

OCT 13 2010

SUSAN M SPRAUL, CLERK  
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NOT FOR PUBLICATION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 <sup>1</sup>
	)	
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

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<sup>1</sup> 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.<sup>2</sup> 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.<sup>3</sup>

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 <sup>2</sup> 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.

<sup>3</sup> 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.<sup>4</sup>  
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

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25 <sup>4</sup> 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.<sup>5</sup> 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.

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21 <sup>5</sup> 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,<sup>6</sup> 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

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26 <sup>6</sup> 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.<sup>7</sup>

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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25 <sup>7</sup> 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 Flow<sup>8</sup> 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  
20

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21 <sup>8</sup> "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.<sup>9</sup> 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.'

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23 <sup>9</sup> 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.<sup>10</sup> 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 <sup>10</sup> 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.<sup>11</sup>

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.

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26 <sup>11</sup> 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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