UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF TEXAS
DALLAS DIVISION

IN RE:	§	
	§	
TOM BRANSFORD	§	**Case No. 04-32912 HDH-7**
	§	
Debtor	§	

ELLIS WOLBE and GARY KANER, PARTNERS	§	
	§	
	§	
Plaintiffs	§	
	§	
VS.	§	**Adversary No. 04-3378**
	§	
TOM BRANSFORD	§	
	§	
Defendant	§	

MEMORANDUM OPINION ON
DISCHARGEABILITY COMPLAINT

On January 25, 2005, this Court conducted a trial on the *Complaint to Determine Dischargeability of a Debt* filed by Ellis Wolbe and Gary Kaner, Partners ("Plaintiffs"). Both sides appeared and offered testimony and documentary evidence. Both sides argued at the end of the trial.

The Plaintiffs seek to except from Debtor Tom Bransford's ("Defendant") discharge a claim of approximately $167,000. Plaintiffs claim that the debt should be excepted under Bankruptcy Code Sections 523(a)(2)(A) (fraud), -(a)(4) (embezzlement or larceny), and -(a)(6) (willful and malicious injury).

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 Plaintiffs must show by a preponderance of the evidence that all the elements exist under sections 523(a)(2)(A), -(a)(4) and -(a)(6), as alleged in their complaint. *Recoveredge, L.P. v. Pentecost (In re Carpenter)*, 44 F.3d 1284, 1292 (5th Cir. 1995). In this case, Plaintiffs have not met their 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, Plaintiffs 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 Plaintiffs justifiably relied on the representations, and that they 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)).

Plaintiffs allege that the debt owed to them is nondischargeable on the basis of alleged misrepresentations made by the Debtor at the time the debt was incurred. To prove this allegation, Plaintiffs 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.

There was no real evidence offered at trial that the Defendant committed fraud in the Plaintiffs' business relationship with Allegiance Mortgage, Defendant's former employer. There was evidence that Plaintiffs did not get all of their money back from their investment. 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.

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), 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, Plaintiffs' claim that the debt is nondischargeable under section 523(a)(4) rests 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. No funds were taken by the Defendant for his own use. He did not abscond with Plaintiffs' money. The funds from the Special Account, so described at the trial, were used first to fund mortgages, per the original agreement, and then to fund operations, as allowed by the second agreement. Defendant's role in the business arrangement was diminished after the second agreement, as he had stepped down as president and was only serving as a consultant.

Willful and Malicious Injury

Section 523(a)(6) states: "A discharge under section 727 . . . of this title does not discharge an individual debtor from any debt—(6) for willful and malicious injury by the debtor to another entity or to the property of another entity . . ."

A "willful and malicious injury" results from an act done with the actual intent to cause injury, not from an act done intentionally that causes injury. *See Kawaauhau v. Geiger*, 523 U.S. 57 (1998). In other words, "for willfulness and malice to prevent discharge under § 523(a)(6), the debtor must have intended the actual injury that resulted." *In re Delaney*, 97 F.3d 800, 802 (5th Cir.1996). "[D]ebts arising from recklessly or negligently inflicted injuries do not fall within the compass of § 523(a)(6)." *Kawaauhau*, 523 U.S. at 64.

No evidence was offered which shows that the Defendant did anything willful or malicious to the Plaintiffs. Plaintiffs certainly lost on their investment with the Defendant's employer. However, no evidence shows that such loss was caused by a wilful or malicious act by the Defendant. Plaintiffs won a state court judgment against Defendant, while Defendant was *pro se*. This time Defendant is represented by able counsel and the issues are different. While the standard of proof is the same in this Court as in the state court, the elements Plaintiffs must prove are not the same. Discharge is favored in this Court, and, unless the Plaintiffs had proven their case, it should be granted.

In this case, the Plaintiffs simply have not put forth sufficient evidence of the elements of these exceptions to discharge they claim under section 523. On the other hand, Defendant testified credibly and explained his actions. Plaintiffs' witness was also credible, but not as persuasive as Defendant on the matters at issue.

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

SIGNED: 1/28/05

Harlin D. Hale
United States Bankruptcy Judge