

**United States Bankruptcy Court
District of New Mexico**

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UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF NEW MEXICO

In re:

LULA M. GRAY and
DON JONES,
Debtors.

No. 7-02-10913 SR

WESTERN UNION FINANCIAL SERVICES, INC.,
Plaintiff,
v.

Adv. No. 02-1174 S

LULA MAUD GRAY,
Defendant.

MEMORANDUM OPINION

This matter came before the Court for trial on the merits of Plaintiff's complaint to determine dischargeability of a debt owed to it by Defendant under § 523(a)(4) (Count 1), § 523(a)(6) (Count 2), and to deny discharge under § 727(a)(3) (Count 3). Plaintiff appeared through its attorney Elvin Kanter. Defendant appeared through her attorney James Klipstine. This is a core proceeding. 28 U.S.C. § 157(b)(2)(I).

FACTS

1. Defendant was the owner, vice president and treasurer of Frontier Mortgage Company, Inc. ("Frontier") (Exhibit D, interrogatory 2). Defendant's daughter was President of Frontier.
2. On or about July 10, 1998, Plaintiff and Frontier entered into a "Payment Services Agency and Trust Agreement."

(hereafter "Agreement")(Exhibit A). The Agreement was executed on behalf of Frontier by Defendant¹ as "Owner/President." The Agreement provides, in part:

1. Appointment.

a. ... Western Union hereby appoints Agent [Frontier] as Western Union's non-exclusive agent authorized to provide services through Western Union's bill payment system (the "System") in accordance with and subject to the terms and conditions hereafter set forth. ... Upon the Start Date of this Agreement, and pursuant to its terms, Agent shall be a trustee and act in a fiduciary capacity with respect to any Customer Payments (defined below) in Agent's possession. ...

b. Agent shall hold the Customer Payments in trust for the benefit of the Billers. In the event Agent commingles Customer Payments with any other funds and/or monies such other funds and/or monies shall be deemed to be impressed with a trust up to the amount owed to Billers. It is expressly understood that Agent does not by operation of this Agreement acquire any right, title or interest of any kind in the Customer Payments. All Customer Payments remain the sole and exclusive property of the Billers.

Under the Agreement, customers would come to Frontier to pay utility bills through Western Union for a fee. Frontier would take the payments and transmit the information to Western Union, which would in turn draft an account at Frontier and pay the utility bills.

¹ Defendant testified that she did not recall signing Exhibit A and that her daughter may have signed it on her behalf, with her permission.

3. On or about April 19, 1999, Defendant² executed a "Personal Indemnity and Guaranty" ("Guaranty") of Frontier's Agreement with Western Union. (Exhibit B). This agreement provides, in part: "[T]he undersigned [Defendant]... guarantees to Western Union the prompt payment in full by Agent (as defined in the Agency Agreement) of all sums and amounts payable under such Agency Agreement and the prompt and complete performance by Agent of all other obligations thereunder."

4. Exhibit C is taken from Western Union's business records and contains printouts of financial transactions between Frontier and Western Union. Defendant stipulated to the dates and amounts shown. The Court believes that it shows an amount due from Frontier to Western Union of \$38,974.90. If this is incorrect, either party may ask to supplement the exhibit. This amount represents funds collected by Frontier in the summer and fall of 1999 and not turned over to Western Union pursuant to the Agreement.

5. Defendant is a nurse. She provided the money to start Frontier, which was managed by her daughter. At the time of the Agreement and the Guaranty Defendant was not actively

² Defendant testified that she did not recall signing Exhibit B either and that her daughter may have signed it on her behalf, with her permission.

involved with Frontier. Defendant's uncontradicted testimony was that she never received any payments for utility bills and never deposited money received by Frontier that was owed to Plaintiff. Defendant never wrote any corporate checks after July, 1998. Defendant never received any income from Frontier.

6. Plaintiff had no evidence that the missing funds were due to any wilful or malicious behavior of the Defendant.

7. In response to Plaintiff's interrogatories 4 and 10 Defendant replied that there were no documents related to the facts or events of this case.

CONCLUSIONS OF LAW

1. Count 1 seeks relief under 11 U.S.C. § 523(a)(4) which provides "A discharge under section 727 ... does not discharge an individual debtor from any debt for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny."

2. Plaintiff did not provide evidence of fraud, embezzlement, or larceny. Plaintiff relies on the defalcation prong of the statute.

[D]efalcation under section 523(a)(4) is a fiduciary-debtor's failure to account for funds that have been entrusted to it due to any breach of a fiduciary duty, whether intentional, wilful, reckless, or negligent. Furthermore, the fiduciary-debtor is charged with knowledge of the law and its

duties. Once a creditor objecting to the dischargeability of a debt under section 523(a)(4) has met its burden of showing that the debtor is a fiduciary and that its debt has arisen because the debtor-fiduciary has not paid the creditor funds entrusted to it, the burden then shifts to the debtor-fiduciary to render an accounting to show that it complied with its fiduciary duties.

Antlers Roof-Truss & Builders Supply v. Storie (In re Storie),

216 B.R. 283, 288 (10th Cir. B.A.P. 1997). See also Bellity

v. Wolfington (In re Wolfington), 48 B.R. 920, 923 (Bankr.

E.D. Pa. 1985)("Defalcation includes the failure of a

fiduciary to account for money he received in his fiduciary

capacity. It is sufficient if the misrepresentation is due to

negligence or ignorance. It is irrelevant that the default by

the fiduciary was innocent.")

3. The Agreement created an express trust. Frontier was a fiduciary for the funds entrusted to it. The trust and Frontier's duty predated the misapplication of funds.

4. Defendant was also a fiduciary because she explicitly guaranteed both Frontier's prompt payment and "complete performance" of "all obligations" under the Agreement. In other words, the Guaranty made Defendant a co-trustee under the Agreement. Furthermore, as an owner, officer and director of Frontier she should be held liable for any defalcations by Frontier that resulted from her negligent or reckless delegations of duties to her daughter. It would be unfair to

Plaintiff to allow Defendant to plead ignorance as a defense after putting herself in a position of trust.

5. Plaintiff has met its burden to show, by a preponderance of the evidence³, that Defendant is a fiduciary and that its debt has arisen because the Defendant-fiduciary has not paid funds entrusted to Frontier. The burden shifted to the Defendant-fiduciary to render an accounting to show that she complied with her fiduciary duties. Id. Defendant made no such showing. Therefore, Judgment should be awarded to Plaintiff on Count 1.

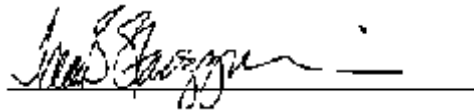
6. Count 2 seeks relief under 11 U.S.C. § 523(a)(6) which provides "A discharge under section 727 ... does not discharge an individual debtor from any debt for willful and malicious injury by the debtor to another entity or to the property of another entity." In Kawaauhau v. Geiger, 523 U.S. 57, 64 (1998) the United States Supreme Court ruled that debts arising from recklessly or negligently inflicted injuries do not fall within the compass of § 523(a)(6). The Court reasoned that "The word 'willful' in (a)(6) modifies the word 'injury,' indicating that nondischargeability takes a deliberate or intentional injury, not merely a deliberate or

³ Preponderance of the evidence is the standard for all § 523(a) actions. Grogan v. Garner, 498 U.S. 279, 287 (1991).

intentional act that leads to injury." Id. at 61 (Emphasis in original.)

The Court finds that Defendant acted negligently, or perhaps recklessly, in entrusting funds to her daughter's management. There is no evidence that Defendant deliberately or intentionally converted the funds, or that she even knew the funds were converted at the time. Therefore, Count 2 should be dismissed.

7. The Court ruled orally at the conclusion of trial that the evidence did not support Plaintiff's Count 3 to deny discharge. First, the records not produced were those of Frontier. Debtor explained that she had not been active in Frontier for years. Second, Plaintiff has not demonstrated that the lack of records was a general condition as opposed to an isolated case. Count 3 should be dismissed.



Honorable James S. Starzynski
United States Bankruptcy Judge

I hereby certify that on October 14, 2003, a true and correct copy of the foregoing was either electronically transmitted, faxed, delivered, or mailed to the listed counsel and parties.

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