

**FEB 23 2006**

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

**NOT FOR PUBLICATION**

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

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.	)	<b>MEMORANDUM<sup>1</sup></b>	
	)		
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

Before: SMITH, KLEIN and PERRIS, Bankruptcy Judges.

<sup>1</sup> 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.

1 The debtor, Veronica Cornell, appeals a judgment that  
2 excepts from discharge two judgment debts totaling \$185,000 under  
3 11 U.S.C. §§ 523(a)(4) and (a)(6). We AFFIRM.

4  
5 **FACTS**

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

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

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

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

3 Benda thereupon assumed the position of Chief Operating  
4 Officer.

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

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

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

24 In April, 1998, the check Cornell caused to be issued  
25 for her federal tax deposit was in the amount of \$78,000,  
26 not in an identical amount issued to Benda (\$69,000) as she  
27 had testified before Judge Smoak in May, 1998 or as Benda  
28 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

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

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

6 In a second unsworn written statement submitted at the  
7 hearing, Cornell asserts that attorneys then representing  
8 the corporation were to have notified Benda and his counsel  
9 of this second distribution, and blames them for not doing  
10 so. At best, this shows that Benda's consent, which she  
11 knew was required, was not obtained. That alone is enough  
12 to require repayment of that distribution. The timing of  
13 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.

14 Amended Order, at p. 7.

15 The shareholder agreement of a statutory close  
16 corporation may regulate the business and affairs of the  
17 corporation, including restricting discretion normally  
18 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.

19 Cornell's acts regarding the two distributions before  
20 the court while she was in control of U.S. Energy violated  
21 the undisputed provision of the agreement between the  
22 shareholders. In addition, the July 10th distribution  
23 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).

24 Amended Order, at pp. 7-8.

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

1 against her (“\$135,000 Judgment”).

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

5 Energy and Benda initiated a timely adversary proceeding  
6 seeking to except from discharge the \$50,000 Judgment and the  
7 \$135,000 Judgment, as well as the amounts awarded to Benda in the  
8 1997 jury verdict that included the \$1,760,000 award for breach  
9 of fiduciary duty. The complaint, which invoked §§ 523(a)(4) and  
10 (a)(6), alleged that Cornell breached her fiduciary duty by  
11 wasting assets of the corporation, abandoning the company,  
12 draining capital of the company, and using the company’s assets  
13 for her own personal benefit.

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

18 Following a trial, which included a review of the records of  
19 the South Carolina state court litigation, the bankruptcy court  
20 found in favor of U.S. Energy and excepted from discharge the  
21 \$50,000 Judgment under §§ 523(a)(4) and (a)(6), and the \$135,000  
22 Judgment under § 523(a)(6).

23 This timely appeal ensued.  
24

25 **ISSUES ON APPEAL**

- 26 1. Whether the bankruptcy court erred in excepting from  
27 discharge the \$50,000 Judgment.  
28 2. Whether the bankruptcy court erred in excepting from

1 discharge the \$135,000 Judgment.

2  
3 **JURISDICTION**

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

7  
8 **STANDARD OF REVIEW**

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

14  
15 **DISCUSSION**

16 Although the bankruptcy court ruled that the \$50,000  
17 Judgment and the \$135,000 Judgment were nondischargeable under a  
18 theory of willful and malicious conduct per § 523(a) (6) and that,  
19 in addition, the \$50,000 was nondischargeable under § 523(a) (4)  
20 on an embezzlement theory, we view the appeal as presenting a  
21 straightforward example of the fraud or defalcation while acting  
22 in a fiduciary capacity that was alleged in the pleadings in the  
23 counts stated under § 523(a) (4). Hence, rather than delve into  
24 the precise reasoning by the bankruptcy judge, we will resolve  
25 the appeal on the basis alleged in the pleadings as an exercise  
26 of our authority to affirm for any reason supported by the  
27 record. Dittman v. California, 191 F.3d 1020, 1027 n.3 (9th Cir.  
28 1999); Donald v. Curry (In re Donald), 328 B.R. 192, 204 (9th

1 Cir. BAP 2005).

3 I

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

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

14 Whether a relationship is fiduciary is a question of federal  
15 law in which the key question is whether the fiduciary  
16 relationship arises from an express or technical trust that was  
17 imposed before and without reference to the wrongdoing that  
18 caused the debt. Davis v. Aetna Acceptance Co., 293 U.S. 328,  
19 333 (1934); Lewis v. Scott (In re Lewis), 97 F.3d 1182, 1185 (9th  
20 Cir. 1996). Whether a fiduciary is a trustee in that strict and  
21 narrow sense is determined in part by referring to state law.  
22 Lewis, 97 F.3d at 1185; Ragsdale v. Haller, 780 F.2d 794, 795  
23 (9th Cir. 1986).

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

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

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

9           Defalcation includes misappropriation of trust funds or  
10 failure to properly account for such funds and includes innocent,  
11 as well as intentional or negligent, defaults. Thus, one may be  
12 liable for a § 523(a)(4) fiduciary defalcation without having an  
13 intent to defraud. Lewis, 97 F.3d at 1186-87, disapproving  
14 Martin v. Fid. & Dep. Co. of Md. (In re Martin), 161 B.R. 672,  
15 678 (9th Cir. BAP 1993).<sup>2</sup>

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

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25           <sup>2</sup> Even if there is a requirement of circumstances indicating  
26 fraud in order to have a § 523(a)(4) fiduciary defalcation, the  
27 record before us amply demonstrates circumstances indicating  
28 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).



1 II

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

11 The bankruptcy court correctly focused on the overall course  
12 of conduct and concluded that the \$135,000 Judgment was the  
13 product of one continuous course of conduct as to which the  
14 findings by "four different decision makers was clearly to the  
15 effect that she did not have the right to abandon and waste."  
16 Partial Tr. of Proceedings of [Bankruptcy] Judge's Ruling (Nov.  
17 26, 2003), at 28.

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

25  
26 **CONCLUSION**

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

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

7 AFFIRMED.

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