status upon the debtor.  
20 Id.; see also Blyler v. Hemmeter (In re Hemmeter), 242 F.3d 1186,  
21 1190 (9th Cir. 2001) ("Fiduciary relationships imposed by statute  
22 may cause the debtor to be considered a fiduciary under  
23 § 523(a)(4)."). Generally, a trust exists where the statute  
24 defines the res, sets forth the fiduciary duties, and imposes a  
25 trust prior to, and without reference to, the wrong for which the  
26 debt arose. In re Hemmeter, 242 F.3d at 1190. This general

1 principle applies to state construction trust fund statutes.<sup>6</sup>

2 See In re Faulkner, 213 B.R. at 665.

3 In Baird, a case involving Arizona law, we surveyed the  
4 murky landscape of published decisions grappling with the  
5 application of state-created contractor trusts to the federal  
6 standard of "fiduciary" within the context of § 523(a)(4):

7 At one end of the spectrum, courts hold that  
8 statutes which only impose criminal or other  
9 penalties for the failure of a contractor to  
10 make a certain disposition of construction  
11 funds do not create fiduciary capacity for  
12 dischargeability purposes. These courts  
13 reason that any trust relationship that is  
14 created by such statutes does not arise prior  
15 to and independently of the wrong. At the  
16 other end of the spectrum, courts hold that  
17 statutes which expressly designate the funds  
18 received by the contractor as trust funds and  
19 which explicitly impose specific and detailed  
20 duties on the contractor regarding the funds  
21 create a fiduciary relationship for  
22 dischargeability purposes.

23 Between the two ends of the spectrum are  
24 cases, such as this one, dealing with statutes  
25 which refer to the funds as trust funds, but  
26 which do not explicitly impose specific and  
27 detailed duties upon the contractor with  
28 respect to those funds . . . . The Ninth  
Circuit has indicated that such statutes create

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29  
30 <sup>6</sup> Construction fund statutes, common in many states,  
purport

31 to raise a "trust" in favor of subcontractors  
32 or suppliers against contractors who have  
33 received payment on a given job ahead of  
34 them. The trust is discharged when the  
35 contractor applies the monies it receives  
36 towards the payment of these subcontractors  
37 or suppliers. Such statutes, while couched  
38 in trust language, may, but do not  
necessarily, create the requisite fiduciary  
relationship for purposes of section  
523(a)(4) analysis.

39 Airtron, Inc. v. Faulkner (In re Faulkner), 213 B.R. 660, 665  
(Bankr. W.D. Tex. 1997).

1 true fiduciary relationships for dischargeability  
2 purposes.

3 114 B.R. at 202-03 (citations omitted).

4 In our analysis of cases involving trust fund statutes with  
5 no specific trustee duties, we closely reviewed two important  
6 decisions from the Fifth Circuit in light of the BAP's decision  
7 in Baird. In Carey Lumber Co. v. Bell, 615 F.2d 370 (5th Cir.  
8 1980), we observed that while the applicable Oklahoma statute did  
9 not impose specific trustee duties, the Fifth Circuit  
10 nevertheless found that it "expressly prohibits the diversion or  
11 use of [trust] funds for any purpose other than to satisfy the  
12 claims of [beneficiaries]," thereby creating a fiduciary  
13 relationship for purposes of dischargeability. In re Baird, 114  
14 B.R. at 203-04. We distinguished Carey Lumber from the Fifth  
15 Circuit's subsequent decision in Boyle v. Abilene Lumber, Inc.  
16 (In re Boyle), 819 F.2d 583 (5th Cir. 1987), a case involving an  
17 earlier version of the Texas statute in which the court  
18 determined that the requisite trust relationship did not exist,  
19 explaining that the statute only prohibited the fraudulent  
20 misapplication of trust funds. In re Baird, 114 B.R. at 203-04.  
21 As such, to the extent that Boyle was indistinguishable from  
22 Carey Lumber and supported a contrary result, we were unpersuaded  
23 by the Boyle analysis. Id.

24 Subsequent to our decision in Baird, the Texas statute was  
25 expanded to include both the "intentional" and "knowing"  
26 diversion of trust funds.<sup>7</sup> The Fifth Circuit re-examined the

27  
28  

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<sup>7</sup> The Texas statute was amended in 1987 to broaden the  
scienter requirements to include "intentional" and "knowing"  
diversion of funds, and to create affirmative defenses. TEX PROP.  
CODE ANN. § 162.031(a); In re Nicholas, 956 F.2d at 112.

1 statute under Nicholas and determined that Boyle remained good  
2 law. In re Nicholas, 956 F.2d at 113. It opined that although  
3 the amended statute was significantly broadened, it still did not  
4 rise to the level of Carey Lumber or Baird. Id. According to  
5 Nicholas, the Texas statute, unlike Carey Lumber (Oklahoma law)  
6 and Baird (Arizona law), failed to create an express trust  
7 because it did not require the segregation of funds. Id. The  
8 statute, instead, excused the general misapplication of trust  
9 funds if it was found that they were used to pay "actual expenses  
10 directly related to the construction or repair of [an]  
11 improvement." TEX PROP. CODE ANN. § 162.031(b). The Fifth Circuit,  
12 in interpreting the Texas statute in the context of  
13 dischargeability, effectively shifted the burden of proof onto the  
14 plaintiff to not only prove that funds were paid to the defendant  
15 for the benefit of plaintiff - but that the funds were  
16 misapplied. Id. It concluded that the Texas statute created a  
17 limited trust for purposes of § 523(a)(4) that only arose where  
18 the funds were found to be misapplied (retained, used, or  
19 diverted to any use other than "actual expenses directly related  
20 to the construction or repair of [an] improvement").<sup>8</sup> Id. at

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21  
22 <sup>8</sup> We note that the Fifth Circuit's rationale contravenes  
23 well established bankruptcy case law that the trust cannot be  
24 created as a result of the debt. See Davis v. Aetna Acceptance  
Co., 293 U.S. 328, 333 (1934); In re Lewis, 97 F.3d at 1185.

25 In Faulkner, a bankruptcy case from the Western District of  
26 Texas, the court grudgingly followed Nicholas, but pointed out  
27 that

28 One may quibble with the Fifth Circuit's  
analysis on this point, as it seems to raise  
the trust only in the event the debtor acts  
in a fashion prohibited by the statute,  
seemingly permitting an action to be brought  
on what amounts to a trust ex maleficio.

(continued...)

1 113. We decline to follow the Fifth Circuit.

2 In Baird, we found that the Arizona statute created  
3 fiduciary duties for purposes of dischargeability even though the  
4 statute itself, like in Carey Lumber (Oklahoma law), did not  
5 expressly oblige the contractor to maintain the separate identity  
6 of any of the funds, nor did the law require segregation or  
7 separate bookkeeping obligations. 114 B.R. at 203.

8 Nevertheless, we found that because the Arizona statute  
9 prohibited diversion or use of trust funds for any other purpose  
10 other than to satisfy the claims of beneficiaries, a trust was  
11 created for purposes of § 523(a)(4). Id. at 203-204.

12 In examining the current version of the Texas statute post-  
13 Boyle, we find that the amended statute has been sufficiently  
14 enlarged to create fiduciary duties for purposes of  
15 dischargeability. As noted above, in Baird, we observed that the  
16 earlier statute was limited to the fraudulent misapplication of  
17 funds. See In re Baird, 114 B.R. at 203 ("The Texas statute at  
18 issue in Boyle prohibits only the fraudulent misapplication of  
19 trust funds. In other relevant respects, the Texas statute is  
20 similar to . . . Carey Lumber Co."). We believe, however, that  
21 as the scienter requirements have been broadened, the Texas  
22 statute is now substantively indistinguishable from the Oklahoma

23  
24 <sup>8</sup>(...continued)

25 Nonetheless, this court is constrained to  
26 follow what it views to be binding precedent.  
27 The Fifth Circuit has, in effect, carved out  
28 a special exception from its general rule  
regarding trusts ex maleficio (which are  
generally not actionable under section  
523(a)(4)) for trusts "raised" by the conduct  
of contractors in misapplying funds subject  
to Texas' construction trust fund statute.

213 B.R. at 665 n.9.

1 and Arizona statutes, and therefore, is now in line with Carey  
2 Lumber and Baird. Thus, the Texas statute sufficiently satisfies  
3 the "fiduciary capacity" requirements for purposes of  
4 § 523(a)(4).

5 The Texas statute, as amended, exhibits the characteristics  
6 of a traditional trust relationship as established by the Ninth  
7 Circuit. A trust exists where the statute: (1) defines the res;  
8 (2) sets forth the fiduciary duties; and (3) imposes a trust  
9 prior to the wrong for which the debt arose. See In re Hammeter,  
10 242 F.3d at 1190; see also Runnion v. Pedrazzini (In re  
11 Pedrazzini), 644 F.2d 756, 759 n.2 (9th Cir. 1981). The Texas  
12 statute clearly defines the trust res, i.e. construction payments  
13 made to a contractor "under a construction contract for the  
14 improvement of specific real property in [Texas]." TEX. PROP. CODE  
15 ANN. § 162.001(a). The Texas statute imposes fiduciary duties by  
16 prohibiting the intentional use or retention of the trust funds  
17 without first paying all obligations owed to the beneficiaries.  
18 Id. § 162.031(a). Contrary to the holding in Nicholas, proof  
19 that the trustee used trust funds, that were not paid to the  
20 beneficiaries, to pay related expenses is relevant only to  
21 determine if the trustee breached his fiduciary duty, and not  
22 whether the Texas statute creates a trust. Id. §§ 162.031(a) &  
23 (b). Finally, the Texas statute imposes the trust upon receipt  
24 of the trust funds, prior to any wrongful conduct by the trustee.  
25 Id. § 162.002.

26 In addition, in the Ninth Circuit, under Niles, 106 F.3d at  
27 1462, it has been established that the creditor bears the burden  
28 of proving that the debtor was a fiduciary to whom funds had been

1 entrusted. The burden then shifts to debtor "to account fully  
2 for all funds received . . . for [creditor's] benefit, by  
3 persuading the trier of fact that she complied with her fiduciary  
4 duties . . . ." Id.

5 Here, Moravits satisfied its burden of proof by establishing  
6 that Debtor was a fiduciary to whom funds had been entrusted  
7 under the Texas statute. The bankruptcy court erred when it  
8 applied Nicholas and determined that it was Moravits' burden to  
9 disprove Debtor's affirmative defenses, i.e., that the loan  
10 proceeds were not used to pay expenses allowed under Tex. Prop.  
11 Code § 162.031(b), as it is contrary to Ninth Circuit law.

12 C. The Record Supports a Finding of Defalcation for Purposes of  
13 § 523(a)(4)

14 A defalcation is a "failure of a party to account for money  
15 or property that has been entrusted to them." In re Baird, 114  
16 B.R. at 204. For purposes of § 523(a)(4), defalcation includes  
17 "innocent, as well as the intentional or negligent defaults so as  
18 to reach the conduct of all fiduciaries who were short in their  
19 accounts." Id.

20 The bankruptcy court found that Debtor failed to account for  
21 loan proceeds received and not paid to Moravits:

22 THE COURT: I'm satisfied as of this point in  
23 time of the following: that is, the Texas  
24 court made a determination expressly that it  
25 had both subject matter and in personam  
26 jurisdiction over the parties, including  
27 [Debtor]; secondly, it found and granted the  
28 judgment for breach of the construction trust  
fund provisions of the Texas law, chapter  
162, reflecting that funds were paid to the  
general contractor CPWH; that the funds were  
not paid to the plaintiff, Moravits. And  
that's what appears to be the elements of a  
cause of action under the construction trust  
fund provision.

