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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NOT FOR PUBLICATION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

5	In re:)	BAP No.	AZ-10-1304-MkMaD
)		
6	RANDY ELBERT GRAY and)	Bk. No.	08-11894
	KIMBERLY LORRAINE GRAY,)		
7)	Adv. No.	08-00931
	Debtors.)		
8	_____)		
)		
9	RANDY ELBERT GRAY; KIMBERLY)		
	LORRAINE GRAY,)		
10)		
	Appellants,)		
11)		
	v.)	MEMORANDUM*	
12)		
	WALTER WENZEL; CHERYL L.)		
13	WENZEL,)		
)		
14	Appellees.)		
15	_____)		

Submitted Without Oral Argument
on May 13, 2011

Filed - July 7, 2011

Appeal From The United States Bankruptcy Court
for the District of Arizona

Honorable Charles G. Case, II, Bankruptcy Judge, Presiding

Before: MARKELL, MANN** and DUNN, Bankruptcy Judges.

*This disposition is not appropriate for publication. Although it may be cited for whatever persuasive value it may have (see Fed. R. App. P. 32.1), it has no precedential value. See 9th Cir. BAP Rule 8013-1.

**Hon. Margaret M. Mann, U.S. Bankruptcy Judge for the Southern District of California, sitting by designation.

1 **INTRODUCTION**

2 Randy Gray and Kimberly Gray (the "Grays") appeal from the
3 bankruptcy court's summary judgment declaring that all amounts
4 awarded in a state court judgment in favor of Walter Wenzel and
5 Cheryl Wenzel (the "Wenzels") are nondischargeable in the Grays'
6 chapter 7¹ bankruptcy. We AFFIRM IN PART, REVERSE IN PART, AND
7 REMAND this matter for further proceedings.

8 **FACTS**

9 In 2006, the Wenzels filed a lawsuit against the Grays and
10 their company, Gray Mobile Tire Service, Inc. ("GMTS"), in the
11 Arizona Superior Court for Maricopa County (Case No. CV2006-
12 015259) (the "State Court Litigation"). The Wenzels have never
13 introduced into the record the complaint from the State Court
14 Litigation, or any other document describing the interactions
15 between the Wenzels and the Grays that eventually led the Wenzels
16 to sue the Grays. The Wenzels only introduced: (1) the
17 instructions given to the state court jury (the "Jury
18 Instructions"), (2) the jury's verdict (the "Jury Verdict"), and
19 (3) the state court's judgment based on the Jury Verdict (the
20 "State Court Judgment"). In addition, no party has given us any
21 useful general description of their pre-lawsuit relations.
22 Consequently, our understanding of pre-lawsuit events is quite
23 limited.

24
25 _____
26 ¹Unless specified otherwise, all chapter and section
27 references are to the Bankruptcy Code, 11 U.S.C. §§ 101-1532, and
28 all "Rule" references are to the Federal Rules of Bankruptcy
Procedure, Rules 1001-9037. All "Civil Rule" references are to
the Federal Rules of Civil Procedure.

1 But from what has been provided, we have pieced together
2 that the Wenzels' invested money in GMTS, and some or all of the
3 Wenzels' investment was lost. After trial, the jury considered
4 the Wenzels' legal theories after receiving instructions on
5 various legal theories including breach of contract, breach of
6 fiduciary duty, "common law fraud," negligent misrepresentation,
7 innocent misrepresentation, securities fraud, and unjust
8 enrichment.

9 In June 2008, the jury returned a verdict in favor of the
10 Wenzels on some, but not all, of their claims. The jury awarded
11 the Wenzels, among other things: \$18,000 against the Grays for
12 breach of contract; \$171,731.73 against GMTS for breach of
13 contract; \$276,731.73 against the Grays for breach of fiduciary
14 duty; \$190,000 against the Grays for fraud; and, \$207,477.60
15 against the Grays for securities fraud.² The jury also awarded
16

17 ²Nothing in the record specifies whether the Wenzels'
18 securities fraud claim was based on state law, federal law or
19 both. Securities fraud is similarly described in both A.R.S.
20 § 44-1991 and in 17 C.F.R. § 240.10b-5. While the Jury
21 Instruction on securities fraud arguably could have been modeled
22 on either, the Jury Instruction did not include any reference to
23 interstate commerce, the mails, or a national securities
24 exchange, as referenced in 17 C.F.R. § 240.10b-5. Thus, we
25 presume that the Wenzels' securities fraud claim was based on
26 § 44-1991(A), which provides:

27 It is a fraudulent practice and unlawful for a person,
28 in connection with a transaction or transactions within
or from this state involving an offer to sell or buy
securities, or a sale or purchase of securities,
including securities exempted under § 44-1843 or
44-1843.01 and including transactions exempted under
§ 44-1844, 44-1845 or 44-1850, directly or indirectly
to do any of the following:

(continued...)

1 \$23,768 against the Grays for punitive damages.³

2 In September 2008, before the state court entered judgment
3 on the Jury Verdict, the Grays filed a chapter 11 bankruptcy, but
4 they later stipulated to conversion of their case to chapter 7,
5 and the bankruptcy court entered an order converting the case in
6 December 2009. Meanwhile, in March 2009, the bankruptcy court
7 granted the Wenzels relief from stay, thereby enabling the
8 parties to complete the State Court Litigation.

9 Apparently, there were lengthy post-trial proceedings in the
10 State Court Litigation, but the bankruptcy court record does not
11 reveal their nature. The State Court Judgment, entered in March
12 2010, awarded the Wenzels compensatory damages of \$207,477.60 for
13 securities fraud and an additional \$105,000.00 for breach of
14 fiduciary duty. The State Court Judgment also awarded \$23,768.00
15 in punitive damages, \$125,000 in attorneys' fees and \$3,942.17 in
16 costs. The State Court Judgment referenced ARS § 44-2001,⁴ ARS

17
18
19 ²(...continued)

20 1. Employ any device, scheme or artifice to defraud.

21 2. Make any untrue statement of material fact, or omit
22 to state any material fact necessary in order to make
23 the statements made, in the light of the circumstances
24 under which they were made, not misleading.

25 3. Engage in any transaction, practice or course of
26 business which operates or would operate as a fraud or
27 deceit.

28 ³The Jury Instructions reflect that the punitive damages
award was likely based on the Gray's breach of fiduciary duty.

⁴ARS § 44-2001 provides for the award of fees and costs in
an action based on the violation of Arizona securities law.

1 § 12-341⁵ and ARS § 12-341.01⁶ as grounds for awarding fees and
2 costs. However, the record does not specify what amount of fees
3 and costs was attributable to each particular ground.

4 The Grays appealed the State Court Judgment, and that appeal
5 is still pending (Arizona Court of Appeals, Division One, Case
6 No. CV 10-0338).

7 The Wenzels, representing themselves in the bankruptcy
8 court, filed a complaint against the Grays in December 2008. It
9 is not entirely clear from the single page of allegations in
10 their complaint whether the Wenzels sought to object to the
11 Grays' discharge under § 727, to obtain a determination under
12 § 523 that the Grays' indebtedness to them was nondischargeable,
13 or both. In fact, the complaint does not reference any specific
14 exception to discharge under § 523(a).

15 In any event, the Grays answered the complaint with a
16 general denial in January 2009. The bankruptcy court from time
17 to time held scheduling and status conferences, but essentially
18 suspended prosecution of the adversary proceeding pending the
19 completion of the post-trial proceedings in the State Court
20 Litigation.

21 In April 2010, shortly after entry of the State Court
22 Judgment, the Wenzels filed their motion for summary judgment.
23 Reading their moving papers liberally, it appears that the
24 Wenzels asserted that they were entitled to summary judgment

25
26 ⁵ARS § 12-341 is Arizona's general provision for an award of
costs to the prevailing party in civil actions.

27
28 ⁶ ARS § 12-341.01 provides for attorneys' fees awards under
certain circumstances in an actions arising out of contract.

1 based on issue preclusion, because the State Court Judgment
2 established the requisite elements for nondischargability under
3 §§ 523(a)(2)(A), 523(a)(2)(B), 523(a)(4), 523(a)(6) and
4 523(a)(19). As previously indicated, the only materials from the
5 State Court Litigation that the Wenzels presented in support of
6 their summary judgment motion were the Jury Instructions, the
7 Jury Verdict and the State Court Judgment.

8 In response, the Grays (who were represented by counsel
9 before the bankruptcy court) objected to the summary judgment
10 motion solely on two grounds. First, they argued that the
11 bankruptcy court could not properly apply issue preclusion
12 because of their pending appeal of the State Court Judgment.
13 According to the Grays, in light of the pending state court
14 appeal, there was no final judgment on the merits. And second,
15 the Grays argued that the State Court Judgment's award of
16 punitive damages, attorneys' fees and costs should be deemed
17 dischargeable because no particular exception to discharge under
18 § 523(a) specifically covered these items.

19 On July 7, 2010, the bankruptcy court held a hearing on the
20 summary judgment motion at which it considered and rejected both
21 of the Grays' objections. The court entered summary judgment on
22 July 27, 2010, deeming nondischargeable the entire debt
23 represented by the State Court Judgment. Neither the court's
24 comments at the July 7 hearing nor its July 27 judgment specified
25 the grounds for granting summary judgment.

26 The Grays timely appealed on August 10, 2010.

27 JURISDICTION

28 The bankruptcy court had jurisdiction pursuant to 28 U.S.C.

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

3 **ISSUE**

4 Did the bankruptcy court err when it granted the Wenzels'
5 motion for summary judgment?

6 **STANDARDS OF REVIEW**

7 The bankruptcy court's order granting summary judgment is
8 reviewed de novo. Centre Ins. Co. v. SNTL Corp. (In re SNTL
9 Corp.), 380 B.R. 204, 211 (9th Cir. BAP 2007). "Viewing the
10 evidence in the light most favorable to the non-moving party, we
11 must determine 'whether there are any genuine issues of material
12 fact and whether the trial court correctly applied relevant
13 substantive law.'" New Falls Corp. v. Boyajian (In re Boyajian),
14 367 B.R. 138, 141 (9th Cir. BAP 2007) (quoting Tobin v. San Souci
15 Ltd. P'ship (In re Tobin), 258 B.R. 199, 202 (9th Cir. BAP
16 2001)).

17 We also review de novo the preclusive effect of a judgment;
18 whether issue preclusion is available is a mixed question of law
19 and fact in which the legal questions predominate. The Alary
20 Corp. v. Sims (In re Associated Vintage Group, Inc.), 283 B.R.
21 549, 554 (9th Cir. BAP 2002); Stephens v. Bigelow (In re
22 Bigelow), 271 B.R. 178, 183 (9th Cir. BAP 2001).

23 If issue preclusion is available, the bankruptcy court's
24 decision to apply it is reviewed for abuse of discretion. Lopez
25 v. Emergency Serv. Restoration, Inc. (In re Lopez), 367 B.R. 99,
26 104 (9th Cir. BAP 2007); see also Parklane Hosiery Co., Inc. v.
27 Shore, 439 U.S. 322, 331 (1979).

28 Under the abuse of discretion standard of review, we first

1 "determine de novo whether the [bankruptcy] court identified the
2 correct legal rule to apply to the relief requested." United
3 States v. Hinkson, 585 F.3d 1247, 1262 (9th Cir. 2009) (en banc).
4 And if the bankruptcy court identified the correct legal rule, we
5 then determine under the clearly erroneous standard whether its
6 factual findings and its application of the facts to the relevant
7 law were: "(1) illogical, (2) implausible, or (3) without support
8 in inferences that may be drawn from the facts in the record."
9 Id. (internal quotation marks omitted).

10 DISCUSSION

11 A. Summary Judgment Standards

12 It is axiomatic that a court should not grant summary
13 judgment unless: (1) there are no genuine and disputed issues of
14 material fact; and (2), when viewing the evidence most favorably
15 to the non-moving party, the movant is clearly entitled to
16 prevail as a matter of law. See Civil Rule 56(a) (made
17 applicable in adversary proceedings by Rule 7056);⁷ Celotex Corp.
18 v. Catrett, 477 U.S. 317, 322-23 (1986). The moving party bears
19 the initial burden of showing that there is no material factual
20 dispute. Id. At the time of the bankruptcy court's ruling, Civil
21 Rule 56(e)(2) provided:

22 Opposing Party's Obligation to Respond. When a motion
23 for summary judgment is properly made and supported, an
24 opposing party may not rely merely on allegations or
25 denials in its own pleading; rather, its response must
26 - by affidavits or as otherwise provided in this rule
- set out specific facts showing a genuine issue for
trial. If the opposing party does not so respond,
summary judgment should, if appropriate, be entered

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28 ⁷All references to Civil Rule 56 are to the form in which it
appeared prior to the December 2010 amendments.

1 against that party.
2 Civil Rule 56(e)(2) (emphasis added). The phrases "is properly
3 made and supported" and "if appropriate" were meant to emphasize
4 the necessity of the moving party meeting its initial burden,
5 under any and all circumstances, before the granting of summary
6 judgment: "[w]here the evidentiary matter in support of the
7 motion does not establish the absence of a genuine issue, summary
8 judgment must be denied even if no opposing evidentiary matter is
9 presented." Advisory Committee Notes accompanying the 1963
10 amendments to Civil Rule 56.⁸

11 Material facts that would preclude summary judgment are
12 those which, under applicable substantive law, may affect the
13 outcome of the case. The substantive law determines which facts
14 are material. Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 248
15 (1986).

16 **B. Issue Preclusion Standards**

17 Issue preclusion prohibits relitigation of issues that have
18 been adjudicated in a prior lawsuit. In re Lopez, 367 B.R. at
19 104. Issue preclusion protects parties from the unnecessary
20

21 ⁸The latest version of Civil Rule 56, which became effective
22 December 1, 2010, uses different language and numbering, but it
23 embodies the same key concepts as set forth in the old version.
24 Two subdivisions of the new version are particularly relevant
25 here. First, new subdivision (c)(1)(a) makes clear that the
26 moving party "must" point to materials in the record
27 demonstrating that the material facts cannot be genuinely
28 disputed. And second, new "[s]ubdivision (e)(3) recognizes that
the court may grant summary judgment only if the motion and
supporting materials - including the facts considered undisputed
under subdivision (e)(2) - show that the movant is entitled to
it." Advisory Committee Notes accompanying the 2010 amendments
to Civil Rule 56.

1 multiplication of litigation, helps prevent inconsistent
2 decisions, and conserves judicial resources. Montana v. U.S.,
3 440 U.S. 147, 153 (1979). The party asserting issue preclusion
4 must prove all of the elements necessary to apply the doctrine.
5 Honkanen v. Hopper (In re Honkanen), 446 B.R. 373, 382 (9th Cir.
6 BAP 2011) (citing Kelly v. Okoye (In re Kelly), 182 B.R. 255, 258
7 (9th Cir. BAP 1995)).

8 To meet this burden, the moving party must have
9 pinpointed the exact issues litigated in the prior
10 action and introduced a record revealing the
11 controlling facts. Reasonable doubts about what was
12 decided in the prior action should be resolved against
13 the party seeking to assert preclusion.

14 446 B.R. at 382. (Citations omitted and emphasis added.)

15 Issue preclusion may be applied in nondischargeability
16 litigation. Grogan v. Garner, 498 U.S. 279, 284-285 (1991). As
17 a matter of full faith and credit, federal courts must give a
18 state court judgment the same preclusive effect that another
19 court of that state would give to that judgment. 28 U.S.C.
20 § 1738; Far Out Prods., Inc. v. Oskar, 247 F.3d 986, 993 (9th
21 Cir. 2001). Accordingly, we must apply Arizona law to determine
22 whether issue preclusion applies here. See Gayden v. Nourbakhsh
23 (In re Nourbakhsh), 67 F.3d 798, 800 (9th Cir. 1995) (citing
24 Marrese v. Am. Acad. of Orthopaedic Surgeons, 470 U.S. 373, 380
25 (1985)).

26 To apply issue preclusion in the Arizona courts:

27 (1) the issue must have been actually litigated in a
28 previous proceeding, (2) the parties must have had a
full and fair opportunity and motive to litigate the
issue, (3) a valid and final decision on the merits
must have been entered, (4) resolution of the issue
must be essential to the decision, and (5) there must
be a common identity of the parties.

1 Short v. Dewald, 244 P.3d 92, 97 n.4 (Ariz. App. 2010) (citing
2 Schalkenbach Found. v. Lincoln Found., Inc., 91 P.3d 1019, 1023
3 (Ariz. App. 2004)); see also Hullet v. Cousin, 63 P.3d 1029,
4 1035-36 (Ariz. 2003).

5 **C. Application of Issue Preclusion**

6 As mentioned previously, the bankruptcy court did not
7 specify its grounds for granting summary judgment. The court did
8 not identify which exceptions to discharge under § 523(a) were
9 implicated by giving the State Court Judgment issue preclusive
10 effect.⁹ It would have facilitated our review if the bankruptcy
11 court had stated its reasoning for granting summary judgment.
12 See generally Civil Rule 56(a) (stating that "[t]he court should
13 state on the record the reasons for granting or denying the
14 motion.").

15 But the lack of such a statement, in the summary judgment
16 context, may not by itself necessitate remand because we have the
17 duty under the de novo standard of review to examine the record
18 ourselves and to independently determine whether the motion for
19 summary judgment should have been granted. See B-Real, LLC v.
20 Chaussee (In re Chaussee), 399 B.R. 225, 229 (9th Cir. BAP 2008)
21 (stating that, under de novo review, "we consider a matter anew,
22 as if it had not been heard before, and as if no decision had
23 been previously rendered."). Further, as an appellate panel, we
24 may affirm on any basis supported by the record. See Leavitt v.

25
26 ⁹The court made a couple of passing references during the
27 summary judgment hearing to "§ 523(a)(2)(A)" and "actual fraud."
28 The court might have meant to imply that the issue preclusive
effect of the State Court Judgment established actual fraud under
§ 523(a)(2)(A).

1 Soto (In re Leavitt), 171 F.3d 1219, 1223 (9th Cir. 1999); Canino
2 v. Bleau (In re Canino), 185 B.R. 584, 594 (9th Cir. BAP 1995).

3 In light of the above, we will independently consider the
4 exceptions to discharge invoked by the Wenzels and make our own
5 assessment of whether the issue preclusive effect of the State
6 Court Judgment established the necessary elements for any of the
7 exceptions to discharge.¹⁰ However, before we do so, we note one
8 of the fundamental premises of nondischargeability litigation:
9 that the exceptions to discharge set forth in § 523(a) are
10 construed narrowly in favor of the debtor's receipt of the full
11 discharge that the Bankruptcy Code allows. See Ryan v. United
12 States (In re Ryan), 389 B.R. 710, 713 (9th Cir. BAP 2008)
13 (quoting Snoke v. Riso (In re Riso), 978 F.2d 1151, 1154 (9th
14 Cir. 1992)). Accordingly, we will conclude that the issue
15 preclusive effect of the State Court Judgment establishes the
16 elements of nondischargeability only if that is clear on the face
17 of the record.

18 **1. The securities fraud award**

19 **a. Applicability of issue preclusion - § 523(a)(19)**

20 The State Court Judgment awarded the Wenzels \$207,477.60
21 based on the jury's finding that the Grays "knowingly or
22
23

24 ¹⁰We acknowledge that the Grays, by not raising the relevant
25 issues, arguably might be deemed to have waived the issues we
26 address in this appeal regarding the application of issue
27 preclusion. See, e.g., Scovis v. Henrichsen (In re Scovis),
28 249 F.3d 975, 984 (9th Cir. 2001). However, we do not view the
appellate waiver doctrine as trumping the clear mandate of Civil
Rule 56 that the moving party must, as a preliminary matter,
establish that no genuine issue of material fact exists.

1 recklessly committed securities fraud" under A.R.S. § 44-1991.¹¹
2 The Grays cannot seriously dispute that they had a full and fair
3 opportunity to dispute this claim in the State Court Litigation,
4 that the same parties were before the bankruptcy court in the
5 nondischargeability litigation, or that the state court rendered
6 a valid and final decision on the merits.¹²

7 Further, based on the record presented, the elements for
8 nondischargeability under § 523(a)(19) were actually litigated
9 and necessarily decided in reaching the securities fraud award.

10 Section 523(a)(19), enacted on July 30, 2002 as part of the
11 Sarbanes-Oxley Act of 2002, renders nondischargeable any debt
12 that results from a judgment for violation of any federal or
13 state securities law or for common law fraud, deceit or
14 manipulation in connection with the purchase or sale of any
15 security. Smith v. Gibbons (In re Gibbons), 289 B.R. 588, 589
16 (Bankr. S.D.N.Y. 2003), aff'd, 311 B.R. 402 (S.D.N.Y. 2004),
17 aff'd, 155 Fed.Appx. 534 (2nd Cir. 2005). The legislative
18 history reflects that Congress intended § 523(a)(19) to have very
19 broad application, to any judgment arising from the purchase or
20 sale of a security that violated any state or federal securities
21 law, and also intended to facilitate the application of issue

22
23 ¹¹See Footnote 2, supra.

24 ¹²We agree with the bankruptcy court regarding the finality
25 of the State Court Judgment. Under Arizona law, a judgment is
26 considered final for purposes of issue preclusion and claim
27 preclusion even if an appeal is pending from that judgment.
28 Ariz. Downs v. Superior Court, 623 P.2d 1229, 1232 (Ariz. 1981);
Murphy v. Bd. of Med. Exam'rs, 949 P.2d 530, 538 (Ariz. App.
1997); see also Pochiro v. Prudential Ins. Co. of Am., 827 F.2d
1246, 1253 (9th Cir. 1987) (interpreting Arizona law).

1 preclusion to such judgments. See id. at 591-92 (discussing
2 legislative history and purpose of § 523(a)(19)).

3 Here, the Jury Instructions in the State Court Litigation
4 concerning securities fraud met the elements for securities fraud
5 under Arizona securities law. See A.R.S. § 44-1991; Aaron v.
6 Fromkin, 994 P.2d 1039, 1042 (Ariz. App. 2000). In particular,
7 the Jury Instructions required the Wenzels to prove that the
8 Grays "made, participated in or induced the unlawful sale or
9 purchase" of a security.

10 Thus, the Wenzels established all of the elements necessary
11 to give issue preclusive effect to the portion of the State Court
12 Judgment awarding damages based on securities fraud.

13 **b. Discretion in applying issue preclusion**

14 In addition, the bankruptcy court did not abuse its
15 discretion in actually giving the securities fraud portion of the
16 State Court Judgment issue preclusive effect. The Grays
17 essentially asserted both before the bankruptcy court and on
18 appeal that the bankruptcy court should not exercise its
19 discretion to give any part of the State Court Judgment issue
20 preclusive effect because it created the potential for
21 inconsistent judgments. According to the Grays, if the
22 bankruptcy court granted summary judgment, but the state court of
23 appeals ultimately reversed, then the Grays would be subject to
24 one judgment (the state court of appeals judgment) absolving them
25 of liability and another judgment (the bankruptcy court's summary
26 judgment) holding them liable.

27 The bankruptcy court considered this concern and rejected it
28 before granting summary judgment, and we agree with the

1 bankruptcy court's reasoning. The bankruptcy court's summary
2 judgment solely determined that any liability imposed by the
3 State Court Judgment was nondischargeable. In other words, the
4 bankruptcy court's judgment did not make any determination as to
5 liability. As explained by the bankruptcy court, if the state
6 court of appeals ultimately reversed the State Court Judgment,
7 then there would be no nondischargeable liability under the
8 bankruptcy court's judgment. Thus, the bankruptcy court's
9 judgment did not create a potential for inconsistent results.¹³

10 The Grays have not pointed us to any other potential grounds
11 for concluding that the bankruptcy court abused its discretion in
12 applying issue preclusion. Nor are we aware of any. In sum, we
13 AFFIRM the portion of the bankruptcy court's summary judgment
14 determining the securities fraud award nondischargeable.

15 **2. Breach of fiduciary duty awards**

16 **a. Applicability of issue preclusion - § 523(a)(4)**

17 Based on the jury's finding that the Grays breached their
18 fiduciary duty, the State Court Judgment awarded the Wenzels
19 additional compensatory damages of \$105,000.00 and punitive
20 damages of \$23,768.00.

21 Notably, § 523(a)(4) does not apply to all breaches of all
22 fiduciary relationships. To prevail under § 523(a)(4), a
23 creditor must prove (1) that the debtor was acting as a
24 "fiduciary" within the meaning of the Bankruptcy Code, and
25

26 ¹³Even if the bankruptcy court judgment was not derivative,
27 Civil Rule 60(b)(5) (made applicable by Rule 9024) provides that
28 a court may set it aside if "it is based on an earlier judgment
that has been reversed, or vacated"

1 (2) that the debt arose from "fraud or defalcation." In re
2 Honkanen, 446 B.R. at 378; Nahman v. Jacks (In re Jacks),
3 266 B.R. 728, 735 (9th Cir. BAP 2001). We will separately
4 examine each of these elements.

5 (i) **Fiduciary Capacity**

6 The term "fiduciary" is construed narrowly for purposes of
7 § 523(a)(4). The term as used therein does not include all
8 relationships of trust and confidence; rather, the fiduciary
9 relationship must arise from an express or technical trust. See
10 Cal-Micro Inc. v. Cantrell (In re Cantrell), 329 F.3d 1119, 1125
11 (9th Cir. 2003). "The broad, general definition of fiduciary - a
12 relationship involving confidence, trust and good faith - is
13 inapplicable in the dischargeability context." Id. (citing
14 Ragsdale v. Haller (In re Haller), 780 F.2d 794, 796 (9th Cir.
15 1986)).¹⁴ Federal courts must look to state law to determine
16 whether a true trust relationship exists. In re Cantrell,
17 329 F.3d at 1125. A technical trust created by statute and/or
18 case law will suffice, provided that the law (1) defines the
19 trust res, (2) identifies the fiduciary's asset management
20 duties, and (3) imposes obligations on the fiduciary prior to the
21 alleged wrongdoing. See Blyler v. Hemmeter (In re Hemmeter),
22 242 F.3d 1186, 1190 (9th Cir. 2001).

23 Cantrell held that, under California corporations law,
24 corporate officers and directors are not fiduciaries within the

25
26 ¹⁴The narrow definition of fiduciary for purposes of
27 § 523(a)(4) is consistent with the general rule that discharge
28 exceptions are construed narrowly in favor of the debtor's
discharge. See In re Riso, 978 F.2d at 1154; In re Ryan, 389
B.R. at 713.

1 meaning of § 523(a)(4). In re Cantrell, 329 F.3d at 1127. As
2 Cantrell explained, “although officers and directors [under
3 California law] are imbued with the fiduciary duties of an agent
4 and certain duties of a trustee, they are not trustees with
5 respect to corporate assets.” Id. at 1126 (emphasis added).
6 Cantrell relied on Bainbridge v. Stoner, 106 P.2d 423 (Cal.
7 1940), which explicitly held that the relationship in California
8 between a director on the one hand and the corporation and its
9 shareholders on the other hand, strictly speaking, was one of
10 agency and not trust. See In re Cantrell, 329 F.3d at 1126
11 (citing Bainbridge, 106 P.2d at 426).

12 Here, we are faced with the question of whether, under
13 Arizona law, corporate officers and directors are fiduciaries
14 within the meaning of § 523(a)(4). At first blush, F.D.I.C. v.
15 Jackson, 133 F.3d 694 (9th Cir. 1998), would appear to answer
16 this question for us. Jackson explicitly held that, under
17 Arizona law, a corporate director is a fiduciary for purposes of
18 § 523(a)(4). Id. at 703; see also Braden Trust v. Chavez (In re
19 Chavez), 430 B.R. 890, 894-95 (Bankr. D. Ariz. 2010) (citing
20 Jackson and, for purposes of § 523(a)(4), stating that “[i]n
21 Arizona, corporate directors and officers and shareholders that
22 have the ability to control a corporation owe a fiduciary duty to
23 the corporation and other shareholders.”).

24 Jackson cited several Arizona cases in support of its
25 holding, but unlike Cantrell, Jackson did not search the Arizona
26 cases for the requisite trust res. We have searched the Arizona
27 cases cited by Jackson, and many others, and we have been unable
28 to find any authority establishing a trust res in such

1 circumstances.

2 We acknowledge that there are a number of statements in
3 Arizona case law referring to officers and directors as trustees.

4 For instance:

5 A director of a corporation occupies a fiduciary
6 relation to it and its stockholders. His position is
7 one of trust and he is frequently denominated a trustee
8 and so held accountable in equity. The ordinary trust
9 relationship of directors of a corporation and
10 stockholders is not a matter of statutory or technical
11 law. It springs from the fact that directors have the
12 control and guidance of the corporate business affairs
13 and property and hence of the property interests of the
14 stockholders. Equity recognizes that stockholders are
15 the proprietors of the corporate interest and are
16 ultimately the only beneficiaries thereof. Those
17 interests are in virtue of the law entrusted through
18 the corporation to the directors and from that
19 condition arises the trusteeship of the directors with
20 the concomitant fiduciary relationship.

21 Hatch v. Emery, 400 P.2d 349, 353 (Ariz. App. 1965).

22 The Arizona Supreme court essentially adopted Hatch's
23 statement of corporate director duties:

24 In Arizona a director of a corporation owes a fiduciary
25 duty to the corporation and its stockholders
26 This duty is in the nature of a trust relationship
27 requiring a high degree of care on the part of the
28 director. Hatch v. Emery, supra

29 Atkinson v. Marquart, 541 P.2d 556, 558 (Ariz. 1975) (also citing
30 Kenton v. Wood, 56 Ariz. 325, 107 P.2d 380 (1940) ("It is true
31 that directors are trustees for the benefit of the stockholders
32 of a corporation, but there is no fiduciary relation between two
33 directors as such"))).

34 But these statements merely describe as "trust-like" the
35 ordinary types of fiduciary duties that all corporate directors
36 bear. Other statements of the Arizona Supreme Court support our
37 reading:
38

1 It is true that, in a certain sense, the directors of a
2 corporation occupy the position of trustees towards the
3 stockholders. As the value of the shares of the
4 stockholders and their rights in connection therewith
5 are affected by the conduct of the directors, a trust
6 relation is created between them. The directors owe a
7 fiduciary duty towards the stockholders in dealings
8 which may affect the stock.

9 Steinfeld v. Nielsen, 139 P. 879, 889 (Ariz. 1913) (emphasis
10 added).¹⁵

11 To reiterate, we cannot read any of the statements of the
12 Arizona courts as identifying corporate assets as a trust res
13 that the officers and directors hold in trust for the benefit of
14 the corporation's shareholders. Consequently, we cannot
15 reconcile Jackson's holding with Cantrell's statement of the
16 fiduciary capacity requirements under § 523(a)(4).

17 We recently faced a similar situation in Honkanen. There,
18 we dealt with whether California real estate brokers are
19 fiduciaries under § 523(a)(4). The Ninth Circuit Court of
20 Appeals held in Bugna v. McArthur (In re Bugna), 33 F.3d 1054,
21 1057 (9th Cir. 1994), that California real estate brokers were

22 ¹⁵The most recent statement from the Arizona courts on this
23 subject states:

24 Here, the relationship between the parties is that of
25 directors and officers of a corporation to its
26 shareholders. The parties do not dispute that a
27 contract created that relationship. But "[i]n Arizona
28 a director of a corporation owes a fiduciary duty to
the corporation and its stockholders. This duty is in
the nature of a trust relationship requiring a high
degree of care on the part of the director."

Dooley v. O'Brien, 244 P.3d 586, 590 (Ariz. App. 2010) (quoting
Atkinson, 541 P.2d at 558).

1 § 523(a)(4) fiduciaries, but in so holding, Bugna did not find or
2 identify any trust res. Accord, Woosley v. Edwards (In re
3 Woosley), 117 B.R. 524, 529 (9th Cir. BAP 1990); Rettig v. Peters
4 (In re Peters), 191 B.R. 411, 419 (9th Cir. BAP 1996). In
5 Honkanen, we concluded that we could not reconcile Bugna's
6 holding with Cantrell's statement of the fiduciary capacity
7 requirements. See Honkanen, 446 B.R. at 380-81. Consequently,
8 we determined that we should follow Cantrell, as the most-recent
9 and better-reasoned of the two decisions, over Bugna. Id.

10 For the same reasons Honkanen followed Cantrell over Bugna,
11 we here must follow Cantrell over Jackson. We are faced with the
12 situation that in Arizona, corporate assets are not held in trust
13 by corporate officers and directors for the benefit of the
14 corporation's shareholders. Consequently, following Cantrell, we
15 hold that, under Arizona law, corporate officers and directors
16 are not § 523(a)(4) fiduciaries.

17 Under these circumstances, the Wenzels have not shown that
18 the State Court Litigation actually litigated and necessarily
19 decided the requisite element of fiduciary capacity. As a
20 result, issue preclusion did not establish the
21 nondischargeability of their breach of fiduciary duty awards
22 under § 523(a)(4).

23 **(ii) Fraud or Defalcation**

24 Even though we already have determined that the first
25 element under § 523(a)(4) was not satisfied, we will also examine
26 the second element: whether the debt arose from fraud or
27 defalcation. For purposes of defining fraud under § 523(a)(4),
28 fraud means actual fraud. Honkanen, 446 B.R. at 382. Meanwhile,

1 [t]he definition of defalcation includes both the
2 "misappropriation of trust funds or money held in any
3 fiduciary capacity; [and the] failure to properly
4 account for such funds." Even 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.

5 In re Hemmeter, 242 F.3d at 1190 (citations omitted); see also
6 Oney v. Weinberg (In re Weinberg), 410 B.R. 19, 28 (9th Cir. BAP
7 2009). Regardless of the debtor's state of mind, the creditor
8 must establish that trust assets have gone missing and that the
9 debtor has failed to account for them or is responsible for their
10 loss. In re Hemmeter, 242 F.3d at 1191.

11 In this case, the bankruptcy court record is quite sparse,
12 and we simply cannot discern from it what were the underlying
13 grounds for the Wenzels' breach of fiduciary duty claim. The
14 Wenzels did not make the state court complaint part of the
15 bankruptcy court record, nor does any other document in the
16 record describe the gravamen of the fiduciary duty claim.
17 Furthermore, the Jury Instructions and the Jury Verdict are not
18 specific enough for us to conclude that the breach of fiduciary
19 duty found by the state court jury was in the nature of fraud or
20 defalcation. Simply put, we cannot tell on this record whether
21 the Gray's breach of fiduciary duty was the result of fraud,
22 defalcation, or some other conduct of the Grays. Under these
23 circumstances, the Wenzels have not shown that the State Court
24 Litigation actually litigated and necessarily decided the
25 requisite element of fraud or defalcation. This serves as an
26 independent basis for our determination that issue preclusion did
27 not apply to establish the nondischargeability of the breach of
28 fiduciary duty awards under § 523(a)(4).

1 **b. Applicability of issue preclusion - other**
2 **exceptions to discharge**

3 Issue preclusion does not establish that the breach of
4 fiduciary duty award is nondischargeable under any other
5 exception to discharge cited by the Wenzels. Among other things,
6 § 523(a)(2)(A) requires a false representation and an intent to
7 deceive. Ghomeshi v. Sabban (In re Sabban), 600 F.3d 1219, 1222
8 (9th Cir. 2010). Meanwhile, § 523(a)(2)(B) requires a false
9 written financial statement. See Boyajian, 564 F.3d at 1090 n.2.
10 The record before us simply does not connect the breach of
11 fiduciary duty determination and awards to any false statements,
12 written or otherwise, nor to any intent to deceive by the Grays.

13 The Wenzels also sought to invoke § 523(a)(6), which excepts
14 from discharge a debt arising from a willful and malicious
15 injury. In relevant part, for creditors to prove a willful
16 injury, they must show that the debtor subjectively intended to
17 injure them, or subjectively believed that harm was substantially
18 certain to occur from the debtor's conduct. See Carrillo v. Su
19 (In re Su), 290 F.3d 1140, 1143-45 (9th Cir. 2002).

20 There is nothing whatsoever in the Jury Instruction
21 regarding breach of fiduciary duty indicating that willful injury
22 was a consideration for the jury in finding that the Grays had
23 breached their fiduciary duty. On the other hand, the jury also
24 awarded punitive damages based on the Gray's breach of fiduciary
25 duty. The Jury Instructions indicated that awarding punitive
26 damages based on breach of fiduciary duty required a finding that
27 the Grays either were "(1) gross, wanton, malicious and
28 oppressive; or (2) showed spite, ill will or reckless

1 indifference to the interests of the [Wenzels] "
2 Moreover, the State Court Judgment specifies in connection with
3 the punitive damages award that the jury found that the Grays
4 "acted with spite, ill will or deliberate indifference to the
5 interests" of the Wenzels.

6 Even if we were to assume that some of the descriptors used
7 in the Jury Instructions and in the State Court Judgment to
8 describe the Grays' breach of fiduciary duty would satisfy the
9 high level of scienter necessary to establish willfulness under
10 § 523(a)(6), the disjunctive language in the Jury Instructions
11 and the State Court Judgment is fatally problematic. In short,
12 it is impossible to say on this record that the requisite state
13 of mind was actually litigated and necessarily decided in the
14 State Court Litigation.

15 Finally, the Wenzels invoked § 523(a)(19), which we
16 previously held rendered the securities fraud award
17 nondischargeable. However, there is nothing in the record
18 connecting the breach of fiduciary determination and awards to
19 any violation of either federal or state securities laws. That
20 the State Court Judgment granted separate awards for securities
21 fraud and breach of fiduciary duty suggests instead that the
22 grounds for liability were separate and distinct. In any event,
23 we cannot say on this record that the Grays' breach of fiduciary
24 duty involved a violation of the securities laws.

25 In sum, we find no basis in the record to conclude that
26 issue preclusion established the nondischargeability of the
27 breach of fiduciary duty awards (both compensatory and punitive)
28 under any exception to discharge. Accordingly, we must REVERSE

1 the portion of the bankruptcy court's summary judgment
2 determining the breach of fiduciary duty awards nondischargeable.

3 **3. Attorneys' fees and costs**

4 The Grays argued that the attorneys' fees and costs awarded
5 in the State Court Judgment were dischargeable because no
6 exception to discharge specifically covered them. The bankruptcy
7 court rejected this argument, citing Cohen v. de la Cruz,
8 523 U.S. 213 (1998). Cohen stands for the general proposition
9 that any liability duly imposed as a direct, but-for result of
10 the defendant's nondischargeable conduct constitutes a
11 nondischargeable debt, regardless of whether the liability
12 reflects the actual damages incurred by the plaintiff. See id.
13 at 220; see also Suarez v. Barrett (In re Suarez), 400 B.R. 732,
14 738-39 (9th Cir. BAP 2009)(applying Cohen holding to affirm
15 bankruptcy court's determination under § 523(a)(6) that
16 attorneys' fees and costs were nondischargeable, even though
17 there was no award of compensatory damages).

18 The record presented here does not make clear whether (or to
19 what extent) the State Court Judgment's award of costs and
20 attorneys' fees flowed from nondischargeable conduct. The State
21 Court Judgment identified more than one basis for awarding fees
22 and costs, and we simply cannot tell on this record to what
23 extent the fees and costs were awarded based on the
24 nondischargeable securities law violation.

25 Accordingly, we must REVERSE the portion of the bankruptcy
26 court's summary judgment determining the fees and costs awarded
27 in the State Court Judgment nondischargeable.

28

CONCLUSION

For the reasons set forth above, the summary judgment of the bankruptcy court is AFFIRMED IN PART AND REVERSED IN PART, and this matter is REMANDED for further proceedings consistent with this decision.

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