IN THE UNITED STATES BANKRUPTCY COURT FOR THE EASTERN DISTRICT OF TENNESSEE

In re

Case No. 02-33826

JON C. BANDY
a/k/a JOHN BANDY
POLLY BANDY

Debtors

JULIA MAJERNIK

Plaintiff

v. Adv. Proc. No. 02-3176

JON C. BANDY and
POLLY BANDY

Defendants

MEMORANDUM ON MOTION FOR SUMMARY JUDGMENT

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RICHARD STAIR, JR.
UNITED STATES BANKRUPTCY JUDGE

On October 4, 2002, the Plaintiff, Julia Majernik, filed a Complaint to Determine the Dischargeability of Debt, seeking a determination that two judgments entered in her favor by the Knox County Chancery Court in the aggregate amount of $165,023.83 are nondischargeable pursuant to 11 U.S.C.A. § 523(a)(4) (West 1993).

Presently before the court is the Plaintiff's Motion for Summary Judgment (Motion) filed on December 17, 2002. In support of the Motion, the Plaintiff filed seven exhibits, her Affidavit, the Affidavit of Tim Coode, an attorney, a Statement of Material Facts summarizing the facts established by the affidavits and exhibits, and a Memorandum of Law in Support of Motion for Summary Judgment. The Defendants filed an Opposition to Motion for Summary Judgment, a Response to Statement of Material Facts, and Memorandum of Law in Support of Opposition to Motion for Summary Judgment on January 7, 2003; however, since the Opposition, Response, and Memorandum were not filed within twenty days after the Motion was filed, as required by E.D. Tenn. LBR 7007-1, they will not be considered.

This is a core proceeding. 28 U.S.C.A. § 157(b)(2)(A), (I), and (O) (West 1993).

I

The Plaintiff is the aunt of the Debtor, Polly Bandy (Ms. Bandy), who was appointed as the Plaintiff's attorney-in-fact under a Durable Power of Attorney executed by the Plaintiff on August 21, 1998. Subsequent to this appointment, Ms. Bandy transferred funds belonging to the Plaintiff to an account held jointly with the Debtor, Jon Bandy (Mr. Bandy), her husband. These funds were not used for the Plaintiff's benefit or on behalf of the Plaintiff.

On April 10, 2000, the Plaintiff filed a Petition for Accounting in the Knox County Chancery Court (the Knox County Chancery Court Lawsuit), in connection with the transfer of the Plaintiff's funds in the approximate amount of $190,000.00.[1] An Order for Partial Summary Judgment (Summary Judgment Order) was entered in the Knox County Chancery Court Lawsuit on June 13, 2001, in which the Chancellor found that the Debtors transferred funds in the aggregate amount of $193,290.29 from accounts belonging to the Plaintiff to accounts held jointly by the Debtors. The court held that the Plaintiff had recovered $28,266.46 from the Debtors and that the Debtors had preliminarily accounted for $80,597.12. Accordingly, the Chancellor granted partial summary judgment to the Plaintiff in the amount of $84,426.71, representing the amount that was unaccounted for. Additionally, the Chancellor ordered the Debtors to prove that the $80,597.12 which had been accounted for was actually expended for the Plaintiff's benefit.

A trial was conducted in the Knox County Chancery Court on July 26, 2001. On August 10, 2001, the Chancellor entered an Order (the August 10, 2001 Order) finding that the Debtors **?**have in no way proven that they have expended the assets of [the Plaintiff] in compliance with their obligations as a fiduciary under the laws of the state of Tennessee." Accordingly, the Chancellor granted the Plaintiff a judgment in the amount of $80,597.12, in addition to the $84,426.71 judgment obtained on June 13, 2001 (collectively, the Judgments).

The Debtors filed their bankruptcy case under Chapter 7 of the Bankruptcy Code on July 23, 2002, and they obtained a discharge on November 1, 2002. The Plaintiff filed this

[1] An Amended Petition was filed on June 16, 2000, to include tax liability for unauthorized IRA distributions.

adversary proceeding on October 4, 2002, asserting that the Judgments entered in the Knox County Chancery Court in her favor in the aggregate sum of $165,023.83 are nondischargeable under § 523(a)(4). Specifically, she argues that the Debtors violated their fiduciary duty to her. Additionally, the Plaintiff argues that this matter has already been litigated in the Knox County Chancery Court and is, thus, subject to the doctrine of collateral estoppel.

II

Pursuant to Rule 56 of the Federal Rules of Civil Procedure, summary judgment shall be granted ?if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law." FED. R. CIV. P. 56(c). Rule 56(c) is made applicable to adversary proceedings by Federal Rule of Bankruptcy Procedure 7056.

As the moving party, the Plaintiff bears the initial burden of proving that there is no genuine issue of material fact and that she is, therefore, entitled to judgment as a matter of law. *Owens Corning v. Nat'l Union Fire Ins. Co.*, 257 F.3d 484, 491 (6th Cir. 2001). Once established, the burden then shifts to the nonmoving party, in this case, the Debtors, to produce specific facts showing that there is, in fact, a genuine issue for trial. *Matsushita Elec. Indus. Co., Ltd. v. Zenith Radio Corp.*, 106 S. Ct. 1348, 1356 (1986) (citing FED. R. CIV. P. 56(e)). In doing so, they must cite specific evidence and may not merely rely upon allegations contained in the pleadings. *Harris v. Gen. Motors Corp.*, 201 F.3d 800, 802 (6th Cir. 2000). The facts and all resulting inferences will be viewed in the light most favorable to the Debtors, as the non-moving

parties. *See Matsushita*, 106 S. Ct. at 1356. The court must then decide whether **?**the evidence presents a sufficient disagreement to require submission to a jury or whether it is so one-sided that one party must prevail as a matter of law." *Anderson v. Liberty Lobby, Inc.*, 106 S. Ct. 2505, 2512 (1986).

III

Generally, Chapter 7 debtors may be discharged from all prepetition debts pursuant to 11 U.S.C.A. § 727 (West 1993), subject to the limitation of debts **?**provided in section 523 of this title . . . ." 11 U.S.C.A. § 727(b). Section 523(a) provides, in material part:

> (a) A discharge under section 727 . . . of this title does not discharge an individual debtor from any debt—
>
> . . . .
>
> (4) for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny[.]

11 U.S.C.A. § 523(a)(4). Because the Plaintiff contests the Defendants' dischargeability of the Judgments pursuant to § 523(a)(4), she bears the burden of proof by a preponderance of the evidence. *See Grogan v. Garner*, 111 S. Ct. 654, 661 (1991). The § 523(a)(4) nondischargeability provision shall be strictly construed against the Plaintiff. *See Rembert v. AT&T Universal Card Servs., Inc. (In re Rembert)*, 141 F.3d 277, 281 (6th Cir. 1998).

For the Judgments to be nondischargeable under § 523(a)(4), the Debtors must have obtained the underlying debt in one of three ways: by embezzlement, by larceny, or through fraud

or defalcation while acting in a fiduciary capacity. *See* 11 U.S.C.A. § 523(a)(4). The Plaintiff argues that the Judgments arose from the Defendants' defalcation while acting as fiduciaries.

Defalcation as contemplated by § 523(a)(4) requires proof of: **?**1) a fiduciary relationship; 2) breach of that fiduciary relationship; and 3) a resulting loss." *R.E. Am., Inc. v. Garver (In re Garver)*, 116 F.3d 176, 178 (6th Cir. 1997); *see also* BLACK'S LAW DICTIONARY 417 (6th ed. 1994) (defining defalcation as **?**misappropriation of trust funds or money held in any fiduciary capacity; failure to properly account for such funds."). In the Sixth Circuit, **?**the debtor must hold funds in trust for a third party" for a fiduciary relationship to exist. *Garver*, 116 F.3d at 179. Accordingly, **?**the defalcation provision of § 523(a)(4) is limited to only those situations involving an express or technical trust relationship arising from placement of a specific res in the hands of the debtor." *Id*. at 180.

In Tennessee, an express trust relationship can be created **?**by the direct and positive acts of the parties, by some writing, . . . or by the action of a court in the exercise of its authority . . . ." *Jackson v. Dobbs*, 290 S.W. 402, 404 (Tenn. 1926) (quoting *Lafferty v. Turley*, 35 Tenn. 157, 163 (1855)). Here, the writing in question is the Durable Power of Attorney, and the issue is whether this document created a fiduciary relationship between the Plaintiff and the Debtors under Tennessee law.

?All acts done by an attorney in fact pursuant to a durable power of attorney . . . have the same effect and inure to the benefit of and bind the principal . . . ." TENN. CODE ANN. § 34-6-103 (2001). Because **?**[o]ne acting pursuant to a durable power of attorney must act in the

principal's best interests and within the scope of authority granted by the statute [Tennessee Code Annotated section 34-6-109] and the principal, . . . the relationship between the attorney in fact and the principal is subject to the laws of agency." *Eaton ex rel. Johnson v. Eaton*, 83 S.W.3d 131, 134 (Tenn. Ct. App. 2001). Under Tennessee law, **?**the relationship between the agent and principal is fiduciary in nature and generally treated with the same gravity and strictness as the trustee-beneficiary relationship . . . [and the] agent, as a fiduciary, is under a duty of loyalty to the principal." *Id.* (citing *Marshall v. Sevier County*, 639 S.W.2d 440, 446 (Tenn. Ct. App. 1982) and *Pridemore v. Cherry*, 903 S.W.2d 705, 707 (Tenn. Ct. App. 1995)). Additionally, **?**[a] person who receives the principal's property from an agent of another, with notice that the agent is thereby committing a breach of fiduciary duty to the principal, holds the property thus acquired as a constructive trustee, or at the election of the principal, is subject to liability for its value." *Id*. (quoting RESTATEMENT (SECOND) OF AGENCY § 314 (2000)).

In the case presently before the court, under Tennessee law, the terms of the Durable Power of Attorney created a fiduciary relationship between the Plaintiff and Ms. Bandy. Additionally, the August 10, 2001 Order entered in the Knox County Chancery Court makes the following finding of fact:

> 1. The Respondents [Polly Bandy and Jon C. Bandy] have in no way proven that they have expended the assets of Petitioner in compliance with their obligations as a fiduciary under the laws of the state of Tennessee[.]

August 10, 2001 Order. This finding of fact clearly establishes that the court found a fiduciary relationship existed between the Plaintiff, under Tennessee law, and both Debtors. As such, the first prong of the *Garver* test is met.

In order to meet the second prong of the *Garver* test, the Plaintiff must prove that the Debtors breached their fiduciary relationship. This court defers to the August 10, 2001 Order of the Knox County Chancery Court, which states that the Debtors failed to comply ?with their obligations as a fiduciary under the laws of the state of Tennessee." This finding of fact by the Chancellor clearly establishes that the Debtors breached their fiduciary relationship with the Plaintiff when they transferred her funds to their joint bank account and jointly expended the funds for their benefit and not that of the Plaintiff. The second prong is met.

The third prong of the *Garver* test requires that the party seeking a determination of nondischargeability suffer an actual loss. Once again, the court relies upon the findings of fact entered by the Chancellor in the Knox County Chancery Court. First, the Summary Judgment Order specifically states that (1) the Debtors transferred a total of $193,290.29 in funds belonging to the Plaintiff from her accounts to joint accounts of the Debtors; (2) that the Debtors admitted that they had transferred the funds belonging to the Plaintiff; (3) that the Plaintiff had recovered $28,266.46; (4) that $80,597.12 was purportedly accounted for; and (5) that $84,426.71 was unaccounted for. Based upon these findings of fact, the Chancellor awarded the Plaintiff a judgment in the amount of $84,426.71. Then, after a trial on July 26, 2001, in which the Debtors bore the burden of proof that the accounted for funds had been expended to benefit the Plaintiff, the Chancellor entered the August 10, 2001 Order, awarding an additional judgment to the Plaintiff and against the Debtors in the amount of $80,597.12. The sum of the Judgments, $165,023.97, represents the funds expended by the Debtors but not yet recovered by the Plaintiff; *i.e.*, the

Plaintiff's actual loss suffered as a result of the Debtors' misappropriation of funds in violation of the fiduciary relationship.

The court finds that all three prongs of the *Garver* test are met and that the Judgments awarded the Plaintiff in the aggregate amount of $165,023.83 are nondischargeable under 11 U.S.C.A. § 523(a)(4).

IV

The Plaintiff also raises collateral estoppel as supporting her Motion. Even though the court has determined that the elements of § 523(a)(4) have been met, it will also briefly address the collateral estoppel argument by the Plaintiff.

Collateral estoppel, or issue preclusion, derives from the Full Faith and Credit Statute, which provides that **?**judicial proceedings . . . [of any State] shall have the same full faith and credit in every court within the United States . . . as they have by law or usage in the courts of such State . . . ." 28 U.S.C.A. § 1738 (1994). Accordingly, **?**a federal court must give to a state-court judgment the same preclusive effect as would be given that judgment under the law of the State in which the judgment was rendered." *Migra v. Warren City Sch. Dist. Bd. of Educ.*, 104 S. Ct. 892, 896 (1984).[2]

Under Tennessee state law, **?**collateral estoppel bars relitigation of an issue if it was raised in an earlier case between the same parties, actually litigated, and necessary to the judgment of the

[2] The Supreme Court has held that collateral estoppel applies in proceedings to determine dischargeability under § 523(a). *See Grogan, supra*, 111 S. Ct. at 658 n.11.

earlier case." *Rally Hill Prods., Inc. v. Bursack (In re Bursack)*, 65 F.3d 51, 54 (6th Cir. 1995) (citing *Massengill v. Scott*, 738 S.W.2d 629, 632 (Tenn. 1987)). ?[M]aterial facts or questions, which were in issue in a former action, and were there admitted or judicially determined, are conclusively settled by a judgment rendered therein, and . . . such facts or questions become res judicata and may not again be litigated in a subsequent action between the same parties." *Booth v. Kirk*, 381 S.W.2d 312, 315 (Tenn. Ct. App. 1963) (quoting *Cantrell v. Burnett & Henderson Co.*, 216 S.W.2d 307, 309 (Tenn. 1948)).[3] Applying this standard to the case before this court, the determination of nondischargeability remains the same.

First, the parties to this dischargeability action are the same parties as in the Knox County Chancery Court Lawsuit. Second, the issues which are pertinent to the dischargeability determination, *i.e.*, the existence of a fiduciary relationship, breach of a fiduciary relationship, and actual loss, were also issues in the Knox County Chancery Court Lawsuit, based upon the same material facts and questions of law as to the Debtors' misappropriation of and failure to account for funds entrusted to them by the Plaintiff. The court is persuaded that these issues were ?actually litigated"quite vigorously by evidence that the Debtors hired an attorney, filed an answer to the complaint in which they admitted to both the existence of the Durable Power of Attorney and their transferring of the funds in question, filed many motions, and participated in the trial held in the Knox County Chancery Court on July 26, 2001. Moreover, the court relies upon the August 10, 2001 Order which specifically recites the Chancellor's findings of fact that a fiduciary relationship

[3] The doctrine of collateral estoppel is an ?extension" of the doctrine of res judicata. *Ohio Cas. Ins. Co. v. Hryhorchuk (In re Hryhorchuk)*, 211 B.R. 647, 652 (Bankr. W.D. Tenn. 1997); *see also J.Z.G. Res., Inc. v. Shelby Ins. Co.*, 84 F.3d 211, 214 (6th Cir. 1996) (?The rules of res judicata actually comprise two doctrines concerning the preclusive effect of a prior adjudication, claim preclusion and issue preclusion.").

existed, was breached, and actual damages were incurred by the Plaintiff. Finally, these issues were necessary for a judgment by the state court for misappropriation as well as being necessary for a determination by this court that the debt is nondischargeable.[4]

V

In summary, under either approaches presented by the Plaintiff in her Motion for Summary Judgment, defalcation pursuant to § 523(a)(4) and/or collateral estoppel, the court finds that the Judgments in favor of the Plaintiff and against the Debtors in the aggregate amount of $165,023.83 are nondischargeable.

A judgment consistent with this Memorandum will be entered.

FILED: January 14, 2003

BY THE COURT

/s/

RICHARD STAIR, JR.
UNITED STATES BANKRUPTCY JUDGE

[4] *See also Hryhorchuk, supra* n. 3 (applying collateral estoppel principles to a similar dischargeability action under § 523(a)(4) and finding defalcation based upon specific findings of fact by an Ohio state court chancellor that the debtor had misappropriated funds, held in his capacity as legal guardian over his minor children, and had failed to provide an accounting therefor).

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POLLY BANDY

Debtors

JULIA MAJERNIK

Plaintiff

v. Adv. Proc. No. 02-3176

JON C. BANDY and
POLLY BANDY

Defendants

J U D G M E N T

For the reasons stated in the Memorandum on Motion for Summary Judgment filed this date containing findings of fact and conclusions of law as required by Rule 52(a) of the Federal Rules of Civil Procedure, it is ORDERED, ADJUDGED, and DECREED as follows:

1. The Plaintiff's Motion for Summary Judgment filed December 17, 2002, is GRANTED.

2. The judgments totaling $165,023.83 entered against the Defendants in favor of the Plaintiff in the Chancery Court for Knox County, Tennessee, in the matter styled *Julia Majernik, Petitioner v. Polly Bandy and John C. Bandy, Respondents*, Docket No. 146778-2, consisting of $84,426.71 pursuant to an Order for Partial Summary Judgment entered on June 13, 2001, and $80,597.12 pursuant to an Order entered on August 10, 2001, are nondischargeable under 11 U.S.C.A. § 523(a)(4) (West 1993).

3. The Plaintiff's action having been resolved by summary judgment, the trial set for April 21, 2003, is STRICKEN.

ENTER: January 14, 2003

BY THE COURT

/s/

RICHARD STAIR, JR.
UNITED STATES BANKRUPTCY JUDGE