NOT FOR PUBLICATION

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
JAN AHDOUT,	
Appellant,	**M E M O R A N D U M**[1]
v.	
HIGHLANDS INSURANCE COMPANY,	
Appellee.	

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.

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[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.

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

FACTS

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

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

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

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

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

[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.

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

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

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

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

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

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

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

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

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

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

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[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.

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

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

> I'm going to rule in favor of [Highlands] because it is clear from these papers that the facts are really not disputed. This record is what it is, that this is - - this was done as a breach of fiduciary duty and it also meets the requirements of section 523(a)(4), and the issue of the offsets is simply not relevant. I had a judgment, and the only issue is whether that judgment is non-dischargeable or not. . . .
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> Everything was done in state court, and it's absolutely clear to me. I'll repeat it one more time. We have a 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.

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

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

JURISDICTION

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

ISSUES

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

STANDARD OF REVIEW

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

DISCUSSION

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

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

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

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

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

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

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

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

In order for a debt to be excepted from discharge in

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[6] Quite the opposite occurred. At one point at the beginning of the trial, when the bankruptcy court was considering 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.

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

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

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

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[7] Ahdout's acknowledgment is in accord with California law: "The relationship of . . . conservator and conservatee is a fiduciary relationship . . . ." Cal. Prob. Code § 2101; Cambalik v. Lefkowitz (In re Lefkowitz), 50 Cal. App. 4th 1310, 1314 (Ct. 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).

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

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

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

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

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

Finally, it is also clear Ahdout's debt to Highlands was caused by his defalcation. Highlands was obligated under its bond to satisfy the surcharge imposed upon Ahdout by the state court. It did so by paying the Successor Conservator $171,877.64. With Ahdout's stipulation, the state court, in the indemnity action, awarded Highlands a money judgment against Ahdout for the amounts it paid, together with attorneys' fees incurred in that action, in the amount of $178.877.64. In other words, Ahdout's defalcation caused him to become indebted to Highlands.

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

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

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

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

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

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

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

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

CONCLUSION

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

The judgment of the bankruptcy court is AFFIRMED.

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[8] Of course, Ahdout's argument would have required the bankruptcy court to ignore *two* final state court judgments. In 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.