Ostrum v. Porter (In re Porter), Case No. 03-118, 2008 Bankr. LEXIS 109, 2008 WL 217174 (Bankr. N.D.W. Va. Jan. 10, 2008).

Order Entered.

Patrick M. Flatley
United States Bankruptcy Judge
Dated: Thursday, January 10, 2008 8:53:09 AM

**UNITED STATES BANKRUPTCY COURT**
**FOR THE NORTHERN DISTRICT OF WEST VIRGINIA**

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| IN RE: | ) | |
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| NOAH WILSON PORTER, JR., and DORA JEAN PORTER | ) | BK. NO. 03-700 |
| | ) | |
| | ) | CHAPTER 7 |
| Debtors. | ) | |
| | ) | |
| CATHERINE D. OSTRUM, A. LORRAINE McGEE, and KENNETH C. PORTER, | ) | |
| | ) | |
| Plaintiffs, | ) | |
| | ) | |
| v. | ) | AP. NO. 03-118 |
| | ) | |
| NOAH W. PORTER, JR., and DORA JEAN PORTER, | ) | |
| | ) | |
| Defendants. | ) | |

## MEMORANDUM OPINION

Catherine D. Ostrum, A. Lorraine McGee, and Kenneth C. Porter (the "Plaintiffs"), as representatives of the Estate of Mabel Margaret I. Porter ("Mabel"), seek a judgment excepting up to $200,000 in compensatory damages and up to $500,000 in punitive damages from the Chapter 7 discharge of Noah Wilson Porter Jr. ("Noah," or the "Debtor"), and his spouse, Dora Jean Porter, on the grounds that they committed defalcation while acting an behalf of Mabel pursuant to a power of attorney.

A trial was held in this case on February 2, 2007, in Clarksburg, West Virginia. During the trial, Dora made an oral motion for judgment as a matter of law on the grounds that she was not a fiduciary to Mabel, and, therefore, was not capable of committing defalcation. The court granted the motion, and the

trial proceeded solely as to the Debtor. For the reasons set forth herein, the court finds that the Debtor owes a $3,000 debt to the Estate of Mabel Porter, which is excepted from his Chapter 7 discharge pursuant to 11 U.S.C. § 523(a)(4).

## I. BACKGROUND

On May 9, 1994, Mabel, accompanied by Noah and Dora, went to the office of Mabel's attorney where Mabel executed both her Last Will and Testament (the "1994 Will"), and a durable power of attorney appointing the Debtor as her attorney-in-fact (the "POA"). The 1994 Will provides:

> I hereby give and grant unto my grandson, ROY LEE PORTER, if living at my death, the absolute right and privilege to purchase my home property known as 1258 Woodland Circle, New Windsor, Maryland, at and for the price of Forty Thousand Dollars ($40,000.00) net to my estate, all settlement expenses to be paid by my grandson, ROY LEE PORTER. The exercise of the option shall be made by written notice to the Executors of my estate mailed or delivered within thirty (30) days after my will has been probated, and settlement shall be held within ninety (90) days thereafter.

(Def. Ex. 8).

1258 Woodland Circle (the "Property"), was cobbled together over a period of about fifty years. In 1949, Mabel owned a parcel of real property that was shaped like a pentagon (the "1949 Parcel"). In 1963, Mabel acquired a second parcel of real property (the "1963 Parcel"), that formed a horseshoe around the 1949 Parcel. Combined, Mabel owned slightly less than two acres. In 1976, Mabel divided the combined real property by half, and conveyed one of the parcels to the Debtor, who subsequently built a home on the land. The parcel retained by Mabel was used for a single-family home and a mobile home, which were assigned the postal addresses of 1258 and 1261 Woodland Circle, respectively.

In 1977, Mabel moved from the single-family home, at 1258 Woodland Circle, to the mobile home at 1261 Woodland Circle. She rented the single-family home to various tenants at a rate of $200 per month. In 1988, Roy Lee Porter, the Debtor's son, moved into the single-family home and also paid $200 per month in rent. While the single-family home was in livable condition in 1988, it was in extreme disrepair. Roy Lee Porter, together with the Debtor, made substantial repairs to the home from 1988 to 1995, including replacing the roof, furnace, and kitchen floor.

In 1993, Mabel was hospitalized with a broken hip. After being discharged from the hospital, she

returned to her mobile home at 1261 Woodland Circle. Although Mabel was able to care for herself, the Debtor visited with her a few times each week to make sure that she was okay. In early 1994, Mabel was hospitalized again with a stroke. Rather than immediately returning to her mobile home after being discharged, Mabel decided to stay with Catherine Ostrum for a brief period. Eventually, Mabel moved back into her mobile home, but, as a result of her deteriorating health, she moved in with the Debtor and Dora in October 1994, where she remained until entering the nursing home in September 1995. Mabel died on November 9, 1996.

While Mabel was living with Dora and the Debtor, Dora wrote checks from Mabel's account payable to herself and the Debtor. The checks were appropriately signed by Mabel, and totaled about $1,800. The Debtor maintains that the funds were only used to satisfy Mabel's needs. By June 1995, the Debtor determined that Mabel's physical and mental condition had deteriorated to a point that required him to exercise his rights under the POA, and he began making preparations to transition Mabel into a nursing home. After speaking with a social worker, the Debtor believed that Mabel would have to sell her house to pay for her nursing home expenses. Rather than placing her real property and the mobile home on the open market, he offered his son Roy and his wife Tammy the opportunity to purchase them for the price specified in the 1994 Will. Roy and Tammy accepted, and in exchange for the July 20, 1995 deed, they paid Mabel $40,000.[1]

The Debtor deposited the $40,000 in a savings account held jointly by himself and Mabel. The day after the funds were deposited, the Debtor withdrew $10,000. Of this amount, he kept $7,000 to pay for Mabel's future funeral expenses, and no clear accounting exists regarding the disposition of the remaining $3,000.[2]

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[1]Because Roy Lee and Tammy Sue were unable to obtain financing on their own, the Debtor transferred the Property to them on July 20, 1995, which they, in turn, used as collateral to obtain financing. From the loan proceeds that they obtained, Roy Lee and Tammy Sue paid the closing costs of the purchase, which amounted to $12,000 to $13,000, and paid $40,000 to the Debtor.

[2] The Debtor did purchase a life insurance policy on Mabel around July 1995 in the amount of $10,000, with the beneficiaries being listed as the Debtor and Dora. Although the Debtor apparently paid the premiums under the policy on Mabel's behalf, the insurance company refused to honor the policy on her death on the basis that the Debtor misrepresented relevant facts on the application.

In December 1995, the Plaintiffs commenced an action in the Circuit Court for Carroll County, Maryland to have the Debtor removed as attorney in fact under the POA. In April 1996, the parties reached an agreement, and Linda Holmes was appointed as Mabel's guardian. Ms. Holmes investigated the Debtor's transactions on behalf of Mabel, and she noted that on January 11, 1996, the Debtor had deposited $7,000 in to Mabel's account, which represented a portion of the $10,000 that the Debtor withdrew in July 1995. However, she was unable to account for the remaining $3,000, which the Debtor claims to have deposited into Mabel Porter's account.

After Mabel's November 9, 1996 death, the Plaintiffs submitted a will for probate that pre-dated the 1994 Will. The Debtor subsequently filed the 1994 Will in that proceeding, and the Plaintiffs challenged its validity. Both the Orphans Court for Carroll County, Maryland, and the Circuit Court on appeal, upheld the validity of the 1994 Will. The Debtor's final accounting of Mabel's estate is being contested by the Plaintiffs on the grounds that it fails to account for the proceeds of the present litigation in this court, should this court determine that the Debtor owes Mabel's estate a debt that is excepted from his bankruptcy discharge. The Debtor received his Chapter 7 discharge from the bankruptcy court on June 11, 2003.

## II. DISCUSSION

The Plaintiffs assert that the Debtor, acting under the POA, violated his fiduciary duty to Mabel by (1) selling the Property to his son and daughter-in-law for $40,000 when its fair market value was about $185,000, and (2) failing to produce a complete accounting for the disbursements of Mabel's funds. The Debtor contends that he acted in Mabel's best interests when he sold the Property and used the proceeds for her benefit.

Section 727(b) of the Bankruptcy Code provides that a Chapter 7 discharge relieves a debtor "from all debts" that arose before the filing of the bankruptcy petition. 11 U.S.C. § 727(b). Not every debt, however, is subject to being discharged; § 523(a) of the Bankruptcy Code provides nineteen exceptions whereby a pre-petition debt will remain valid after entry of a debtor's discharge order. Because

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Namely, the Debtor stated that Mabel had not sought medical attention for a stroke in the proceeding two years.

these exceptions to discharge contravene the "fresh start" policy of the Bankruptcy Code, they are construed narrowly in favor of the debtor. *E.g.*, *United States v. Fegeley (In re Fegeley)*, 118 F.3d 979, 983 (3d Cir. 1997) ("[E]xceptions to discharge are to be strictly construed in favor of the debtor."); *Leneski v. Smith (In re Smith)*, No. 017-14, 2007 Bankr. LEXIS 4148 (Bankr. N.D.W. Va. Dec. 18, 2007) (same). The only enumerated exception to discharge that is applicable to this proceeding is § 523(a)(4), which provides:

> 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 . . . .

11 U.S.C. § 523(a)(4).

To prevail on a § 523(a)(4) claim, the movant must establish, by a preponderance of the evidence, the existence of both: (A) a fiduciary relationship and, (B) a defalcation while acting in that fiduciary capacity. *E.g.*, *Grogan v. Garner*, 498 U.S. 279, 282-83 (1991) (applying a preponderance of the evidence standard to § 523(a) causes of action); *Fowler Bros. v. Young (In re Young)*, 91 F.3d 1367, 1371 (10th Cir. 1996) ("[U]nder § 523(a)(4), Fowler Brothers had to establish the following two elements to prevent the discharge of Mr. Young's debt: a fiduciary relationship between Fowler Brothers and Mr. Young and fraud or defalcation committed by Mr. Young in the course of that fiduciary relationship."); 5 *Collier on Bankruptcy* ¶ 523.10 (Alan N. Resnick & Henry J. Sommer eds. 15th ed. Rev. 2004) ("[D]efalcation refers to a failure to produce funds entrusted to a fiduciary").

**A. Fiduciary Capacity**

As an initial element of proving a § 523(a)(4) cause of action, the Plaintiffs must demonstrate that the Debtor acted in a fiduciary capacity to Mabel. The Plaintiffs contend that this element is satisfied on the basis that the Debtor exercised rights over Mabel's financial affairs pursuant to the POA.

In general, the concept of a "fiduciary duty" under § 523(a)(4) applies only to technical or express trusts; it does not generally apply to fiduciary duties implied by law from the contract. *In re Bennett*, 989 F.2d 779, 784 (5th Cir. 1983). The fiduciary duty must preexist the alleged wrong; thus, there can be no cause of action under § 523(a)(4) based on the existence of a constructive or resulting trust because those

types of trusts serve as remedies for another's breach of duty. *E.g.*, *Guerra v. Fernandez-Rocha (In re Fernandez-Rocha)*, 451 F.3d 813, 816 (11th Cir. 2006) ("'[C]onstructive' or 'resulting' trusts, which generally serve as a remedy for some dereliction of duty in a confidential relationship, do not fall within the § 523(a)(4) exception 'because the act which created the debt simultaneously created the trust relationship.'") (citation omitted). To have a technical or express trust, however, no requirement exists that there be a formal trust agreement; rather, a "fiduciary duty" sufficient to support a § 523(a)(4) cause of action includes trust-type obligations that are imposed pursuant to a statute or the common law. *E.g.*, *Bennett*, 989 F.2d at 785 ("[T]rust obligations necessary under section 523(a)(4) can arise pursuant to a statute, common law, or a formal trust agreement."). As explained by the Court of Appeals for the Seventh Circuit, a fiduciary relationship may be created when there is a "'difference in knowledge or power between the fiduciary and principal . . . which gives the former a position of ascendancy over the latter.'" *O'Shea v. Frain (In re Frain)*, 230 F.3d 1014, 1017 (7th Cir. 2000) (citation omitted). Under this test, a fiduciary relationship includes any relationship that calls for the imposition of the same high standard as a trust, such as "a lawyer-client relation, a director-shareholder relation, or a managing partner-limited partner relation" because all theses relationships call for the principal to "'repose a special confidence in the fiduciary.'" *Id.* (citation omitted).

Although the determination of whether a fiduciary duty exists to support a § 523(a)(4) cause of action is a question of federal law, "state law is relevant in determining whether a trust obligation exists." *Martinez v. Goodrich (In re Goodrich)*, No. 03-8172, 2004 Bankr. LEXIS 1951 at *6-7 (Bankr. C.D. Ill. Oct. 20, 2004). If such an obligation exists under state law, then "the court must look behind the provision to ascertain whether the relationship possesses the attributes required for the purposes of Section 523(a)(4)." *Id. See also Texas Lottery Comm'n v. Tran (In re Tran)*, 151 F.3d 339, 342 (5th Cir. 1998) ("A state cannot magically transform ordinary agents, contractors, or sellers into fiduciaries by the simple incantation of the terms 'trust' or 'fiduciary.' "); *Bennett*, 989 F.2d at 784 (stating that federal law defines the scope of "fiduciary capacity" and state law is relevant to whether a trust obligation exists).

In this case, the Plaintiffs assert that the Debtor was acting in a fiduciary capacity to Mabel because

he was exercising his rights under the POA. Under Maryland law,[3] a power of attorney is a "written document by which one party, as principal appoints another as agent (attorney in fact) and confers upon the latter the authority to perform certain specified acts or kinds of acts on behalf of the principal." *King v. Bankerd*, 492 A.2d 608, 611 (Md. 1985). Such an instrument outlines the boundaries of the agent's authority, and places a duty of loyalty on the agent to act for the benefit of the principal. *Id.* at 613. A power of attorney is "strictly construed as a general rule and is held to grant only those powers which are clearly delineated." *Klein v. Weiss*, 284 Md 36, 61, 395 A.2d 126, 140 (1978). Maryland State courts have described the relationship under a power of attorney as one that encompasses obligations of confidentiality, loyalty, and fiduciary duties. *E.g.*, *King*, 492 A.2d at 613 ("[T]he main duty of an agent [under a power of attorney] is loyalty to the interest of his principal. Thus, in exercising granted powers under a power of attorney, the attorney in fact is bound to act for the benefit of his principal and must avoid where possible that which is detrimental unless expressly authorized."); *King v. Bankerd*, 465 A.2d 1181, 1186 (Md. Ct. App. 1983) (concluding that an attorney at law, acting under a power of attorney, breached his fiduciary duty by conveying the principal's property for no consideration), *aff'd*, 492 A.2d 608 (Md. 1985); *Sanders v. Sanders*, 274 A.2d 383, 385 (Md. Ct. App. 1971) ("[T]he designation of Neil as Mr. Sanders' attorney in fact under the power of attorney established . . . a [confidential] relationship."); *cf.*, Md. Code §§ 15-1-2(3)(ii) (stating that the term "fiduciary" does not include a personal representative).

Notably, under Maryland law, a power of attorney granted in favor of another may be revoked at any time. *E.g.*, *Smith v. Dare*, 42 A. 909, 910 (Md. 1899) ("'[A]s a general rule an agent's authority to act for his principal is always revocable at the will of the principal by withdrawing his authority. . . ."); *see also* Md. Code § 13-602 (revocation of power of attorney). Here, no evidence suggests that Mabel was incompetent to handle her own affairs before June 1995; thus, Mabel was competent to monitor the actions

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[3] While the Debtor contends that West Virginia law is applicable, the court will apply Maryland law because the events relevant to the issue of defalcation occurred in Maryland. *Alberto v. Diversified Group, Inc.*, 55 F.3d 201, 203 (5th Cir. 1995) (A federal court must apply the forum state's conflicts rule on choice of law to determine which state's substantive law to apply); *City of Bluefield ex rel. San. Bd. v. Autotrol Corp.*, 723 F. Supp. 362 (S.D.W. Va. 1989) (In West Virginia, the law of the place of wrong applies to substantive issues in tort actions.).

of the Debtor before that time and object if she thought the Debtor was acting improperly. Although Mabel signed the POA in May 9, 1994, the Debtor stated that he never exercised rights given to him by the POA until June 1995. No evidence suggests that Mabel was unaware of the transactions that the Debtor engaged in relating to her financial affairs before this date. Consequently, no basis exists in this case to find that the Debtor was acting in a "fiduciary capacity" to Mabel before June 1995, and no transaction that occurred before this time is subject to a § 524(a)(4) cause of action. *See Estate of Smith v. Marcet (In re Marcet)*, 352 B.R. 462, 473 (Bankr. N.D. Ill. 2006) (finding that an agent acting under a power of attorney was not acting in a fiduciary capacity where the plaintiff failed to produce evidence that the principal was not capable of monitoring the actions of the agent).

However, by the Debtor's own admission, in June 1995, Mabel was no longer able to care for herself on a daily basis, and the Debtor began exercising his rights under the POA to manage Mabel's financial affairs on the basis that Mabel had become incompetent to perform those tasks herself. Consequently, the Debtor enjoyed a position of ascendancy over Mabel, who had, under the power of attorney, reposed a special confidence in the Debtor over her financial affairs. The Debtor was in this position of ascendency from June 1995, to the appointment of his replacement in April 1996. Accordingly, the Plaintiffs have carried both their burden of proof and persuasion that the Debtor acted in a fiduciary capacity – as a matter of federal law – to Mabel from June 1995 to April 1996. Transactions engaged in by the Debtor during this period of time are subject to scrutiny under § 523(a)(4).

**B. Defalcation**

From June 1995 to April 1996, the Plaintiffs allege that the Debtor committed defalcation when he sold the Property to his son and daughter-in-law for $40,000, when the fair market value of the property may have been as much as $185,000.[4] The Plaintiffs also contend that the Debtor committed defalcation by failing to adequately account for the $40,000 in sale proceeds. The Debtor, however, denies any act of defalcation, and argues that he sold the Property for its fair market value considering the need to liquidate

[4]In support of their contention as to value, Plaintiffs offered the deposition testimony of Georgia Hoff, a realtor. She postulated that the Property could have been sold as two separate parcels, ascribing a value of $110,000 to $135,000 to 1258 Woodland Circle, and $50,000 to 1261 Woodland Circle.

the property quickly to pay for Mabel's nursing home expenses.

Black's Law Dictionary provides two modern definitions for defalcation: (1) "embezzlement," and (2) "[l]oosely, the failure to meet an obligation; a non-fraudulent default." *Black's Law Dictionary* 448 (8th ed. 2004). The Court of Appeals for the Fourth Circuit has defined "defalcation" as the " 'misappropriation of trust funds or money held in any fiduciary capacity; [or the] failure to properly account for such funds.' " *In re Ansari*, 113 F.3d 17, 20 (4th Cir. 1997). (citation omitted). In the Fourth Circuit, there is no requirement that the defendant act wrongfully by, for example, embezzling or misappropriating funds; rather, "negligence or even an innocent mistake which results in misappropriation or failure to account is sufficient" to constitute a defalcation. *Republic of Rwanda v. Uwimana (In re Uwimana)*, 274 F.3d 806, 811 (4th Cir. 2001); *cf.*, *Hyman v. Denton, (In re Hyman)*, 502 F.3d 61, 67-68 (2d Cir. 2007) (noting a circuit split on whether wrongful conduct is required to support a cause of action under § 523(a)(4) for defalcation). Regarding the sale of the Property by the Debtor to his daughter and son-in-law for $40,000, the Debtor asserts that the price was fair and reasonable given the condition of the Property, his need to sell the Property quickly to meet Mabel's nursing home expenses, and given that the transaction complied with Mabel's wishes, as set forth in the 1994 Will. Indeed, the contention of the Plaintiffs as to value based on Ms. Hoff's deposition testimony is undercut by her acknowledgment that she had never been inside the dwelling at 1258 Woodland Circle, nor could she accurately recall whether she had driven by the it. On the other hand, the Debtor's testimony valuing the dwelling at far less than the figures offered by the Plaintiffs is more convincing given that it is based on firsthand knowledge. The Debtor asserts that the sale was a proper exercise of his duties under the POA, which provided:

> 1. The powers hereby conferred shall include but are not limited to the following:
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> . . .
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> (e) The power to manage real property; to sell . . . real property in my name if my attorney thinks proper; to execute, acknowledge and deliver deeds of real property . . . which my attorney considers necessary;
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> . . .
>
> 3. I authorize and empower my attorney to make gifts from assets owned or controlled by me in accordance with my estate plan to the extent that my attorney has knowledge and awareness of my estate plan.

(Def. Ex. 7).

Pursuant to the 1994 Will, of which the Debtor had knowledge, Mabel had expressed her intention to sell/gift the Property to the Debtor's son Roy for the amount of $40,000. Pursuant to Paragraphs 1(e) and 3 of the POA, the Debtor followed the terms of the 1994 Will by selling the property to his son for $40,000. Because the Debtor was following both the terms of the 1994 Will, and exercising rights specifically granted to him under the POA, the Debtor did not commit defalcation by misappropriating the value of the Property for the benefit of his son, and did not fail to meet an obligation owed to Mabel in his "fiduciary capacity." Indeed, the Debtor believed that he was acting in Mabel's best interest by both executing on her intention as expressed in the 1994 Will and by creating funds to pay for her nursing home expenses. The Debtor did not act rashly; rather, he took the time to consult with Mabel's attorney on whether or not he had the authority (on Mabel's behalf) to sell the property to his son.

Even considering that the Debtor may have been acting appropriately under the terms of the POA and the 1994 Will by selling the Property to his son, the Plaintiffs contend that the 1994 Will only pertained to 1258 Woodland Circle (the single family home) – not 1261 Woodland Circle (the address of the mobile home). Both 1258 and 1261 Woodland Circle were sold by the Debtor. Importantly, 1258 and 1261 Woodland Circle are not separate parcels of land – they are only two separate postal addresses. Mabel's "home property" was the entire parcel. In fact, Clayton Black, the Chief of the Bureau of Development Review with Carroll County Government, stated that the Property could not have been subdivided and sold for building purposes because the lots would be too small under the Assessment Notice from the State of Maryland Department of Assessments and Taxation of Carroll County. That Notice required lots in agricultural areas to be at least one acre. Richard Hull, a surveyor with Carroll Land Services, CLSI, reiterated the testimony of Clayton Black, that the Property could not be subdivided and reconfigured to create any valuable parcels. Accordingly, the court finds no merit in the Plaintiffs contention that the 1994 Will only intended to convey an undefined, undivided interest in the Property based on the mere fact that two postal addresses were designated for the two homes on the Property.

As the last complained of act of defalcation, the Plaintiffs allege that the Debtor owes a debt to Mabel's estate (and, therefore, themselves as beneficiaries), based on his failure to fully account for the

proceeds of the sale of the Property. More specifically, the Plaintiffs allege that the Debtor took $7,000 of the sale proceeds and kept them in his home to provide for Mabel's future burial expenses, and the remaining $3,000 is simply missing.

The Debtor states that he deposited the $7,000 back in Mabel's account in January 1996; thus, those funds are not missing. No party, however – not even the Debtor – has come forward with a satisfactory explanation as to what happened to the remaining $3,000. Because the Debtor was acting in a fiduciary capacity to Mabel with respect to the sale proceeds, and because the Debtor cannot account for the disposition of those proceeds after they entered his control, the court finds that $3,000 in sale proceeds have been misappropriated (whether it be by intentional act, negligence, or innocent mistake) for the benefit of the Debtor. Therefore, the court concludes that a $3,000 debt owed to the Estate of Mabel Porter is excepted from the Debtor's Chapter 7 discharge pursuant to § 524(a)(4).

## III. CONCLUSION

For the above stated reasons, the court will grant the relief sought by the Plaintiffs to the extent that a $3,000 debt owed by the Debtor to the Estate of Mabel Porter is excepted from the Debtor's discharge pursuant to § 523(a)(4). The court will enter a separate order pursuant to Fed. R. Bankr. P. 9021.