NOT FOR PUBLICATION

**UNITED STATES BANKRUPTCY APPELLATE PANEL**

**OF THE NINTH CIRCUIT**

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| In re | ) | BAP No. NV-04-1398-SKP |
| VERONICA P. CORNELL, | ) | Bk. No. S-01-13281 |
| Debtor. | ) | Adv. No. 02-01285 |
| VERONICA P. CORNELL, | ) | |
| Appellant, | ) | |
| v. | ) | **MEMORANDUM**[1] |
| U.S. ENERGY CORP.; GARY BENDA, | ) | |
| Appellees. | ) | |

Argued and Submitted on
June 23, 2005 at Las Vegas, Nevada

Filed - February 23, 2006

Appeal from the United States Bankruptcy Court
for the District of Nevada

Honorable Robert C. Jones, Bankruptcy Judge, Presiding

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Before: SMITH, KLEIN and PERRIS, Bankruptcy Judges.

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[1] This disposition is not appropriate for publication and may not be cited except when relevant under the doctrine of law of the case or rules of res judicata, including claim and issue preclusion. See 9th Cir. BAP Rule 8013-1.

The debtor, Veronica Cornell, appeals a judgment that excepts from discharge two judgment debts totaling $185,000 under 11 U.S.C. §§ 523(a)(4) and (a)(6). We AFFIRM.

**FACTS**

U.S. Energy Corporation ("U.S. Energy") is a statutory close corporation organized in 1994 under the South Carolina Close Corporation Supplement to the South Carolina Business Corporation Act, S.C. Code § 33-1-101 et seq., with two shareholders. The debtor Cornell was majority shareholder and President and Director. Gary Benda was minority shareholder and Senior Vice President, Secretary and Treasurer.

In October 1995, Benda filed an action in the Aiken County Court of Common Pleas (South Carolina) against both Cornell and U.S. Energy seeking remedies for alleged corporate misconduct. In July 1997, a trial was held on the jury and non-jury issues. The jury awarded Benda "$1,760,000.00 in actual damages against Cornell for her breach of fiduciary duty." Order, Benda v. U.S. Energy Corp. & Veronica P. Cornell, Court of Common Pleas, Second Judicial Circuit, Aiken County, South Carolina, No. 95-CP-02-849 (July 31, 1998), at p. 6.

The non-jury issues relating to dissolution, accounting, and professional fees were taken under submission by the trial court, which ordered in July 1998, based on thirty pages of findings of fact and conclusions of law determining that Cornell was (among other things) wasting corporate assets for her personal benefit, had abandoned the basic functioning of the corporation, and was engaging in self-dealing, that Cornell's powers and authority be

suspended and transferred to Benda and that Benda take control of all corporate property and records. Id. at pp. 27-29.

Benda thereupon assumed the position of Chief Operating Officer.

On October 15, 1998, U.S. Energy, fueled by what Benda had learned after taking control, commenced another state court action against Cornell on the basis of further waste of corporate assets that had occurred after the first trial. The items of waste alleged in the complaint exceeded $200,000.

The state court granted partial summary judgment and entered a judgment against Cornell for $50,000 ("$50,000 Judgment") with respect to two of the items alleged, payments of $10,000 (in April 1998) and $40,000 (in July 1998) to the South Carolina Department of Revenue and the United States Internal Revenue Service, respectively, for tax deposits that solely benefitted Cornell. As to these tax deposit transactions, the state court determined that Cornell distributed the funds without obtaining the requisite shareholder approval in direct contravention of the corporate bylaws. The state court also found that the $40,000 distribution was made in violation of a state court order freezing Energy's assets.

The South Carolina court explained the basis for its entry of the $50,000 Judgment in an order that included the following:

> In April, 1998, the check Cornell caused to be issued for her federal tax deposit was in the amount of $78,000, not in an identical amount issued to Benda ($69,000) as she had testified before Judge Smoak in May, 1998 or as Benda had conditioned his ratification. However there was another, unknown $10,000 distribution made on behalf of Cornell as a deposit for state income taxes which was not discovered until after Benda had access to the corporate books and records after July 31. This payment was not

> disclosed at the May, 1998 hearing and was not mentioned in Benda's written ratification of what he believed to be distributions of identical amounts.

Amended Order, Court of Common Pleas, Second Judicial Circuit, Aiken County, South Carolina, No. 98-CP-02-1024, Sep. 21, 1999, at p. 4 ("Amended Order").

> In a second unsworn written statement submitted at the hearing, Cornell asserts that attorneys then representing the corporation were to have notified Benda and his counsel of this second distribution, and blames them for not doing so. At best, this shows that Benda's consent, which she knew was required, was not obtained. That alone is enough to require repayment of that distribution. The timing of the issuance of the check in light of the freeze on assets and the fact that hers was deposited the day it was issued, while Benda's was not mailed for nearly a week presents a basis for a conclusion that more than a mere mistake was involved. Regardless, Judge Smoak's Order of July 10, 1998 prohibited the distribution from being made, and this is a second reason which in and of itself is sufficient to require the $40,000 to be repaid.

Amended Order, at p. 7.

> The shareholder agreement of a statutory close corporation may regulate the business and affairs of the corporation, including restricting discretion normally vested in its directors. S.C. Code § 33-18-200. It is undisputed that U.S. Energy's shareholders agreed that no dividend distributions would be made without shareholder approval.
>
> Cornell's acts regarding the two distributions before the court while she was in control of U.S. Energy violated the undisputed provision of the agreement between the shareholders. In addition, the July 10th distribution violated a Court order issued in an action in which Cornell individually, as well as the corporation, were parties. Such violations constitute a breach of her fiduciary duty to the corporation as an officer and director to discharge her duties "in the best interests of the corporation and its shareholders." S.C. Code § 33-8-300(a).

Amended Order, at pp. 7-8.

When the trial began in September 2000 on the other waste issues, which exceeded $150,000, that were at issue in U.S. Energy's action in September 2000, Cornell consented to the entry of judgment for $135,000 in compromise of all remaining claims

against her ("$135,000 Judgment").

On April 9, 2001, Cornell filed a chapter 13 case in the District of Nevada, which case was converted to a chapter 7 on May 17, 2002.

Energy and Benda initiated a timely adversary proceeding seeking to except from discharge the $50,000 Judgment and the $135,000 Judgment, as well as the amounts awarded to Benda in the 1997 jury verdict that included the $1,760,000 award for breach of fiduciary duty. The complaint, which invoked §§ 523(a)(4) and (a)(6), alleged that Cornell breached her fiduciary duty by wasting assets of the corporation, abandoning the company, draining capital of the company, and using the company's assets for her own personal benefit.

Before the final trial of the adversary proceeding, Benda and Cornell settled with respect to the counts based on the 1997 jury verdict. That left for trial only the U.S. Energy counts regarding the $50,000 Judgment and the $135,000 Judgment.

Following a trial, which included a review of the records of the South Carolina state court litigation, the bankruptcy court found in favor of U.S. Energy and excepted from discharge the $50,000 Judgment under §§ 523(a)(4) and (a)(6), and the $135,000 Judgment under § 523(a)(6).

This timely appeal ensued.

**ISSUES ON APPEAL**

1. Whether the bankruptcy court erred in excepting from discharge the $50,000 Judgment.
2. Whether the bankruptcy court erred in excepting from

discharge the $135,000 Judgment.

**JURISDICTION**

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

**STANDARD OF REVIEW**

The bankruptcy court's findings of fact are reviewed for clear error and its conclusions of law regarding non-dischargeability are reviewed de novo. First Del. Life Ins. Co. v. Wada (In re Wada), 210 B.R. 572, 575 (9th Cir. BAP 1997); Lin v. Ehrle (In re Ehrle), 189 B.R. 771, 774 (9th Cir. BAP 1995).

**DISCUSSION**

Although the bankruptcy court ruled that the $50,000 Judgment and the $135,000 Judgment were nondischargeable under a theory of willful and malicious conduct per § 523(a)(6) and that, in addition, the $50,000 was nondischargeable under § 523(a)(4) on an embezzlement theory, we view the appeal as presenting a straightforward example of the fraud or defalcation while acting in a fiduciary capacity that was alleged in the pleadings in the counts stated under § 523(a)(4). Hence, rather than delve into the precise reasoning by the bankruptcy judge, we will resolve the appeal on the basis alleged in the pleadings as an exercise of our authority to affirm for any reason supported by the record. Dittman v. California, 191 F.3d 1020, 1027 n.3 (9th Cir. 1999); Donald v. Curry (In re Donald), 328 B.R. 192, 204 (9th

Cir. BAP 2005).

I

We begin the analysis with the $50,000 Judgment that was premised on the South Carolina court's determination that Cornell's violations in using corporate funds to pay her personal tax liabilities "constitute a breach of her fiduciary duty to the corporation as an officer and director to discharge her duties 'in the best interests of the corporation and its shareholders.' S.C. Code § 33-8-300(a)." Amended Order, at p. 8.

Excepted from discharge by virtue of § 523(a)(4) are debts "for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny." 11 U.S.C. § 523(a)(4).

Whether a relationship is fiduciary is a question of federal law in which the key question is whether the fiduciary relationship arises from an express or technical trust that was imposed before and without reference to the wrongdoing that caused the debt. Davis v. Aetna Acceptance Co., 293 U.S. 328, 333 (1934); Lewis v. Scott (In re Lewis), 97 F.3d 1182, 1185 (9th Cir. 1996). Whether a fiduciary is a trustee in that strict and narrow sense is determined in part by referring to state law. Lewis, 97 F.3d at 1185; Ragsdale v. Haller, 780 F.2d 794, 795 (9th Cir. 1986).

In this instance, the fiduciary duty of the officer and director of a South Carolina close corporation is statutory and governed by S.C. Code § 33-8-300(a). Moreover, the South Carolina court ruled that Cornell was a fiduciary by virtue of her status as corporate officer and shareholder.

Cornell's fiduciary status arose when she became an officer and director, long before the conduct occurred that gave rise to liability. It follows that Cornell was a fiduciary for purposes of § 523(a)(4).

The question then becomes whether Cornell committed defalcation while acting in a fiduciary capacity when she made the two tax deposits on account of her personal state and federal income taxes.

Defalcation includes misappropriation of trust funds or failure to properly account for such funds and includes innocent, as well as intentional or negligent, defaults. Thus, one may be liable for a § 523(a)(4) fiduciary defalcation without having an intent to defraud. Lewis, 97 F.3d at 1186-87, disapproving Martin v. Fid. & Dep. Co. of Md. (In re Martin), 161 B.R. 672, 678 (9th Cir. BAP 1993).[2]

The ruling of the South Carolina court that Cornell was a fiduciary and breached her fiduciary duties when she used $50,000 in corporate funds to make deposits on account of her personal tax liabilities amply supports the conclusion that the $50,000 Judgment is a debt based on a nondischargeable § 523(a)(4) fiduciary defalcation.

[2] Even if there is a requirement of circumstances indicating fraud in order to have a § 523(a)(4) fiduciary defalcation, the record before us amply demonstrates circumstances indicating fraud. Hence, we need not remand in order to ask the bankruptcy court for a ruling. See Wada, 210 B.R. at 577 (determining circumstances indicating fraud from face of record on appeal).

II

The $135,000 Judgment was based on the settlement on the first day of trial of the remaining claims by U.S. Energy against Cornell in the same action in which the $50,000 Judgment had been entered. The claims related to a miscellany of uses of corporate funds to pay more than $150,000 in expenses alleged to be attributable to Cornell's personal interests, as well as potentially larger sums resulting from the manner in which she abandoned the corporation's business and relegated to a source of funds for her personal purposes.

The bankruptcy court correctly focused on the overall course of conduct and concluded that the $135,000 Judgment was the product of one continuous course of conduct as to which the findings by "four different decision makers was clearly to the effect that she did not have the right to abandon and waste." Partial Tr. of Proceedings of [Bankruptcy] Judge's Ruling (Nov. 26, 2003), at 28.

We are persuaded that the $135,000 Judgment to which Cornell agreed on the first day of trial in the state court is so firmly rooted in the course of conduct that multiple triers of fact in South Carolina had determined to constitute fiduciary breaches with respect to the close corporation of which she was officer and director, that it likewise constitutes a debt based on a nondischargeable § 523(a)(4) fiduciary defalcation.

**CONCLUSION**

In sum, we hold that the record establishes the existence of nondischargeable fiduciary defalcation under § 523(a)(4) with

respect to the $50,000 Judgment and the $135,000 Judgment. That basis for nondischargeability represented the primary theory of U.S. Energy from the outset of the adversary proceeding. In view of our conclusion, it is not necessary for us to explore whether there was, as found by the bankruptcy court, either § 523(a)(4) embezzlement or § 523(a)(6) willful and malicious conduct. AFFIRMED.