U.S. BANKRUPTCY COURT
NORTHERN DISTRICT OF TEXAS
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UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF TEXAS
DALLAS DIVISION

IN RE:	§	
	§	
ANTHONY JAMES MONTGOMERY and VIRGINIA YERENA MONTGOMERY	§	**Case No. 04-33459 HDH-7**
	§	
	§	
Debtors	§	

JM DANIEL INVESTMENTS, INC.	§	
	§	
Plaintiff/Counter Defendant	§	
	§	
VS.	§	**Adversary No. 04-3419**
	§	
ANTHONY JAMES MONTGOMERY	§	
	§	
Defendant/Counter Plaintiff	§	

MEMORANDUM OPINION ON DISCHARGEABILITY COMPLAINT

On January 28, 2005, this Court conducted a trial on the *Complaint to Determine Dischargeability of Debt* filed by JM Daniel Investments, Inc. ("Plaintiff"). Both sides appeared and offered testimony, documentary evidence, and argument.

The Plaintiff seeks to except from Debtor Anthony James Montgomery's ("Defendant") discharge a claim of approximately $34,000. Plaintiff claims that the debt should be excepted under Bankruptcy Code Sections 523(a)(2)(A) (fraud) and -(a)(4) (embezzlement or larceny).

Standard

Exceptions to discharge should be construed narrowly in favor of the debtor, since the

Bankruptcy Code provides a fresh start to debtors unhampered by pre-existing financial burdens. *In re Davis,* 194 F.3d 570, 574 (5th Cir. 1999); *Miller v. Abrams (In re Miller)*, 156 F.3d 598, 602 (5th Cir. 1998). The creditor objecting to the discharge of a debt has the burden of establishing the exception by a preponderance of the evidence. *Grogan v. Garner,* 498 U.S. 279, 286-88, 111 S.Ct. 654, 112 L.Ed.2d 755 (1991).

In order to prevail, the Plaintiff must show by a preponderance of the evidence that all the elements exist under sections 523(a)(2)(A) and -(a)(4), as alleged in its complaint. *RecoverEdge, L.P. v. Pentecost (In re Carpenter)*, 44 F.3d 1284, 1292 (5th Cir. 1995). In this case, Plaintiff has not met its burden of proof.

Fraud

Under § 523(a)(2)(A), the Court may not discharge a debt for money obtained by false pretenses, a false representation or actual fraud, other than a statement respecting the debtor's financial condition. Fraud may include fraud in the inducement and actual fraud in the transaction. To except a debt under this section, Plaintiff must establish, by a preponderance of the evidence, that either in the inducement or in the actual transaction, Defendant made false representations, with the intent and purpose of deceiving Plaintiffs, and that Plaintiff justifiably relied on the representations, and that it sustained a loss as a result of the representations. *RecoverEdge L.P. v. Pentecost,* 44 F.3d at1292; *Allison v. Roberts (In re Allison)*, 960 F.2d 481, 483 (5th Cir. 1992).

The legislative history of section 523(a)(2)(A) indicates that this section codified *Neal v. Clark*, 95 U.S. 704 (1878), which interpreted fraud under this section to mean actual or positive fraud rather than fraud implied in law. *See RecoverEdge L.P. v. Pentecost,* 44 F.3d at1293 n.16, Legislative Statements. In *Neal*, the Supreme Court interpreted the meaning of fraud in the

Bankruptcy Code as "positive fraud, or fraud in fact, involving moral turpitude or intentional wrong . . . not implied fraud, or fraud in law, which may exist without the imputation of bad faith or immorality." *Neal*, 95 U.S. at 708.

Congress clearly intended to incorporate the Supreme Court's interpretation of fraud when it revised the Bankruptcy Code and enacted section 523(a)(2)(A). Thus, under this section, a creditor must prove a debtor obtained a debt through actual fraud, not constructive fraud. *See Allison*, 960 F.2d at 483 (fraud implied in law which may exist without imputation of bad faith or immorality, is insufficient for purposes of 523(a)(2)(A)).

Plaintiff alleges that the debt owed to it is nondischargeable on the basis of alleged misrepresentations made by the Debtor at the time the parties entered into a contract under which Plaintiff would purchase a house which Defendant inherited from his grandmother. To prove this allegation, Plaintiff must show that the misrepresentations constitute actual fraud. In *Allison*, the Fifth Circuit outlined the elements necessary to prove nondischargeability for misrepresentations. The court held that: "The misrepresentations must have been (1) knowing and fraudulent falsehoods, (2) describing past or current facts, (3) that were relied upon by the other party." 960 F.2d at 483; *see also RecoverEdge, L.P. v. Pentecost*, 44 F.3d at 1292-93.

Plaintiff is a lifelong friend of Defendant and attempted to help him out by buying a house Defendant inherited from his grandmother. Plaintiff is in the real estate business and appears to have acted in good faith. However, the proof offered at trial fell short of establishing fraud by the Defendant.

There was no real evidence offered at trial that the Defendant committed fraud. There was evidence that Defendant could not convey the property because of title problems. However,

Plaintiff's own witness testified that he was present when the title problems were brought to Defendant's attention, and that Defendant acted "surprised" and "agitated." Certainly Defendant did not convey the property as required under the contract. However, that claim is really a breach of contract claim, which is dischargeable, and not a claim for fraud. The present situation appears to the Court to be more of a failed investment than one of fraud, at least by the Defendant.

Breach of Fiduciary Duty - Embezzlement or Larceny

Section 523(a)(4) provides that a debtor is not discharged from a debt "for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny." 11 U.S.C. § 523(a)(4). To show non-dischargeability under § 523(a)(4) for fraud or defelcation, a creditor must prove by a preponderance of the evidence that (1) the debt was caused by fraud or defalcation, and (2) there was a fiduciary relationship between the parties at the time the debt was created. *In re Chavez,* 140 B.R. 413, 422 (Bankr. W.D.Tex. 1992).

In *Miller v. Abrams (In re Miller)*, the Fifth Circuit stated that the discharge exception under section 523(a)(4) "was intended to reach those debts incurred through abuses of fiduciary positions and through active misconduct whereby a debtor has deprived others of their property by criminal acts, both classes of conduct involve debts arising from the debtor's acquisition or use of property that is not the debtor's." 156 F.3d at 602 (quoting *In re Boyle*, 819 F.2d 583, 588 (5th Cir. 1987).

A fiduciary under § 523(a)(4) does not refer to any relationship involving confidence, trust or good faith, rather § 523(a)(4) concerns a relationship arising out of a technical or express trust. *Texas Lottery Commission v. Tran (In re Tran),* 151 F.3d 339, 342 (5th Cir.1998); *Davis v. Aetna Acceptance Co.,* 293 U.S. 328, 333 (1934). An express trust traditionally includes (1) an explicit declaration of a trust, (2) a defined trust *res,* and (3) an intent to create a trust relationship. *Chavez,*

140 B.R. at 423. To create an express trust, the legal and equitable title to the trust *res* must be separate, the former being vested in a trustee and the latter in a beneficiary. But the express trust may be created by an express agreement, the direct acts of the parties or a written instrument. *In re Berry,* 174 B.R. 449, 454 (Bankr. N.D.Tex. 1994). A technical trust, on the other hand, may be imposed by law. *In re Angelle,* 610 F.2d 1335, 1341 (5th Cir.1980). The trust must exist before the transactions that give rise to the claim. *Id.*

The relationship between the parties in this case does not fall within the meaning of fiduciary under the Bankruptcy Code. Thus, Plaintiff's claim that the debt is nondischargeable under section 523(a)(4) must rest primarily on the issue of embezzlement or larceny. To prove that a debt is nondischargeable for embezzlement or larceny, the Plaintiffs must prove fraudulent intent. *See Smith v. Hayden (In re Hayden)*, 248 B.R. 519 (Bankr. N.D. Tex. 2000).

"Texas bankruptcy courts have found that embezzlement requires a showing of three elements: (1) the debtor appropriated funds, (2) the appropriation was *for the debtor's use or benefit*, and (3) the debtor did the appropriation with fraudulent intent." *Id.* at 525. Similarly, larceny under this section is "'the *fraudulent* and wrongful taking and carrying away of the property of another with the *intent to convert* it to the taker's use and with *intent to permanently deprive* the owner of such property.'" *Id.* at 526, quoting *RAI Credit Corp. v. Patton (In re Patton)*, B.R. 113, 116 (Bankr. W.D. Tex. 1991), quoting *First Nat'l Bank of Midlothian (In re Harrell)*, 94 B.R. 86, 90 (Bankr. W.D. Tex. 1988).

No evidence was offered to show that the Defendant was guilty of embezzlement or larceny. The parties entered into a contract under which Plaintiff would purchase a house from Defendant. The evidence suggests Defendant intended to sell the house, but could not because of a cloud on the

title. Eventually, Defendant's house was foreclosed upon, and he and his family were required to move into the house inherited from Defendant's grandmother. Plaintiff had made some payments to Defendant because of his understanding with Defendant. In addition, certain advances were made by Plaintiff to Defendant to fix up Defendant's house. However, those payments were really premature, as the contract had not closed and would not close because of title problems with the house. As stated earlier, the Plaintiff's real damages here were caused by the breach of contract and not due to any fraud or larceny on behalf of the Defendant.

In this case, the Plaintiff simply has not put forth sufficient evidence of the elements of these exceptions to discharge it claims under section 523. On the other hand, Defendant testified credibly and explained his actions.

For these reasons, judgment will be entered in favor of the debtor Defendant.

SIGNED: 2/4/05

Harlin D. Hale
United States Bankruptcy Judge