

DEC 09 2005

NOT FOR PUBLICATION

**HAROLD S. MARENUS, CLERK
U.S. BKCY. APP. PANEL
OF THE NINTH CIRCUIT**

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

In re:)	BAP No.	CC-05-1144-PaMaMo
)		
JAN AHDOUT,)	Bk. No.	LA 03-36799-BR
)		
Debtor.)	Adv. No.	LA 04-01236-BR
)		
<hr/>			
JAN AHDOUT,)		
)		
Appellant,)		
)		
v.)		
)		
HIGHLANDS INSURANCE COMPANY,)		
)		
Appellee.)		
)		

M E M O R A N D U M¹

Argued and Submitted on November 18, 2005
at Los Angeles, California

Filed - December 9, 2005

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

Honorable Barry Russell, Chief Bankruptcy Judge, Presiding.

Before: PAPPAS, MARLAR AND MONTALI, Bankruptcy Judges.

¹ This disposition is not appropriate for publication and may not be cited except when relevant under the doctrines of law of the case, res judicata, or collateral estoppel. See 9th Cir. BAP Rule 8013-1.

1 This is an appeal of a final order of the bankruptcy court
2 determining that a judgment entered in state court against the
3 debtor, Appellant Jan Ahdout ("Ahdout") in favor of appellee
4 Highlands Insurance Company ("Highlands") for \$178,877.64 is non-
5 dischargeable in Ahdout's bankruptcy case under 11 U.S.C.
6 § 523(a)(4).² We AFFIRM.

7
8 FACTS

9 The material facts are undisputed and are found in a Joint
10 Pretrial Order approved by counsel for Ahdout and Highlands and
11 entered by the bankruptcy court under its Local Rule 7016-1(b).³

12 On December 10, 1992, Ahdout was appointed Conservator of the
13 estate of his father, Yaghoub Ahdout, in proceedings in Los
14 Angeles County Superior Court, Case No. LP 002090. As
15 Conservator, Ahdout had a fiduciary obligation to the
16 conservatorship to safeguard the conservatorship property.⁴

17 Highlands issued a \$362,000 Conservator's fiduciary surety
18 bond to Ahdout to secure his faithful performance as Conservator.
19 As a condition of issuing the bond, Ahdout agreed to indemnify
20 Highlands for any loss or expense arising out of the issuance of
21 the bond.

22 _____
23 ² Unless otherwise noted, all section and chapter references
24 are to the Bankruptcy Code, 11 U.S.C. § 101-1330, and all Rule
references are to the Federal Rules of Bankruptcy Procedure.

25 ³ According to the Joint Pretrial Order, the facts set forth
26 by the parties therein "are admitted and require no further
proof." There is no indication in the record that any party
27 raised any objection at any time to the Joint Pretrial Order.

28 ⁴ This statement, taken from the facts section of the Joint
Pretrial Order, is obviously a legal conclusion rather than a
statement of fact. However, it is no less binding on Ahdout.

1 In August 2000, Ahdout was removed as Conservator. John
2 Mickus was appointed Temporary Conservator.

3 Ahdout filed a verified final account in the conservatorship
4 proceedings. Thereafter, the Temporary Conservator filed
5 objections to Ahdout's accounting. On February 13, 2001, the state
6 court appointed Gerald L. Gerstenfeld (the "Referee") as Mediator
7 and Referee pursuant to a Mediation and Reference Agreement (the
8 "Reference Agreement") signed by Yaghoub Ahdout, John Mickus as
9 Temporary Conservator and Ahdout as Suspended Conservator.
10 Highlands also signed the Reference Agreement at a later date not
11 disclosed in the record. The Reference Agreement empowered the
12 Referee to mediate the parties' disputes and "to the extent that
13 the parties do not agree to a settlement as to any particular
14 issue between them, to act as referee to make certain findings of
15 fact and to submit the same and [his] recommendations with respect
16 thereto to the court." Report of Referee.

17 Highlands filed an indemnity action against Ahdout on March
18 30, 2001, in Los Angeles Superior Court, Case no. LC-055720,
19 seeking collateralization of the anticipated surcharge against
20 Ahdout.

21 On September 10, 2001, the Referee filed the Report of
22 Referee in the conservatorship proceedings. In the Report, the
23 Referee recommended that Ahdout be surcharged by the court for
24 certain unauthorized and not repaid borrowings he made from the
25 conservatorship estate.

26 On December 7, 2001, the court in the conservatorship
27 proceedings entered a minute order concerning Ahdout's final
28 account. It adopted the Referee's recommendation and surcharged

1 Ahdout for his unauthorized borrowing from the conservatorship
2 estate. A final order establishing the amount of the surcharge at
3 \$162,997.27 was entered on December 6, 2002.

4 Highlands was obligated by the bond to pay the surcharge
5 imposed against Ahdout together with interest thereon.⁵ It did so
6 on December 31, 2002, by paying John D. Mickus, now Successor
7 Conservator, \$171,877.64, which was accepted as payment in full
8 including interest.

9 Having signed the indemnity in favor of Highlands, Ahdout
10 later stipulated to the entry of a \$178,877.64 judgment against
11 him, in Highlands's favor in the indemnity action, which amount
12 included \$7,000 payable to Highlands for attorney's fees incurred
13 in the defense of the fiduciary bond claim (the "Judgment Debt").

14 Ahdout filed a chapter 7 bankruptcy petition on October 16,
15 2003. On January 20, 2004, Highlands commenced an adversary
16 proceeding seeking a declaration that the debt represented by the
17 judgment entered against Ahdout in the indemnity action was
18 excepted from discharge under § 523(a)(4).

19 On September 27, 2004, the bankruptcy court entered its
20 "Order Re Presentation of Evidence by Declarations for Court
21 Trial; Filing Joint Pre-Trial Order Pursuant to Local Rule 7016-1"
22 (the "Trial Order"). The Trial Order specified that all witness
23 testimony other than rebuttal testimony be presented by written
24 declaration. The declaration would be admissible only if the
25 declarant was present at the time of trial to submit to cross-
26 examination. The Trial Order also required the parties to

27
28 ⁵ The Panel notes that this is a legal conclusion rather than a fact acknowledged by the parties. Nevertheless, under the terms of the Pretrial Order and in view of the fact that Ahdout never raised any objections, pretrial or during trial, to the Pretrial Order, this legal conclusion is binding on Ahdout.

1 cooperate in the execution and submission of a joint pretrial
2 order which, as noted above, they did.

3 The bankruptcy court conducted the trial of the adversary
4 proceeding on January 25, 2005, at which the parties appeared
5 through their attorneys. The bankruptcy court had reviewed the
6 declarations submitted by the parties. The court heard the
7 arguments of counsel and asked the attorneys questions about their
8 positions. Neither of the parties asked to cross-examine any of
9 the declarants, nor offered to submit any additional evidence. At
10 the conclusion of the trial, the bankruptcy court stated its oral
11 findings of fact and conclusions of law on the record, and on the
12 basis of the written record and, in particular, the surcharge
13 order and indemnification judgment entered by the state courts,
14 ruled that Ahdout's debt to Highlands was excepted from discharge
15 under § 523(a)(4). The bankruptcy court also rejected Ahdout's
16 arguments that he was entitled to certain setoffs against the
17 amount of the judgment. In material part, the bankruptcy court
18 stated:

19 I'm going to rule in favor of [Highlands] because it is
20 clear from these papers that the facts are really not
21 disputed. This record is what it is, that this is - -
22 this was done as a breach of fiduciary duty and it also
23 meets the requirements of section 523(a)(4), and the
24 issue of the offsets is simply not relevant. I had a
25 judgment, and the only issue is whether that judgment is
26 non-dischargeable or not. . . .

24 Everything was done in state court, and it's absolutely
25 clear to me. I'll repeat it one more time. We have a
26 defalcation. It was done without - well, it was
improperly done, and the fact that [Ahdout] may have
offsets was taken care of in the state court.

27 Transcript of hearing (January 25, 2005), pp. 20-21, lines 4-12,
28 21-25, 1.

1 A judgment was entered by the bankruptcy court on April 4,
2 2005. On April 7, 2005, Ahdout filed this timely appeal.

3
4 JURISDICTION

5 The bankruptcy court had jurisdiction of this action under 28
6 U.S.C. § 1334 and § 157(b) (I). Our jurisdiction is based upon 28
7 U.S.C. § 158(b) (1).

8
9 ISSUES

- 10 1. Whether Ahdout was denied the right to cross-examine
11 witnesses during the bankruptcy court trial.
- 12 2. Whether the bankruptcy court erred in determining that the
13 Judgment Debt was excepted from discharge pursuant to 11
14 U.S.C. § 523(a) (4).
- 15 3. Whether the bankruptcy court erred in determining that
16 Ahdout's claim for additional setoffs for loans to the
17 conservatorship was barred by issue preclusion.

18
19 STANDARD OF REVIEW

20 A trial court's decision to require submission of evidence
21 and testimony by declaration is reviewed for abuse of discretion.
22 Adair v. Sunwest Bank (In re Adair), 965 F.2d 777, 779 (9th Cir.
23 1992). Whether a claim is nondischargeable is a mixed question
24 of law and fact reviewed *de novo*. Murray v. Bammer (In re
25 Bammer), 131 F.3d 788, 792 (9th Cir. 1997) (en banc). The same
26 standard is used to review the bankruptcy court's application of
27 issue preclusion. In re Tobin, 258 B.R. 199, 202 (9th Cir. BAP
28 2001).

DISCUSSION

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3 1. Ahdout never sought to cross-examine witnesses at the trial.

4 Ahdout argues that the bankruptcy court "did not at any time
5 inform any party that it would be taking judicial notice of any
6 matters, pleadings or proceedings. Such conduct on the part of
7 the trier of fact, in reality denied Ahdout his right to trial."
8 He also contends that "[Ahdout] was resolutely denied all
9 opportunity to cross-examine witnesses, and even if there had been
10 some bleak opportunity for cross-examination, [Ahdout] was still
11 unduly restricted in his right to cross-examination."

12 A trial court's decision to receive direct testimony at a
13 trial in the bankruptcy court by written declaration, subject to
14 the parties' right to object to the admissibility of the contents
15 of the declaration, and to the right to cross-examine the
16 declarant at trial, has been expressly endorsed by the Ninth
17 Circuit. Lee-Benner v. Gergely (In re Gergely), 110 F.3d 1448,
18 1452 (9th Cir. 1997) ("Requiring evidence to be presented by
19 declaration is an 'accepted and encouraged technique for
20 shortening bench trials that is consistent with [Fed. R. Evid.]
21 611(a) (2).'" (citation omitted); Adair v. Sunwest Bank (In re
22 Adair), 965 F.2d 777, 780 (9th Cir. 1992) (disagreeing with a BAP
23 decision that "the bankruptcy court's procedure [employing trial
24 by declaration] raises significant due process concerns" provided
25 witness statements may be tested by cross-examination.)

26 In this case, the bankruptcy court's Trial Order was
27 consistent with the requirements of Fed. R. Bankr. P. 7016, Fed.
28 R. Evid. 611 and the case law. It adequately and seasonably

1 advised the parties of the requirement to submit direct witness
2 testimony by declaration, accommodated the parties' right to make
3 evidentiary objections to the declarations and, if necessary,
4 allowed for cross-examination of the declarants at trial. The
5 bankruptcy court committed no error in adopting and utilizing this
6 procedure.

7 Nor did the bankruptcy court deviate from its announced
8 procedures at trial. It considered the written declarations
9 submitted by the parties and ruled on their evidentiary objections
10 to some of the declarations.

11 More importantly, there is nothing in the record to show that
12 Ahdout's counsel objected to the trial procedure at any time,
13 either before or at the trial. While none of the declarants were
14 cross-examined at the trial, Ahdout's attorney made no request to
15 do so.⁶ Under these circumstances, Ahdout has waived any
16 arguments alleging that the trial procedure was somehow unfair.

- 17
18 2. Based upon the agreed facts in the Joint
19 Pretrial Order, and the order and judgment
20 entered by the state courts, the bankruptcy
21 court correctly decided that Ahdout's debt to
22 Highlands was excepted from discharge under
23 § 523(a)(4).

24 In order for a debt to be excepted from discharge in
25

26 ⁶ Quite the opposite occurred. At one point at the
27 beginning of the trial, when the bankruptcy court was considering
28 whether to continue the proceedings to a later date, Ahdout's
counsel told the court:

Your Honor, we would like to go [forward with
the trial], if possible. We already - - I
think all the documents have been presented.
*There is not going to be any oral testimony
today, so I really don't see any point in
continuing.*

Transcript of hearing (January 25, 2005), pp. 2-3, lines 25, 1-3.

1 bankruptcy under § 523(a)(4), the creditor must show by a
2 preponderance of the evidence (1) the existence of a trust; (2)
3 the debt was caused by fraud or defalcation; and (3) the debtor
4 acted as a fiduciary at the time the defalcation was created.
5 Banks v. Gill Distribution Cntrs. Inc., (In re Banks), 263 F.3d
6 862, 870 (9th Cir. 2001) (citing Otto v. Niles (In re Niles), 106
7 F.3d 1456, 1459 (9th Cir. 1997)). The definition of "defalcation"
8 includes not only the misappropriation of funds held in trust, but
9 also any failure to properly account for those funds. Hemmeter v.
10 Hemmeter (In re Hemmeter), 242 F.3d 1186, 1190 (9th Cir. 2001).
11 Significantly, "[e]ven innocent acts of failure to fully account
12 for money received in trust will be held as non-dischargeable
13 defalcations; no intent to defraud is required." Id. (citations
14 omitted).

15 In this case, the conservatorship was a trust under state
16 law. And for purposes of the adversary proceeding, Ahdout agreed
17 that he was a fiduciary in his role as the conservator of his
18 father's estate.⁷ As a result, these two elements of Highlands'
19 § 523(a)(4) claim were satisfied.

20 Issue preclusion applies in actions to determine
21 dischargability of debts under § 523(a). Grogan v. Garner, 498
22 U.S. 279, 284-285 (1991). Under California law, a final state

23
24 ⁷ Ahdout's acknowledgment is in accord with California law:
25 "The relationship of . . . conservator and conservatee is a
26 fiduciary relationship" Cal. Prob. Code § 2101; Cambalik
27 v. Lefkowitz (In re Lefkowitz), 50 Cal. App. 4th 1310, 1314 (Ct.
28 App. 1996) ("a conservator must exercise his or her powers solely
in the interests of the conservatee".) This panel has previously
reached the same conclusion: "Because the conservator is
essentially a trustee over all the conservatee's assets for all
purposes under state law, he is a fiduciary within the narrow
meaning of § 523(a)(4)". Martin v. Fidelity and Deposit Company
of Maryland, 161 B.R. 672, 676 (9th Cir. BAP 1993).

1 court order will conclusively preclude a party from relitigating
2 the same issues actually determined by the state court in a
3 subsequent § 523(a) action. Gayden v. Nourbakhsh (In re
4 Nourbakhsh), 67 F.3d 798, 800 (9th Cir. 1995) (holding that effect
5 of state court judgment must be determined by state's law of issue
6 preclusion, and citing state cases). Issue preclusion bars
7 relitigation of an issue argued and decided in an earlier
8 proceeding when the issues are identical; the issue was actually
9 litigated; its determination was necessary in the prior action;
10 and the party to be estopped was a party, or in privity with a
11 party, in the prior action. Lucindo v. Superior Court, 51 Cal. 3d
12 335, 341 (1990); In re Baldwin, 249 F.3d 912, 917-918 (9th Cir.
13 2001).

14 In reviewing the objections made to Ahdout's final accounting
15 as conservator, the Referee found that, over several months in
16 1997, Ahdout "borrowed" \$233,407.68 from the assets of the
17 conservatorship and that "[t]hese borrowings were without
18 authority." The Referee recommended to the state court that
19 Ahdout be surcharged in the amount of the unauthorized borrowings
20 plus interest. The state court expressly adopted the Referee's
21 findings and recommendation and ordered that Ahdout be surcharged
22 in the amount of \$162,997.27, after allowing Ahdout certain
23 offsets for monies lent to his father.

24 Ahdout was a party to the conservatorship proceedings.
25 Whether his borrowings were authorized, and whether he should be
26 surcharged for the funds he took, were issues actually and
27 necessarily litigated in, and decided by, the state court. The
28 state court's order is final. Therefore, Ahdout is precluded from

1 relitigating these matters in this action. See Harmon v. Korbin
2 (In re Harmon), 250 F.3d 1240, 1245 (9th Cir. 2001) (discussing
3 elements of issue preclusion under California law.)

4 The state court order preclusively established that Ahdout
5 had failed to account for funds entrusted to him and the amount of
6 his unauthorized borrowings. Given the preclusive effect of that
7 order, the bankruptcy court correctly decided that Ahdout's
8 failure to account for these funds amounted to a defalcation.

9 Finally, it is also clear Ahdout's debt to Highlands was
10 caused by his defalcation. Highlands was obligated under its bond
11 to satisfy the surcharge imposed upon Ahdout by the state court.
12 It did so by paying the Successor Conservator \$171,877.64. With
13 Ahdout's stipulation, the state court, in the indemnity action,
14 awarded Highlands a money judgment against Ahdout for the amounts
15 it paid, together with attorneys' fees incurred in that action, in
16 the amount of \$178,877.64. In other words, Ahdout's defalcation
17 caused him to become indebted to Highlands.

18 Given the facts Ahdout admitted in the Joint Pretrial Order,
19 and the binding findings and conclusions of the state court in the
20 conservatorship proceeding, it is clear Ahdout's conduct in making
21 unauthorized borrowings from the conservatorship estate amounted
22 to a fiduciary defalcation, and caused Ahdout to become indebted
23 to Highlands for purposes of § 523(a)(4). The bankruptcy court
24 correctly concluded that Ahdout's debt to Highlands was excepted
25 from discharge in bankruptcy under § 523(a)(4).

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1 3. The bankruptcy court correctly concluded that
2 Ahdout was not entitled to offsets against
3 Highlands's judgment debt.

4 Ahdout insists the bankruptcy court erred by not allowing him
5 to set off, against Highlands's judgment debt, certain amounts he
6 loaned his father in 1982, 1989, 1993 and 1994. If the offsets
7 are allowed, the amount Ahdout was owed by his father, by his
8 calculations, exceeds any amounts he was surcharged.

9 The bankruptcy court decided that the issue of Ahdout's right
10 to offsets was "simply not relevant", since Highlands' debt was
11 based upon both the state court order in the conservatorship
12 proceeding and a state court judgment in the indemnity action, and
13 presumably Ahdout's right to offsets was dealt with in those
14 actions. In the alternative, the bankruptcy court noted that any
15 remaining offset claims Ahdout may have had against his father (or
16 the conservatorship estate), which were based upon loans owed to
17 Ahdout, passed to Ahdout's bankruptcy estate. As the bankruptcy
18 court told Ahdout's counsel:

19 "So you can't have it both ways. Either [the offset
20 claim] was taken care of in the state court, or it's
21 still a viable claim and if that's the case, that should
22 have been listed in the bankruptcy, and your client has
23 no standing to bring those. Those are assets of the
24 [bankruptcy] estate."

25 Transcript of hearing (January 25, 2005), p. 6, lines 13-18.

26 The state court's order took into account any claims Ahdout
27 may have had for offsets. While the Referee recommended to the
28 conservatorship court that Ahdout be surcharged in the amount of
29 \$233,407.68 plus interest as the total of unauthorized borrowings
30 made by Ahdout, the state court allowed Ahdout a setoff for
31 amounts stated in his creditor's claims filed in the

1 conservatorship, and reduced the surcharge to \$171,877.64.
2 Ahdout's right to offsets was therefore yet another issue actually
3 litigated in the conservatorship proceedings, and Ahdout cannot
4 relitigate that issue in this action.⁸ For these reasons, the
5 bankruptcy court was correct in rejecting Ahdout's claims for any
6 further setoffs.

7 CONCLUSION

8 The trial procedure employed by the bankruptcy court was
9 appropriate and consistent with the Rules and case law. The
10 bankruptcy court correctly decided that Ahdout's debt to Highlands
11 was excepted from discharge under § 523(a)(4). The bankruptcy
12 court also correctly refused to allow Ahdout any setoffs against
13 the amount of Highlands's debt.

14 The judgment of the bankruptcy court is AFFIRMED.
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26 ⁸ Of course, Ahdout's argument would have required the
27 bankruptcy court to ignore *two* final state court judgments. In
28 addition to being bound by the order issued in the conservatorship
proceeding, if Ahdout had offsets to assert, he presumably should
have done so in the indemnity action. He did not, but rather
stipulated to entry of judgment. He cannot now complain about the
amount of that judgment.