

OCT 13 2010

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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NOT FOR PUBLICATION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. AZ-10-1011-JuPaDu
)	
HARLAN J. RATLIFF and)	Bk. No. 09-03138-JMM
THERESA L. RATLIFF,)	
)	Adv. No. 09-00275-JMM
Debtors.)	
_____)	
)	
HARLAN JEFFERSON RATLIFF;)	
THERESA L. RATLIFF,)	
)	
Appellants,)	
)	
v.)	M E M O R A N D U M ¹
)	
COCHISE AGRICULTURAL)	
PROPERTIES, LLC; TODD)	
CAMPBELL; STEPHANIE McRAE,)	
)	
Appellees.)	
_____)	

Argued and Submitted on September 23, 2010
at Pasadena, California

Filed - October 13, 2010

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

Honorable James M. Marlar, Chief Bankruptcy Judge, Presiding

Appearances: John A. Baade, Esq. argued for Appellants Harlan J. Ratliff and Theresa L. Ratliff
Robert Marshall Charles, Jr., Lewis and Roca LLP argued for Appellees Cochise Agricultural Properties, LLC, Todd Campbell and Stephanie McRae

¹ 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.

1 Before: JURY, PAPPAS, and DUNN Bankruptcy Judges.

2 Appellants Harlan J. Ratliff and Theresa L. Ratliff
3 (collectively, the "Ratliffs" or "Debtors") appeal the
4 bankruptcy court's judgment awarding damages to appellees
5 Cochise Agricultural Properties, LLC ("CAP"), Todd Campbell and
6 Stephanie McRae (collectively, the "Campbells") and finding the
7 debt nondischargeable under § 523(a)(4) and (6).

8 We have carefully considered the issues Debtors raised on
9 appeal and the record provided. Having done so, we conclude
10 that the bankruptcy court erred in declaring the judgment debt
11 excepted from discharge under § 523(a)(4) because there was no
12 fiduciary relationship between Debtors and the Campbells.
13 Accordingly, we REVERSE the bankruptcy court's decision under
14 § 523(a)(4), but AFFIRM the court's decision in all other
15 respects.

16 I. FACTS

17 Mr. Ratliff was a third-generation Cochise County farmer.
18 On February 25, 2000, the Ratliffs formed Ratliff Farms, LLC
19 ("RF"), each holding a fifty percent community property
20 interest.

21 On February 5, 2004, the Ratliffs purchased a 1,105 acre
22 farm in Cochise County, Arizona for \$427,539. To partially pay
23 for the purchase, the Ratliffs borrowed funds from Western Bank
24 of Lordsburg, New Mexico ("Western Bank"). The bank made two
25 secured loans to the Ratliffs for \$299,492.50 and \$90,155,
26 respectively. Both notes were dated February 5, 2004 and became
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1 due one year later. Escrow closed and on February 12, 2004, the
2 deeds to the Ratliffs as community property were recorded as
3 were the trust deeds to Western Bank.

4 Since the Ratliffs did not have the financial ability to
5 carry and upgrade the farm on their own, Mr. Ratliff called on
6 his long-time friend, Mr. Campbell, to enter into a venture to
7 refinance, improve, and eventually sell the farm. In
8 furtherance of the venture, Mr. Ratliff and Mr. Campbell each
9 signed a handwritten note dated July 21, 2004, which stated:

10 I hereby transfer 50% interest in the Farm Real Estate
11 located ½ mile east of Bell Ranch Road, in Sunizona
12 Arizona to Todd Campbell and Family for \$10.00 and
13 other consideration.

14 On September 13, 2004, Mr. Ratliff signed a one-year
15 listing agreement with Willcox Real Estate, in an effort to sell
16 the farm.

17 In the meantime, the Campbells made their credit available
18 to Mr. Ratliff's efforts to improve the property by installing a
19 center pivot irrigation system. By October 7, 2004, the pivot
20 financing was moving forward, and Mr. Ratliff was urging
21 Mr. Campbell to "put together the partnership agreement" as
22 "We're in business!"

23 On October 26, 2004, Western Bank wrote to Mr. Ratliff,
24 reminding him that the two loans were fully due on February 5,
25 2005. The bank rejected Mr. Ratliff's request for long-term
26 financing. However, by December 2004, the bank had agreed that
27 once interest on the loans was paid, it would extend the
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1 maturity on the principal balances of the loans for an
2 additional year, until February 5, 2006.

3 On February 24, 2005, the Ratliffs and the Campbells formed
4 CAP. The Articles of Incorporation showed each of the couples
5 were members who together owned all of the interests in the
6 capital and the profits of the company. On the same date, the
7 parties entered into the operating agreement. Each couple made
8 an initial contribution of \$500 in capital and each couples'
9 participation interest was reflected at fifty percent in Exhibit
10 "A" to the operating agreement.

11 The stated purpose of CAP was to purchase, operate and sell
12 agricultural property located in Cochise County, Arizona. The
13 operating agreement dealt with the Ratliffs' post-formation
14 contribution of the farm property in Section 9.1.3.1.2 which
15 stated that the capital accounts of the members "shall be
16 credited by . . . the fair market value of the property
17 contributed by the member to the Company (net of liabilities
18 secured by such property)."

19 In April 2005, to acquire the components for the center
20 pivot irrigation system, CAP executed six purchase money
21 installment notes and security agreements with First National
22 Equipment Finance, Inc. ("FNEF"). CAP borrowed a total of
23 \$450,871.80, and the parties each signed personal guarantees on
24 the loans.

25 Around April 12, 2005, an entity known as the Benross
26 Corporation began negotiations with CAP to purchase the farm.

1 Upon learning of the sale, Western Bank agreed that the balance
2 of its loans could be paid off at the closing rather than the
3 previously agreed date of February 5, 2006. Thereafter, on
4 May 18, 2005, CAP entered into a one year extension on the two
5 loans with Western Bank. On May 25, 2005, Mr. Ratliff executed
6 escrow instructions for the sale of the farm to Benross for
7 \$3,646,500. However, escrow never opened, and the sale died.

8 In June 2005, the parties completed the process with
9 Western Bank to extend the land loans. To execute the
10 extension, Western Bank opened an escrow account into which the
11 Campbells paid \$50,562.96 for interest on the previous loans.
12 CAP then became a co-borrower on the Western Bank loans and,
13 upon closing, title to the farm transferred from the Ratliffs to
14 CAP, recorded on June 20, 2005. Western Bank's primary land
15 loans were "paid off" by renewal for an additional year. The
16 total principal payoff amount was \$389,647.50.

17 Thereafter, CAP agreed to let the Ratliffs farm the
18 property and use it as collateral for debts incurred by the
19 Ratliffs, individually, to achieve that end. In July 2005, the
20 Ratliffs opened a one year, \$350,000 personal line of credit
21 with Wells Fargo Bank, N.A. ("Wells Fargo"). The loan closed on
22 July 15, 2005. Wells Fargo secured the loan with an
23 Agricultural Security Agreement and a junior deed of trust on
24 the farm property, to which the Campbells agreed. At all times,
25 the Ratliffs acknowledged that they were personally liable for
26 the loan, and the deed of trust lists the borrowers on the line
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1 of credit as RF and the Ratliffs. CAP never entered into any
2 written agreement with the Ratliffs regarding their farming
3 operation.

4 In late June or early July 2005, Maricopa Orchards, LLC
5 entered into a contract to purchase the farm property for
6 \$3,520,000. This contract was subsequently assigned to NK Casa
7 Grande ("NK"), an investment firm. The contract stated that the
8 sale was subject to a lease agreement with Mr. Ratliff for a
9 three-year term with an option for an additional two years. The
10 contract called for a \$1,050,000 down payment at closing, which
11 was scheduled for October 7, 2005. The balance of the sales
12 price would be paid with a seller financed \$2,420,000 carry-back
13 note.

14 Mr. Ratliff and NK entered into a lease agreement dated
15 September 30, 2005 and signed by the parties on October 3, 2005.
16 CAP was not a party to the lease.

17 By October 4, 2005, escrow was set to close with NK placing
18 \$1 million into escrow to pay off FNEF for the pivot irrigation
19 system and Western Bank. However, at the last minute, NK
20 discovered Wells Fargo's junior deed of trust securing its
21 \$350,000 line of credit to the Ratliffs. As a result, there
22 would not be enough proceeds at close of escrow to pay off all
23 encumbrances, taking into account the deeds of trust held by
24 FNEF for equipment financing and the Western Bank land loan.
25 The sale finally closed on October 24, 2005, with Wells Fargo
26 agreeing to release its deed of trust in return for an

1 assignment of the carry-back note and deed of trust. The
2 Campbells agreed to the assignment.

3 When NK made the down payment, the proceeds, after
4 expenses, were split fifty-fifty between the Ratliffs and the
5 Campbells.

6 Due to the late closing, Mr. Ratliff chose not to plant
7 crops for the year, as he feared frost damage would destroy
8 them. Without any crops in the ground, the Ratliffs had no
9 assurance of income for that crop year and diminished prospects
10 for repaying the Wells Fargo line of credit. The Campbells
11 declined to participate in the farming business with the
12 Ratliffs, trusting that the Ratliffs would be able to pay off
13 the Wells Fargo debt – which encumbered the NK receivable, a CAP
14 asset.

15 Further interest payments from NK were also split fifty-
16 fifty between the parties until October 2006. When NK's
17 installment payment of \$479,754.20 in October 2006 came due,
18 Wells Fargo demanded and received from the proceeds its payoff
19 of \$358,092.89. The Ratliffs had used the line of credit in
20 that amount to pay personal living expenses, as well as other
21 personal or RF obligations. After leaving \$2,000 in the CAP
22 account, Mr. Ratliff divided the remainder of the installment,
23 \$78,266.05, equally between the CAP members.

24 In an e-mail dated October 28, 2006, Mr. Ratliff
25 acknowledged liability to CAP for using part of the Campbells'
26 share of the proceeds to pay off the Ratliffs' personal line of
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1 credit. He declared that there was now a note payable by the
2 Ratliffs to CAP for the deficiency between his "services
3 rendered" in preparing the farm for sale and the Campbells'
4 share of the NK payment. On November 10, 2006, RF sent Mr.
5 Campbell a breakdown of the claimed expenses totaling
6 \$284,817.59: (1) \$68,859.29 for "[d]irect expenses (tillage,
7 labor, seed, electrical, tractor, misc.)" and (2) \$215,958.30 as
8 a "[c]ommission" for "10% of the net profit to CAP." Mr. Ratliff
9 contended that the sale to NK would not have closed but for the
10 lease agreement he entered into with NK.

11 CAP, however, never agreed to pay a commission to the
12 Ratliffs. In fact, Mr. Ratliff testified that if he had been
13 able to farm the land in 2006 as planned, he would not have
14 requested a commission. And, after Mr. Campbell received his
15 diminished share of the NK payment in October, he repeatedly
16 requested to "see the receipts for the farm prep costs" before
17 agreeing to any reimbursement. As Mr. Campbell's protests
18 against reimbursement without proper documentation continued
19 into 2007, he also disputed Mr. Ratliff's commission request.

20 In 2007, Mr. Ratliff continued to split the interest
21 payments from NK fifty-fifty between the Ratliffs and the
22 Campbells.

23 On October 12, 2007, the Campbells filed an eleven-count
24 complaint against the Ratliffs in the Maricopa County, Arizona
25 Superior Court and obtained a temporary restraining order
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1 ("TRO") on the second upcoming NK principal payment.² On
2 October 25, 2007, at a hearing before the state court, the
3 parties agreed to dissolve the TRO and that further interest and
4 principal payments from NK would be split equally between them,
5 after payment of expenses. The agreement was without prejudice
6 to either side to argue that its position in the underlying
7 lawsuit was correct.

8 On February 24, 2009, as the parties were preparing to
9 litigate the complaint, the Ratliffs filed a Chapter 13 case,
10 which was converted to a Chapter 11 on April 20, 2009. The
11 Campbells removed the state court action to the bankruptcy court
12 and filed a separate adversary proceeding against Debtors
13 alleging that the debt was nondischargeable under § 523(a)(2),
14 (4) and (6), which was consolidated with the removed action for
15 trial.³

16 The bankruptcy court held a five-day trial on the matters.
17 The main issue in the case centered on the parties' intent
18 regarding their capital contributions to CAP and how the profits
19 from the sale should be shared. Since the Ratliffs contributed
20 the farm property to CAP, it was also necessary for the court to

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22 ² The complaint alleged (1) Breach of Contract;
23 (2) Breach of Implied Covenant of Good Faith and Fair Dealing;
24 (3) Breach of Fiduciary Duty; (4) Fraud; (5) Conversion;
25 (6) Unjust Enrichment; (7) Tortious Interference with Contract;
26 (8) Unlawful Withholding of Company Records; (9) Unlawful
27 Assumption of Power; (10) Injunctive Relief as to the Ratliffs;
28 and (11) Injunctive Relief as against Security Title Agency, Inc.

³ The Campbells withdrew the claim for relief under
§ 523(a)(2) before trial.

1 determine the farm's fair market value under Section 9.1.3.1.2
2 of the operating agreement after it ascertained their intent.⁴
3 In that regard, as the bankruptcy court observed, the parties
4 held "radically different views" on how the farm property should
5 be valued. Debtors contended the "net value" of the farm should
6 be \$2,372,943.95 based on the sale to NK on October 24, 2005.
7 On the other hand, the Campbells sought to use the "book value"
8 of the farm as of the contribution date which was \$37,842. The
9 parties each testified, as did their respective accounting
10 experts. Neither party presented appraisal testimony. Numerous
11 documents were entered into evidence. At the conclusion of the
12 trial, the court took the matter under advisement.

13 On December 7, 2009, the bankruptcy court issued its
14 Memorandum Decision. The court determined that it was the
15 parties' intent to be equal partners in all respects. With
16 respect to the parties' capital contributions, the court found
17 the fair market value of the farm property was \$427,539, subject
18 to \$389,647 in debt. The court concluded that Debtors
19 contributed \$37,892 while the Campbells contributed \$50,562 in
20 cash. To equalize the capital accounts, the court added \$12,670
21 to Debtors' side of the ledger to even out the contributions to
22 CAP as of June 20, 2005.

23 With respect to the proceeds from the sale of the farm
24 property, the court concluded that when the Wells Fargo loan was

25 ⁴ Although the court did recognize the necessity of
26 making the determination after trial, as pointed out by appellee
27 at oral argument, the need for that determination was not
highlighted in the joint pretrial order.

1 paid off, Debtors withdrew \$358,234.89 from CAP's accounts, to
2 which they were not entitled, although the court gave them an
3 offset against the unauthorized draw of \$1,858.61.⁵ The court
4 concluded that Debtors breached the CAP operating agreement and
5 converted the Campbells' property while acting in a fiduciary
6 capacity for CAP's members, thereby rendering the debt
7 nondischargable under § 523(a)(4) and (6).

8 On December 17, 2009, Debtors filed a Motion to Alter or
9 Amend Judgment. Debtors essentially reargued their view of the
10 evidence. On January 2, 2010, the bankruptcy court issued a
11 Memorandum Decision denying Debtors' motion. The court entered
12 Judgment against Debtors and for the Campbells on February 18,
13 2010. Debtors timely appealed.

14 Debtors moved for a stay pending appeal. The bankruptcy
15 court denied their motion by order entered on March 2, 2010.
16 The Panel denied a similar motion by order entered March 11,
17 2010.

21 ⁵ The bankruptcy court rejected Mr. Ratliff's claim for a
22 commission because CAP's operating agreement did not provide for
23 one. As to Mr. Ratliff's claim for \$68,859.59 in hard expenses,
24 the court found that he was entitled to \$1,858.61. The court's
25 decision was based on a provision in the operating agreement
26 which required member approval for a liability or indebtedness
27 exceeding \$1,000 in a single transaction or greater than \$5,000
in the aggregate. Mr. Ratliff had not received member approval
for his expenses over \$1,000. The court's denial of
Mr. Ratliff's commission and his expenses are not at issue in
this appeal.

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II. JURISDICTION

The bankruptcy court had jurisdiction over this proceeding under 28 U.S.C. §§ 1334 and 157(b)(2)(A) and (I). We have jurisdiction under 28 U.S.C. § 158.

III. ISSUES

A. Whether the bankruptcy court erred in its factual finding that the parties intended to be equal partners with respect to their capital contributions to, and distributions from, CAP;

B. Whether the bankruptcy court erred in its factual finding that Debtors' capital contribution to CAP, consisting of the farm property, had a fair market value of \$427,539 as of June 20, 2005;

C. Whether the bankruptcy court erred as a matter of law in finding that Mr. Ratliff was a fiduciary within the meaning of § 523(a)(4);

D. Whether the bankruptcy court erred as a matter of law in finding Debtors converted the Campbells' property under Arizona law, thereby meeting the threshold inquiry for nondischargeability under § 523(a)(6); and

E. Whether the bankruptcy court erred in finding that the Campbells' claim was liquidated as of October 26, 2006, for purposes of awarding prejudgment interest.

IV. STANDARDS OF REVIEW

While "[t]he interpretation of a contract is a mixed question of fact and law [,] . . . [t]he factual findings by the [bankruptcy] court as to what the parties said and did . . .

1 must be accepted unless clearly erroneous." Interpetrol Berm.
2 Ltd. v. Kaiser Aluminum Int'l Corp., 719 F.2d 992, 998 (9th Cir.
3 1983).

4 A fair market value determination is a finding of fact
5 which we review for clear error. Arnold & Baker Farms v. United
6 States (In re Arnold & Baker Farms), 85 F.3d 1415, 1421
7 (9th Cir. 1996). We overturn a finding of fact only if it is
8 "illogical, implausible, or without support in inferences that
9 may be drawn from the record." United States v. Hinkson,
10 585 F.3d 1247, 1263 (9th Cir. 2009).

11 Exceptions to discharge present a mixed question of fact
12 and law that we review de novo. Carrillo v. Su (In re Su),
13 290 F.3d 1140, 1142 (9th Cir. 2002).

14 Awards of prejudgment interest are reviewed for abuse of
15 discretion. Oney v. Weinberg (In re Weinberg), 410 B.R. 19, 28
16 (9th Cir. BAP 2009). We follow a two-part test to determine
17 objectively whether the bankruptcy court abused its discretion:
18 (1) we determine de novo whether the bankruptcy court identified
19 the correct legal rule to apply to the relief requested and
20 (2), if it did, we examine the bankruptcy court's factual
21 findings under the clearly erroneous standard. Hinkson, 585
22 F.3d at 1261-62.

23 V. DISCUSSION

24 A. The Bankruptcy Court Did Not Err In Determining The 25 Fair Market Value Of The Farm Property

26 Debtors argue that the court's decision regarding the
27 farm's fair market value rested on a series of erroneous factual
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1 findings: (1) the parties' intent, from July 21, 2004,⁶ was
2 always to combine their assets and talents into a common shared
3 enterprise and to become equal partners; (2) the Ratliffs'
4 accountant "found that the fair market value of the farm was
5 what the Ratliffs paid for it in February, 2004, \$427,539"; and
6 (3) "[a]ccording to the various tax returns, CAP considered the
7 capital contributions of each member-couple to be equal in the
8 returns filed for the years 2004, 2005 and 2006."

9 According to Debtors, based on these erroneous findings,
10 the bankruptcy court incorrectly determined that the parties
11 intended their capital account balances to be equal and
12 calculated their accounts accordingly. Debtors maintain that
13 there is no evidence "whatsoever" to support the court's
14 valuation. In support of their various challenges, Debtors call
15 our attention to evidence which they contend the bankruptcy
16 court either ignored, did not fully take into account, or
17 evaluated incorrectly.

18 First, Debtors argue that the court did not take into
19 account "compelling evidence" that the value of farm land in the
20 area increased markedly from the time they purchased the
21 property until the time they contributed it to CAP. Debtors
22 contend that they presented undisputed and uncontroverted
23 evidence that there was a marked increase in the market value of
24 farm land after they acquired the farm, while the Campbells did
25 not present any opinion evidence of value except to contend that

26 ⁶ This is the date of the handwritten note where
27 Mr. Ratliff transferred a fifty percent interest in the farm
28 property to the Campbells.

1 Debtors' proposed value was too high. Debtors further argue
2 that the court failed to articulate the definition of fair
3 market value that it relied upon, much less follow it, since the
4 court erroneously considered whether Debtors could have improved
5 the farm without the assistance of the Campbells - a fact that
6 Debtors assert is irrelevant.

7 Additionally, Debtors maintain that Mr. Ratliff, who was
8 competent to give his opinion regarding value, testified without
9 contradiction that the value of the farm property increased and
10 that the arms-length sale to NK for \$3,520,000 further
11 corroborated his opinion. Finally, Debtors ask this Panel to
12 take judicial notice of the publication of the United States
13 Department of Agriculture entitled "Land Values and Cash Rents
14 2006 Summary" and attached a copy of the publication to their
15 brief.

16 Second, Debtors contend that the court erroneously relied
17 on the tax basis of the property as stated in the accountant's
18 memorandum and tax returns, where the tax basis of the property
19 was determined by its acquisition cost, rather than its fair
20 market value. They contend that the value of the property
21 stated in their tax capital account is different from the value
22 in their book capital account.

23 Third, Debtors argue the court erroneously concluded that
24 the parties' intent to be equal or fifty-fifty partners was
25 probative on the fair market value of the farm property. In
26 this regard, they argue the operating agreement established by
27 its plain language that the amount of their capital contribution
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1 was the "fair market value" of the farm property. According to
2 Debtors, because the operating agreement had an integration
3 clause, nothing that occurred between the parties before or
4 after the execution of the operating agreement alters their
5 right to distributions set forth in the agreement. Debtors
6 maintain that being "equal partners" did not equate, under the
7 operating agreement, to having made equal capital contributions.

8 Finally, Debtors argue that the court erred as a matter of
9 law in finding that they were estopped by the state court
10 stipulation in which they agreed that, upon receiving any
11 payments, the title company would pay escrow and brokerage fees
12 first, then split the remaining proceeds equally between Debtors
13 and the Campbells. Debtors maintain that this stipulation was
14 without prejudice to the claims of either side in this case.⁷

15 We consider each of Debtors' contentions below.

16 **Analysis**

17 This adversary proceeding arose out of a dispute between
18 friends and business partners where the parties did not
19 adequately document their agreement. Because the formula for
20 calculating the parties' capital accounts was set forth in the
21 operating agreement, we begin with a brief discussion of the
22 relevant provisions of the agreement. See ARIZ. REV. STAT. § 29-

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24
25 ⁷ We are unpersuaded by Debtors' assignment of error
26 related to the state court stipulation. We read the bankruptcy
27 court's legal conclusion regarding the stipulation in the context
28 of its overall holding, i.e., that the parties intended their
capital contributions and distributions to be calculated fifty-

1 682 (operating agreement governs the relations between the
2 members and sets forth their rights, duties and powers).

3 Section 4.1 entitled "Distribution of Net Cash Flow" states
4 that Net Cash Flow⁸ shall be distributed in the following order:
5 "first, to repay Member loans; second to repay the total capital
6 contributions made to the Company by the Members; and third, to
7 the Interest Holders, in proportion to their Participation
8 Percentages."

9 Section 9.1.3 provides that each Interest Holder's capital
10 account includes many different items, including initial
11 contributions made to CAP and those made after its formation.
12 This section and those related generally provide the formula for
13 keeping track of the members' interests in the company from an
14 accounting perspective and for tax purposes. Pertinent is
15 Section 9.2.3.1.2 which states that an Interest Holder's capital
16 account should be credited by the "fair market value" of the
17 property contributed.

18 However, nowhere does the operating agreement define "fair
19 market value." Nor did the parties identify the farm's fair
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21 ⁸ "Net Cash Flow" is defined in Article 2.2.18 as:

22 [A]ll cash funds derived from operations of the Company
23 (including interest received on reserves), increased by
24 the reduction of any previously established reserves
25 and reduced by cash funds used to pay current operating
26 expense (including interest on member Loans) or to pay
27 or establish reasonable reserves for future expenses,
28 debt payments (other than payments of member Loans),
Net Cash flow used to pay member Loans, capital
improvements, and replacements as determined by the
Members.

1 market value because Exhibit "A" to the operating agreement,
2 which set forth the parties' initial capital contributions and
3 Participation Percentages, was never amended.

4 Operating agreements are construed according to the general
5 principles of contract law.⁹ 1 Larry E. Ribstein & Robert R.
6 Keatinge, Limited Liability Companies § 4:16 (2010). Here, the
7 operating agreement states that Arizona law governs. In
8 Arizona, courts attempt to enforce a contract according to the
9 parties' intent. Darner Motor Sales, Inc. v. Universal
10 Underwriters Ins. Co., 682 P.2d 388, 398 (Ariz. 1984). Words in
11 a contract are given their ordinary meaning unless the
12 circumstances show a different meaning is applicable. Brady v.
13 Black Mountain Inv. Co., 459 P.2d 712, 714 (Ariz. 1969).

14 It is well established that contract 'words . . . are
15 interpreted in the light of all the circumstances.'
16 'When interpreting an agreement, the court may always
17 consider the surrounding circumstances' and 'the
18 context in which it was made.' In addition, 'courts
19 are not constrained by textual omissions to abandon
20 common sense and experience or to ignore the
21 surrounding circumstances of an agreement.'
22 Similarly, '[i]t is sometimes said that extrinsic
23 evidence cannot change the plain meaning of a writing,
24 but meaning can almost never be plain except in a
25 context.'

23 ⁹ The bankruptcy court acknowledged that the fundamental
24 question in the case was "what did the parties intend and how
25 they are estopped by the documents", and stated that the "whole
26 case is really contract . . . [w]hat are the respective rights of
27 the parties as I see it." At another time, the court observed
28 that when faced with conflicting documents, it "would reconcile
[them] by looking at the whole history of the case from the
beginning of their involvement with one another and seeing what
was going on at each specific step . . . along the way"

1 Miller v. Hehlen, 104 P.3d 193, 197 (Ariz. Ct. App. 2005)
2 (citations omitted). Finally, Arizona requires the application
3 of a standard of reasonableness in contract interpretation.
4 Gesina v. Gen. Elec. Co., 780 P.2d 1380, 1386 (Ariz. Ct. App.
5 1989).

6 The clearly erroneous standard guides our review of the
7 factual findings Debtors challenge. This standard is
8 significantly deferential. Sec. Farms v. Int'l Brh. of
9 Teamsters, 124 F.3d 999, 1014 (9th Cir. 1997). If the
10 bankruptcy court's account of the evidence is plausible in light
11 of the record viewed in its entirety, we may not reverse it even
12 though convinced that had we been sitting as the trier of fact,
13 we would have weighed the evidence differently. "Where there
14 are two permissible views of the evidence, the factfinder's
15 choice between them cannot be clearly erroneous." Anderson v.
16 City of Bessemer City, N.C., 470 U.S. 564, 574 (1985).

17 Debtors assert that the bankruptcy court did not state the
18 definition of "fair market value" that it employed and argue
19 that its ordinary meaning applies. See Restatement (Second) Of
20 Contracts § 202(3)(a)(1981) ("Unless a different intention is
21 manifested, . . . where language has a generally prevailing
22 meaning, it is interpreted in accordance with that meaning.").
23 Fair market value is defined as the "amount at which property
24 would change hands between a willing buyer and a willing seller,
25 neither being under any compulsion to buy or sell and both
26 having reasonable knowledge of the relevant facts." Black's Law
27 Dictionary (8th ed. 2004).

1 We are unpersuaded by Debtors' argument. Under a contract
2 analysis, the parties' intent regarding their agreement on the
3 value of their capital contributions was highly relevant to the
4 court's valuation decision. Each side had its own
5 interpretation of the agreement between the parties. As the
6 bankruptcy court observed, the documents were conflicting, and
7 it could reconcile them only by looking at the whole history of
8 the business relations between the parties. Thus, the
9 bankruptcy court was entitled to examine the surrounding
10 circumstances and the context in which the operating agreement
11 was made to determine what the parties intended by the term
12 "fair market value."

13 Debtors argue that the court ignored or gave little weight
14 to Mr. Ratliff's testimony regarding the increase in value of
15 farm land. Debtors point to the actual sale to NK in July, 2005
16 for \$3,520,000 as strong evidence of the farm's value when they
17 contributed it to CAP on June 20, 2005, only one month earlier.
18 Debtors overlook, however, that the ultimate question in the
19 case was the parties' intent under the operating agreement.
20 Thus, neither Mr. Ratliff's testimony nor the actual sale of the
21 property was decisive on that issue. In considering the
22 surrounding circumstances, the court was entitled to weigh the
23 worth of Mr. Ratliff's testimony against the actual situation of
24 the parties at the time the operating agreement was made and any
25 other evidence that would assist it in determining the parties'
26 intent regarding their agreement.

1 Debtors' request for judicial notice of the publication
2 they attach to their Opening Brief further sidesteps the
3 appellate standard of review applicable here. Debtors
4 improperly seek to introduce evidence to prove that the value of
5 the farm property was higher than that found by the bankruptcy
6 court. However, the clearly erroneous standard is not whether
7 there is evidence from which this Panel could draw an inference
8 contrary to that drawn by the bankruptcy court. Rather, we
9 review whether there was any evidence from which a rational
10 trier of fact could have drawn the conclusions that it did.
11 Accordingly, we deny Debtors' request for judicial notice
12 because it seeks to introduce new evidence that is irrelevant to
13 the issues presented here.

14 In short, the record shows that both parties testified in
15 support of their respective positions to clarify and explain
16 what the agreement was between them regarding their capital
17 contributions and distributions. Numerous documents were
18 entered into evidence that were inconsistent with, or failed to
19 fully support, either of the parties' positions. Near the end
20 of the trial, the bankruptcy court observed that the
21 documentation between the parties was a "complete mess" and that
22 trying to make sense out of it one way or the other was a
23 "nightmare."

24 Although the bankruptcy court determined, as a matter of
25 law, that there was no legal transfer of the farm by virtue of
26 the handwritten note of July 21, 2004, the note supported the
27 court's inference that it was always the parties' intent from
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1 that point forward to become equal partners. Further, the court
2 found Debtors' accountant's notes made prior to the parties'
3 dispute more credible than her later notes which were created
4 after the litigation began.¹⁰ The bankruptcy court found that
5 the accountant's notes supported an inference that Debtors'
6 intended to contribute their equity of \$37,892 in the farm in
7 return for the Campbells' financial strength. Because we give
8 even greater deference to the court's findings based on
9 determinations regarding the credibility of witnesses, we cannot
10 say the bankruptcy court erred by relying on the accountant's
11 earlier notes to determine the parties' intent.

12 In addition, the court considered Debtors' tax returns,
13 CAP's tax returns and RF's tax returns. The bankruptcy court
14 found that Debtors' tax returns showed they understood the
15 farm's June 20, 2005 fair market value was its purchase price,
16 \$427,539, and that each party held an equal share of the CAP
17 capital going forward. An amended tax return Debtors filed
18 March 7, 2006 for the 2004 tax year showed a transfer of a
19 half-interest in the farm to CAP valued at \$213,770. Next, the
20 2006 and 2007 CAP tax returns showed Debtors and the Campbells
21 with near-equal capital account balances of \$397,175 and
22 \$397,024 in 2006, respectively, and \$454,009 and \$453,795 in
23 2007. Debtors complain that the court erroneously used the
24 values in the parties' tax capital accounts which are different

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26 ¹⁰ The accountant's earlier notes showed that the farm's
27 fair market value was equal to its acquisition cost. Further,
28 the accountant had calculated Debtors' equity as \$37,892 after
deducting amounts owed to Western Bank.

1 from their book capital accounts. However, the bankruptcy court
2 was entitled to examine the various tax returns and make
3 inferences from them regarding the parties' agreement.

4 Finally, the record shows that the parties split the NK
5 quarterly interest payments in 2006 and the remainder of the
6 October principal payment after Mr. Ratliff paid off the Wells
7 Fargo loan. A rational factfinder could infer that the fifty-
8 fifty distributions of the sale proceeds manifested the parties'
9 intent for equal participation based on their equal capital
10 contributions.¹¹

11 In short, the record shows that neither side provided
12 conclusive evidence contradicting the other side's story. Given
13 the absence of such evidence, we cannot say that the trial
14 court's interpretation of the facts was illogical, implausible
15 or without support in inferences that may be drawn from the
16 record. Hinkson, 585 F.3d at 1262.

17 **B. The Bankruptcy Court Erred In Finding The Judgment Debts**
18 **Excepted From Discharge Under § 523(a)(4)**

19 Section 523(a)(4) excepts from discharge a debt "for fraud
20 or defalcation while acting in a fiduciary capacity"
21 § 523(a)(4). A debt is excepted from discharge under this
22 provision where "1) an express trust existed, 2) the debt was
23 caused by fraud or defalcation, and 3) the debtor acted as a
24 fiduciary to the creditor at the time the debt was created."
25 Otto v. Niles (In re Niles), 106 F.3d 1456, 1459 (9th Cir.

26 ¹¹ Notably, the bankruptcy court did not find either of
27 the expert witnesses competent to testify regarding the fair
28 market value of the farm property.

1 1997). The meaning of "fiduciary" under § 523(a)(4) is a matter
2 of federal law. Ragsdale v. Haller, 780 F.2d 794, 796 (9th Cir.
3 1986). The broad, general definition of fiduciary - a
4 relationship involving confidence, trust and good faith - is
5 inapplicable in the dischargeability context. Lewis v. Scott
6 (In re Lewis), 97 F.3d 1182, 1185 (9th Cir. 1996). Rather, this
7 circuit requires that for the purposes of § 523(a)(4) the debtor
8 must have been a trustee in the strict or narrow sense through
9 an express or technical trust imposed before and without
10 reference to the wrongdoing that caused the debt. Id.

11 Debtors contend Mr. Ratliff was not a "fiduciary" within
12 the meaning of § 523(a)(4). We agree. We look to state
13 statutory and case law for guidance in determining whether the
14 requisite trust relationship exists. Id.

15 CAP was an LLC governed by the Arizona Limited Liability
16 Company Act (the "LLC Act"). The LLC Act shows that the Arizona
17 legislature elected not to impose fiduciary duties among and
18 between the LLC's members as individuals or impose a fiduciary
19 duty to other LLC members upon the members who manage the LLC.
20 Accordingly, the statute does not create the basic elements of a
21 trust for § 523(a)(4) purposes; no res is defined, and no
22 fiduciary duties are spelled out. See Terence Thompson, et.
23 al., 6 Ariz. Prac., Corporate Practice § 12:65 (2009-10 ed.)
24 (noting that the LLC Act is silent on the fiduciary duties of
25 members or managers).

26 On this basis, the bankruptcy court's reliance on Arizona
27 statutory partnership law is misplaced. ARIZ. REV. STAT. § 29-

1 1034(B)(2) provides that partners in Arizona owe the partnership
2 a fiduciary duty to provide an accounting and hold in trust
3 property, profits, or benefits derived by the partners' use of
4 partnership property. In contrast to partnership law, there is
5 no parallel provision in the LLC Act.

6 Moreover, Arizona case law on the fiduciary duties of
7 managing members in the LLC context is sparse. While a director
8 or officer of a corporation owes a fiduciary duty to the
9 corporation and its stockholders under Mims v. Valley Nat'l
10 Bank, 481 P.2d 876, 878 (Ariz. App. Div. 1971), there is no
11 corresponding case law in the LLC context.

12 Finally, there is nothing in the CAP operating agreement
13 that imposes any fiduciary duty on Debtors as to LLC funds.
14 Runnion v. Pedrazzini (In re Pedrazzini), 644 F.2d 756, 759 n.2
15 (9th Cir. 1981) ("The intent to create a trust relationship
16 rather than a contractual relationship is the key element in
17 determining the existence of an express trust."). The operating
18 agreement did not expressly designate Mr. Ratliff as the
19 managing member. Rather, the operating agreement shows that CAP
20 was a member managed LLC, and we found no evidence in the record
21 that would indicate the Campbells had any less control of CAP
22 than the Ratliffs. Thus, even if an analogy to corporate law
23 were appropriate, it would be inapplicable under these
24 circumstances.

25 We construe the Bankruptcy Code's limited exceptions to the
26 general policy of discharge narrowly. Snoke v. Riso (In re
27 Riso), 978 F.2d 1151, 1154 (9th Cir. 1992). Given the Arizona
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1 legislature's silence in the LLC Act and lack of controlling
2 case law, we conclude that the type of relationship required for
3 nondischargeability purposes under § 523(a)(4) did not exist
4 between Debtors and the Campbells. Accordingly, the bankruptcy
5 court erred in finding the judgment debt excepted from discharge
6 under § 523(a)(4).

7 **C. The Bankruptcy Court Did Not Err In Finding The Judgment**
8 **Debts Excepted From Discharge Under § 523(a)(6)**

9 Section 523(a)(6) excepts from discharge any debt "for
10 willful and malicious injury by the debtor to another entity or
11 to the property of another entity." Both the willful and
12 malicious prongs must be proved to except a debt from discharge
13 under § 523(a)(6). Khaligh v. Hadaegh (In re Khaligh), 338 B.R.
14 817, 831 (9th Cir. BAP 2006).

15 **1. The Conversion Was Tortious Under Arizona Law**

16 Before reaching the willful and malicious inquiry, the
17 court must find that the debtor engaged in some form of
18 "tortious conduct." Lockerby v. Sierra, 535 F.3d 1038, 1044
19 (9th Cir. 2008). Conduct is tortious for purposes of
20 § 523(a)(6) if it constitutes a tort under state law. Id. at
21 1040-41. Debtors dispute whether the threshold requirement of
22 tortious conduct for applicability of § 523(a)(6) has been met
23 here. They assert that their failure to pay the Campbells under
24 the operating agreement was a breach of contract, "an ordinary
25 failure to pay a debt", and not accompanied by tortious conduct.
26 In their reply brief, they reiterate there could be no
27 conversion since it was Wells Fargo, not CAP, that had the right
28 to immediate possession of the funds.

1 Here, the bankruptcy court specifically found that Debtors
2 converted a portion of the Campbells' sale proceeds. Conversion
3 is "[a]n intentional exercise of dominion or control over a
4 chattel which so seriously interferes with the right of another
5 to control it that the actor may justly be required to pay the
6 other the full value of the chattel." Focal Point, Inc. v.
7 U-Haul Co. of Az., 746 P.2d 488, 489 (Ariz. Ct. App. 1986)
8 (quoting Restatement (Second) of Torts § 222A(1) (1965)). The
9 record shows that Debtors acknowledged they personally owed the
10 money to Wells Fargo. It was only after they were unable to pay
11 their debt to Wells Fargo that they unilaterally made the
12 decision to use the Campbells' share of the sale proceeds to pay
13 their personal debt. All the elements for a conversion are
14 present here.

15 **2. The Willful And Malicious Prongs Were Each Met**

16 The bankruptcy court properly considered both the willful
17 and malicious prongs. Whether a debtor acted willfully is a
18 subjective inquiry: "the willful injury requirement is met only
19 when the debtor has a subjective motive to inflict injury or
20 when the debtor believes that injury is substantially certain to
21 result from his own conduct." Ormsby v. First Am. Title Co. of
22 Nev. (In re Ormsby), 591 F.3d 1199, 1206 (9th Cir. 2010) (citing
23 Carrillo v. Su (In re Su), 290 F.3d 1140, 1142 (9th Cir. 2002)).
24 Further, "[t]he debtor is charged with the knowledge of the
25 natural consequences of his actions." Ormsby, 591 F.3d at 1206.

26 Debtors always acknowledged that the Wells Fargo debt was
27 their own. Yet, they used a portion of the Campbells' share of
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1 the sale proceeds to pay their personal debt. Under these
2 facts, we have no difficulty concluding that Debtors acted
3 intentionally with the knowledge that the Campbells were
4 certain to be injured.

5 "A malicious injury involves (1) a wrongful act, (2) done
6 intentionally, (3) which necessarily causes injury, and (4) is
7 done without just cause or excuse.'" Ormsby, 591 F.3d at 1207.

8 "Malice may be inferred based on the nature of the wrongful
9 act." Id. citing Transamerica Commercial Fin. Corp. v.

10 Littleton (In re Littleton), 942 F.2d 551, 554 (9th Cir. 1991).

11 As noted by the bankruptcy court, all the elements for a
12 malicious injury were met under the facts here. The bankruptcy
13 court properly inferred malice based on the nature of Debtors'
14 wrongful act of converting the Campbells' property. Moreover,
15 the record supports the court's conclusion that the conversion
16 was done intentionally and that Debtors knew that their conduct
17 was substantially certain to cause the Campbells injury. The
18 only justification Debtors offer for their actions was that the
19 Campbells agreed to allow them to encumber the farm property.
20 However, Debtors acknowledged that they personally owed the
21 money to Wells Fargo which negates just cause or excuse. See
22 Jett v. Sicroff (In re Sicroff), 401 F.3d 1101, 1107 (9th Cir.
23 2005) (finding a specific intent to injure negated any proffered
24 just cause or excuse offered by debtor).

25 Accordingly, we conclude that the bankruptcy court properly
26 found that the debt was excepted from discharge under
27 § 523(a)(6).

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1 **D. The Bankruptcy Court Did Not Err In Awarding Prejudgment**
2 **Interest From October 26, 2006**

3 Debtors contend that the bankruptcy court should not have
4 awarded prejudgment interest because their debt was
5 unliquidated. They argue that determination of the Campbells'
6 claim required both opinion and discretion. They also maintain
7 that when a claim depends upon the value of real estate such as
8 here, it is unliquidated. La Paz County v. Yuma County, 735
9 P.2d 772, 778 (Ariz. 1987).

10 "Damages are liquidated if 'the evidence of damages
11 furnishe[es] data which, if believed, makes it possible to
12 compute the amount of damages with exactness, without relying
13 upon opinion or discretion.'" Weinberg, 410 B.R. at 37. Here,
14 the bankruptcy court awarded the Campbells monetary damages,
15 together with interest at the rate of 10% per annum from
16 October 26, 2006 – the date Debtors diverted the Campbells'
17 funds to Wells Fargo. Thus, the bankruptcy court concluded that
18 October 26, 2006 was the date for purposes of liquidating the
19 claim. See Gemstar Ltd. v. Ernst & Young, 917 P.2d 222, 237
20 (Ariz. 1996) ("As a general rule, the trial judge should
21 calculate prejudgment interest from the date the claim becomes
22 due.").

23 We conclude that the bankruptcy court did not abuse its
24 discretion in awarding prejudgment interest from October 26,
25 2006. Once the bankruptcy court determined the parties' intent
26 regarding their capital contributions and shares of the profits,
27 the parties' respective shares of the sale proceeds could be
28 calculated mathematically and involved no opinion or discretion.

1 The court's "equitable" adjustment to the capital accounts was
2 simply a numerical adjustment to effectuate the parties' intent
3 due to the lack of documentation.

4 **VI. CONCLUSION**

5 For the reasons stated above, we REVERSE the bankruptcy
6 court's decision finding the judgment debt excepted from
7 discharge under § 523(a)(4) and AFFIRM in all other respects.

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