UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF VIRGINIA
Lynchburg Division

In re: LAWLESS J. BARRIENTOS, JR.,	)	Case no. 05-63448-LYN
	)	
Debtor.	)	
	)	
ALAN R. HARTMAN, Administrator of the Estate of Sara J. Frasier,	)	Adversary no. 05-06093
	)	
Plaintiff,	)	
	)	
LAWLESS J. BARRIENTOS,	)	
	)	
Defendant,	)	
	)	

MEMORANDUM AND ORDER

The matter comes before the court on a complaint brought by Alan R. Hartman[1], Administrator of the Estate of Sara J. Frazier ("the Plaintiff") on behalf of the Estate of Sara J. Frazier, ("the Frazier Estate") objecting to the dischargeability of a debt owed to the Estate by Lawless J. Barrientos ("the Debtor"). The complaint is brought under 11 U.S.C. § 523(a)(4). Judgment shall be entered in favor of the Plaintiff.

[1] Sara Jane Frazier was the original plaintiff in this adversary proceeding. She passed away after she filed the complaint. Alan R. Hartman was appointed as the administrator of her estate. He was permitted to intervene as plaintiff.

I. Jurisdiction

This Court has jurisdiction over this matter. 28 U.S.C. § 1334(a) & 157(a). This is a core proceeding. 28 U.S.C. § 157(b)(2)(I). Accordingly, this Court may enter a final order. This memorandum shall constitute the Court's findings of fact and conclusions of law as directed by Fed.R.Civ.P. 52, which is made applicable in this proceeding by Fed. R. Bankr. P. 7052.

II. Facts

On or about April 17, 1989, Mary S. Frazier, as settlor, established the Mary S. Frazier Living Trust ("the Trust") by executing the Mary S. Frazier Living Trust Agreement ("the Trust Agreement").[2] J. Stephen Pullum was appointed the trustee of the Trust. The Trust Agreement provided that the net income of the Trust was to be paid to Mary S. Frazier in convenient installments.[3] The Trust Agreement also provided that, upon the death of Mary S. Frazier, the Trust corpus was to be managed for the benefit of her daughter, Sara Jane Frazier.[4] The provision was made because Sara Jane Frazier was a person of special needs caused by dependence on alcohol and drugs.[5] The Defendant was aware of Ms. Frazier's addiction problems.[6] On June 14, 1990, Sara Jane Frazier became sole beneficiary under the Trust when Mary S. Frazier passed away.

On June 30, 1991, the assets in the Trust were worth $788,057.00.[7] From June 14, 1990

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2 See Plaintiff's Exhibit no. 1, the Mary S. Frazier Living Trust Agreement.

3 See Plaintiff's Exhibit no. 1, the Mary S. Frazier Living Trust Agreement, Article II.

4 See Plaintiff's Exhibit no. 1, the Mary S. Frazier Living Trust Agreement, Article III.

5 Testimony of the Defendant. Transcript of Hearing. p. 10 & 31.

6 Id.

7 Plaintiff's Exhibit 7, C.P.A. Audit Report for the Trust dated June 30, 1991.

through June 30, 1991, the Trust earned $42,723.00 in interest and $11,582.00 in dividend income.[8] This total income of $54,305.00 constituted a return of 6.8% on assets of $788,057.00. Shortly thereafter, Mr. Pullum caused the Trust to purchase a home ("the Residence") for $92,000.00 for Sara Jane Frazier to live in.[9] The Trust owned the Residence free and clear of liens at the time that it was purchased. The purchase of the Residence reduced the value of the non-Residence trust assets to approximately $700,000.00.[10] Mr. Pullum paid Sara Jane Frazier $2,500.00 per month from the funds in the Trust.

In March of 1992, the Defendant replaced Mr. Pullum as the trustee of the Trust.[11] On the date that the Defendant became the trustee of the Trust, the Trust assets had grown in value to $889,000.00 including the Residence.[12] The balance of the assets at that time consisted primarily of high-grade stocks and bonds, many of which were tax-deferred.[13] In 1993, the Trust earned $37,580.00.[14] In 1994, the Trust earned $28,878.00.[15]

From 1992 through 1999, the Defendant used Trust assets to fund business ventures

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[8] Plaintiff's Exhibit No. 7. C.P.A. Audit Report for the Trust.

[9] Testimony of the Defendant. Transcript of Hearing. p. 11.

[10] This conclusion assumes that the income earned by the trust and the distributions under the Trust were approximately equal.

[11] Testimony of the Defendant. Transcript of Hearing. p. 9-10. The defendant is the ex-husband of a cousin of Ms. Frazier.

[12] Testimony of the Defendant. Transcript of Hearing. p. 10.

[13] Testimony of the Defendant. Transcript of Hearing. p. 13. Also see Defendant's Exhibits G, H, and I.

[14] Trust 1993 Federal Income Tax Return. Defendant's Exhibit E. Testimony of the Defendant. Transcript of Hearing. p. 39.

[15] Trust 1994 Federal Income Tax Return. Defendant's Exhibit F. Also see, Testimony of the Defendant. Transcript of Hearing. p. 39.

belonging to himself and his family. Included in the companies that he invested in were (a) Works1Ez, Inc., a software company that designed and sold software that would facilitate filling out tax and related forms using a computer[16]; (b) In Case of Georgia, Inc., a corporation that produced, or imported, briefcases; and (c) Northwind Medical Center, a real estate limited partnership. The Defendant also invested in himself personally. Works1Ez, Inc. was owned by the Defendant, his wife and other family members.[17] The Defendant was the general partner of Northwind Medical Center. The Defendant's wife and her parents owned In Case of Georgia, Inc.[18] Evidently, none of these businesses ever returned any money to the Trust.[19]

Additionally, from 1992 through 1999, the Defendant drafted checks from Trust funds payable to Susan Barrientos, his wife, John Ashley Barrientos, his son, Keith Allen, a personal friend, and other entities. The Defendant asserted that each of these payments constituted a loan to him personally .[20]

In 1992, the Defendant borrowed $80,000.00 on behalf of the Trust and pledged the Residence as collateral for the debt.[21] The Defendant used the $80,000.00 and other funds of the

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[16] Testimony of the Defendant. Transcript of Hearing. p. 11-12.

[17] Id.

[18] See Plaintiff's Exhibits 2 & 3, Plaintiff's First Interrogatories and Defendant's Response to First Interrogatories, Question # 9.

[19] When asked to "[s]tate all returns upon such investments to the Trust", the Defendant responded by listing the distributions from the Trust to Ms. Frazier. See Plaintiff's Exhibit 2 & 3, Plaintiff's First Interrogatories and Defendant's Response to First Interrogatories, Question 3(A)(3). The Defendant did not provide a list of the returns to the Trust.

[20] Testimony of the Defendant. Transcript of Hearing. p. 22.

[21] Testimony of the Defendant. Transcript of Hearing. p. 11 & 12.

Trust to finance Works1Ez, Inc.[22]

In 1993, the Defendant sold assets of the Trust consisting of securities and tax-exempt funds for $355,991.00.[23]

In 1998[24], after negligible success with magazine advertising, the Defendant purchased a test mailing list to sell products of Works1Ez, Inc. The test list of 5000 persons yielded a response of 4%, twice the amount that necessary for a successful mailing. On this basis, the Defendant purchased a much larger list for "several hundred thousand"[25] dollars with funds from the Trust. The test list turned out to be "salted" with high-probability buyers. The full mailing list yielded a response of only 1.50% and the venture failed.

By 1999, the Trust held no assets.[26] In December of 2000, the Superior Court of Cobb County, Georgia entered a default judgment against the Defendant and in favor of Sara Jane Frazier in the amount of $1,034,000.00. Additionally, the Judgment provided that "The Plaintiff is further awarded exemplary damages against Defendants [including the Debtor herein] in the sum of $1,000,000.00 based upon the willful and deliberate conduct of Defendant Barrientos, in his capacity as a Trustee, which was calculated and intended to cause harm and loss to the Plaintiff, all as supported by uncontested evidence."[27]

After the Georgia Judgment was entered against him, the Defendant destroyed all records

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22 Id.

23 Defendant's Exhibit E, Trust 1993 Federal Income Tax Return.

24 Comment of Counsel for the Defendant. Transcript of Hearing. p. 36.

25 Testimony of the Defendant. Transcript of Hearing. p. 32-33.

26 Testimony of the Defendant. Transcript of Hearing. p. 20.

27 Plaintiff's Exhibit #4, Judgment Order dated January 5, 2001.

pertaining to the Trust because "because there was no more need to keep them."[28] Included in the documents destroyed by the Defendant were the following: (1) all documents and records pertaining to the investments of the Trust; (2) all accounting records of the Trust kept or maintained by the Defendant or at the Defendant's direction, showing income received by and payments made from the Trust; (3) all records showing transactions of the Trust, including, but not limited to bank and brokerage statements, cancelled checks, and check registers; (4) all federal and state income tax returns filed by the Trust; and (5) all other documents described in the Defendant's answers to the interrogatories.[29]

From 1991 to 1999, Sara Jane Frazier received approximately $311,000.00 from the Trust. From 2000 to 2005, after there were no more assets in the Trust, the Defendant paid Sara Jane Frazier $51,000.00.

On September 13, 2005, the Debtor filed a petition initiating the instate bankruptcy case. On December 13, 2005, the Plaintiff filed the above-styled adversary proceeding seeking to have the debt arising from the Georgia Judgment declared non-dischargeable under Section 523(a)(4). Shortly thereafter, Sara Jane Frazier passed away and Alan R. Hartman was appointed as the administrator of her estate. He was permitted to intervene as Plaintiff in this adversary proceeding.

III. Discussion

The complaint, as amended, is brought under 11 U.S.C. § 523(a)(4).

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[28] Testimony of the Defendant. Transcript of Hearing. p. 40.

[29] See Plaintiff's Exhibit 2 & 3, Plaintiff's First Interrogatories and Defendant's Response to First Interrogatories, Request for Production of Documents. The Defendant testified that he just happened to locate the 1993 and 1994 federal income tax returns.

That paragraph provides:

> (a) A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt–
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> . . .
>
> (4) for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny;

The meaning of the term "defalcation" has been the subject of much discussion. See Zohlman v. Zoldman, 226 B.R. 767, 775 (S.D.N.Y. 1998) (Citations omitted.) The primary debate focuses or whether mere innocent or negligent conduct can constitute defalcation, or whether defalcation must include some element of wrongdoing. Id.

The Fourth Circuit Court of Appeals, in considered the preclusive effect of a state court judgment, has provided guidance for trial courts when considering a cause of action alleging defalcation under Section 523(a)(4). See In re Ansari, 113 F.3d 17 (4th Cir. 1997).

> . . . A defalcation under 523(a)(4) is "misappropriation of trust funds or money held in any fiduciary capacity; [or the] failure to properly account for such funds." In re Niles, 106 F.3d 1456, 1460 (9th Cir.1997) (quoting Black's Law Dictionary 417 (6th ed.1990)). "[A] 'defalcation' for purposes of this statute does not have to rise to the level of 'fraud,' 'embezzlement,' or even 'misappropriation.' " Quaif v. Johnson, 4 F.3d 950, 955 (11th Cir.1993) (citing Central Hanover Bank & Trust Co. v. Herbst, 93 F.2d 510, 512 (2d Cir.1937) (Learned Hand, J.)).

In re Ansari, 113 F.3d 17, 20 (4th Cir. 1997). In a subsequent opinion, the Court noted that even "an innocent mistake" could result in a finding of defalcation.

> To be defalcation for purposes of 11 U.S.C. § 523(a)(4), an act need not "rise to the level of ... 'embezzlement' or even 'misappropriation.' " Pahlavi v. Ansari (In re Ansari), 113 F.3d 17, 20 (4th Cir.1997) (citations omitted). Thus, negligence or even an innocent mistake which results in misappropriation or failure to account is sufficient.

In re Uwimana, 274 F.3d 806 (4th Cir. 2001).

To summarize, defalcation occurs when a fiduciary fails to properly account for funds or money held in a fiduciary capacity. It is sufficient for a finding of defalcation if the funds are

missing due to negligence or an innocent mistake on the part of the fiduciary.

As with any cause of action, the burden of proof is on the Plaintiff. See 4 Collier on Bankruptcy, "Exceptions to Discharge", ¶ 523.04, p. 523-19 (15th ed. rev.) and cases cited therein. The Plaintiff must prove each element of section 523 by a preponderance of the evidence. Cf. Grogan v. Garner, 498 U.S. 279, 111 S.Ct. 654, 112 L.Ed. 2d 755 (1991).

In the case of defalcation, however, once the plaintiff has shown that the defendant serves or served in a fiduciary capacity and that money or other property entrusted to the fiduciary for the benefit of the plaintiff is missing, the burden shifts to the defendant to properly account for the missing property.

The Defendant as Fiduciary. "[T]he concept of fiduciary under § 523(a)(4) is narrower than it is under the general common law. Under § 523(a)(4), 'fiduciary' is limited to instances involving express or technical trusts." Texas Lottery Comm'n v. Tran, 151 F.3d 339, 342 (5th Cir.1998). In the instant case, there is no dispute that the Defendant acted in a fiduciary capacity as trustee of the Trust.[30]

Missing Assets. Nor is there any dispute that the property entrusted to the Defendant is missing. The value of the assets of the Trust estate went from $887,000.00 when the Defendant became trustee in 1992 to $00.00 in 1999.

The Defendant's Explanation for the Missing Assets. It only remains to be determined whether the Defendant has properly explained why the assets of the trust were dissipated. The Defendant's duties arise under a trust formed in the State of Georgia. The legal standard by which the Defendant is to be judged are provided in the Georgia Code and in the Trust

[30] Statement of counsel for the Defendant, Transcript of hearing, p. 58.

Agreement. The Georgia Code provides:

> (b) In acquiring, investing, reinvesting, exchanging, retaining, selling, and managing property for the benefit of another, *a trustee shall exercise the judgment and care, under the circumstances then prevailing, that a prudent person acting in a like capacity and familiar with such matters would use to attain the purposes of the account*. In making investment decisions, a trustee may consider the general economic conditions, the anticipated tax consequences of the investments, the anticipated duration of the account, and the *needs of its beneficiaries*.

Ga. Code Ann., § 53-12-287(b) (Emphasis added.)

The Trust Agreement provides:

> *The trustee* shall be responsible only for due diligence in the administration and disbursement of any trust created hereunder and *shall not be responsible for any loss or subject to any liability except by reason of his own negligence or willful default proved by affirmative evidence*, and every election, determination or other exercise by the Trustee of any discretion granted to him, expressly or by implication under this Agreement or by law made in good faith, shall fully protect him and shall be conclusive and binding upon all persons interested in any trust created under this Agreement[31]. [Emphasis added.]

The proper perspective is that of the Defendant at the time that the decisions were made, not after the fact when the assets had dissipated. The issue is whether the Defendant, under the circumstances then prevailing, made investment decisions that were so imprudent in light of the financial needs of Sara Jane Frazier as to constitute defalcation.

In this case, the purpose of the Trust was to provide Sara Jane Frazier with an income for as long as possible given the assets in the Trust. When the Defendant became the trustee under the Trust in 1992, it held about $800,000.00 in income-producing assets. It had produced a return of $54,305.00, or 6.8%, during the last full fiscal year before he was appointed. This was the level of income that the Trust produced when the Defendant became the trustee.

The income generated by the Trust was sufficient to take care of the financial needs of

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[31] Plaintiff's Exhibit No. 1, Mary S. Frazier Living Trust Agreement. Article VII, ¶ 2.

Sara Jane Frazier without invading the corpus of the Trust. She was paid $2,500.00 per month, or $30,000.00 per year from the Trust for more than ten years. This level of income was sufficient for her support, especially in light of the fact that she paid no rent and made no mortgage payment. The Defendant paid himself $6,000.00 per year as trustee.[32] Even if the Trust had incurred another $10,000.00 per year in other expenses necessary to support Sara Jane Frazier,[33] the Trust would have only needed to generate $46,000.00 per year to pay the Trustee fee and support her in perpetuity without invading the corpus of the Trust. Indeed, the Defendant testified that during this time the Trust was "breaking even".[34]

If the Trust could generate a return of just 5.75% on the $800,000.00, then the Trust could afford to pay Sara Jane Frazier $2,500.00 per month, could pay the Defendant $6,000.00 per year for his fees, and could pay an additional $10,000.00 in Trust expenses, forever, and never reduce the value of the corpus of the Trust.

Instead, the Defendant sold the Trust assets and used the money fund his own business ventures and those of his family. In 1992, the Defendant encumbered the Residence of Sara Jane Frazier with an $80,000.00 lien. He used the $80,000.00 and other funds of the Trust to finance Works1Ez, Inc.[35]

In 1993, in his first year as trustee under the Trust, the Defendant sold assets of the trust consisting of securities and tax-exempt funds for $355,991.00, an amount that constitutes

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[32] Defendant's Exhibit E and F, Trust Federal Income Tax Returns for the years ended 1993 and 1994.

[33] The Defendant expended a total of approximately $30,000.00 for repairs to the Residence during his tenure as trustee. Testimony of the Defendant, Transcript of hearing, p. 16.

[34] Testimony of the Defendant. Transcript of Hearing, p. 16.

[35] Testimony of the Defendant. Transcript of Hearing, p. 11.

approximately 40% of the value of the Trust.

From 1992 through 1999, the Defendant used Trust assets to fund business ventures owned by himself and his family, including a software company, a corporation that produced, or imported, briefcases, and a real estate limited partnership. He or his family controlled each of these business. Additionally, from 1992 through 1999, the Defendant drafted checks from Trust funds payable to his family and his friends. He described each of these payments as loan to him personally.

By 1999, the Trust would have held assets totaling $700,000.00 to $1,000,000.00 if the Defendant had only continued the prudent investment strategy of his predecessor, a fact that should have been evident to a knowledgeable and prudent investor in 1992. Instead, in 1999 the Trust held no assets.

Rather that simply investing the Trust assets in low-risk investments that would have met the financial needs of the designated beneficiary, the Defendant, a Certified Public Accountant and a sophisticated businessman who has written more than thirty-six books concerning tax law[36], chose to invest the entire corpus of the Trust over a seven-year period in small businesses owned by himself and his family. The record, limited though it is by the fact that the Defendant destroyed most of the Trust records, supports the conclusion that the Defendant breached his duty under the Trust Agreement to such an extent as to require a finding of defalcation.

Further, it is clear that the Defendant has not been completely candid concerning the relationship between the Trust and his business ventures. First, the Defendant stated: "As a side note, as a matter of fact the previous trustee, when I became trustee I had a talk with him and he

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[36] See Defendant's Exhibits A and B. Also see Transcript of Hearing, p. 17.

was most concerned that the trust assets would not last through Ms. Frazier's lifetime. Through her needs. That was his basic concern. And, so, you know, this [the investment of hundreds of thousands of dollars in a mailing list] looked like a way to greatly multiply the size of the trust."[37]

The record belies this assertion. If the Trust asset allocation had remained unchanged from that in 1991, the Trust would have been sufficient to fund the financial needs of Sara Jane Frazier and its assets would have probably grown in value each year. The Trust was, as the Defendant noted, breaking even during the first year under his trusteeship. There was no need to invest in high-risk investments.

Second, the Defendant has both admitted and denied that he used Trust funds to invest in Great Occasions, Gazettes, Inc., d/b/a Special Occasion Publications, a company that contracts with hospitals to take pictures of new-born babies. Question #9 of the Plaintiff's First Interrogatories asked the Defendant to identify certain individuals and entities, to state his relationship to them, and to explain why checks were written to them from the Trust. On May 15, 2006, the Defendant answered Question #9 of the Plaintiff's First Interrogatories, in part, thus: "Great Occasion Gazettes, Inc. A corporation owned by me. Checks would have been a loan to me. This corporation is now defunct."[38]

In his testimony, he denied that he had invested any Trust funds in "Great Occasions, Inc."

Q: [Counsel for the Plaintiff.] Just a couple of follow up questions. Mister

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[37] Testimony of Defendant, Transcript of Hearing, p. 33.

[38] See Plaintiff's Exhibits 2 & 3, Plaintiff's First Interrogatories and Defendant's Response to First Interrogatories, Question 9.

Barrientos, do you know, do you recall how much the trust invested in Great Occasions, Inc.?

A: I do not recall the exact amount. But it would have been several hundred thousand dollars. Oh, you said Great Occasions?

Q: Yes.

A: Nothing. The trust invested nothing.[39]

The response to the interrogatories and the answer given as testimony in Court cannot both be true. Either the Trust invested in Great Occasions Gazette, Inc, or it did not.

Nor can the Defendant rely on the form of the question to reconcile his statements. Counsel for the Plaintiff asked if the Trust invested in "Great Occasions, Inc." After answering that it did, the Defendant asked "Oh, you said Great Occasions?" When counsel responded "Yes", the Defendant changed his answer to "Nothing. The trust invested nothing." The name of the company is "Great Occasions Gazettes, Inc.", not "Great Occasions, Inc." Clearly, the Defendant understood the question and understood that counsel was referring to "Great Occasions Gazettes, Inc." It appears that the Defendant played a word game in order to deceive counsel and the Court.[40]

The Defendant also provided contradictory evidence regarding whether Great Occasions Gazettes, Inc., is an on-going concern. As noted, on May 15, 2006, he stated in his response to the interrogatories that Great Occasions Gazettes, Inc., was defunct on that date. But a letter

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[39] Testimony of the Defendant. Transcript of Hearing, p. 50.

[40] The Defendant also has some association with another company with a similar name, "Great Occasion Publications, Inc." which he asserted in his response to interrogatories, was owned by his mother. See Plaintiff's Exhibits 2 & 3, Plaintiff's First Interrogatories and Defendant's Response to First Interrogatories, Question 9.

from his mother indicates that, as of September 20, 2006, some four months later, Great Occasions Gazettes, Inc. was an on-going business operation earning $80,000.00 per year.[41]

The evidence also indicates that while the Defendant's mother owns Great Occasions Gazettes, Inc., it is run by the Defendant for the benefit of the Defendant. Additionally, the Defendant's mother indicates that it is her intent to gift Great Occasions Gazettes, Inc., to the Defendant if the debt that is the subject of this adversary proceeding is discharged.

The Defendant makes a number of arguments on his own behalf. First he argues that his decisions were those of a prudent fiduciary acting in the best interest of the beneficiary. His own testimony belies this argument. He admitted that his decisions were made with his own benefit in mind.

When asked "What was your intent?" regarding the use of the trust funds, the Defendant answered "To greatly multiply the value of the trust for the benefit of Sara Jane Frazier, and for my own benefit."[42] This answer also reveals that the Defendant failed, or refused, to recognize that the purpose of the Trust was to provide Sara Jane Frazier with a regular and reliable income, not to "greatly multiply the value of the trust", not for her benefit, and surely not for his own.

Second, counsel for the Defendant argued in his opening statement that "the trust agreement, which Mr. Barrientos was in charge of, authorized and allowed the trustee to invest in property of his own." This is factually incorrect. In support of this assertion, the Defendant's counsel asked him to read from the Trust, Article XI, which concerns the powers of the Trust. The Defendant read as follows:

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[41] See Defendant's Exhibits N.

[42] Testimony of the Defendant. Transcript of Hearing. p. 48.

> "The powers of the trustee
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> . . .
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> To invest in any property regardless of whether authorized by law for investment of trust funds, to borrow money for any lawful purpose ***for*** a new lender including the trustee, and to pledge, and ***convert*** any mortgage trust assets to secure any debt or the settlement of claims. And the trustee is specifically given the power also to open a margin account at any brokerage house." (Emphasis added.)[43]

Article XI of the Trust actually provides, in relevant part, that the trustee has the power:

> . . . to invest in any property regardless of whether authorized by law for investment of trust funds, to borrow money for any lawful purpose ***from*** a new lender (including the trustee) and to pledge, and ***encumber*** any mortgage trust assets to secure any debt or to settle claims. . . . The trustee is specifically given the power to open a margin account at any brokerage house. (Emphasis added.)[44]

The Defendant's alteration of the word "from" to "for" changes the meaning of the quoted language. The Trust provides that the trustee may borrow money "from" a new lender including the trustee. When the word is changed to "for", the meaning, although strained, could be construed to authorize the trustee to borrow money from the trust to invest in his own businesses. But the Trust makes no such provision. Nor would such an provision be consistent with the purpose of the Trust. The Defendant was not specifically authorized by the Trust to borrow money from the Trust in order to invest in his own business ventures.

Third, the Defendant asserts that he informed the beneficiary regarding his investment intentions. The Defendant testified that he explained the investment involving the mass mailing to Sara Jane Frazier, and pointed out that she could have consulted an attorney if she had wanted to.[45] He also asserted that he consulted with her before making loans to himself and his

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[43] Testimony of the Defendant. Transcript of Hearing. p. 49.

[44] Plaintiff's Exhibit No 1, Trust Agreement at Article IX.

[45] Testimony of the Defendant. Transcript of Hearing. p. 32.

businesses.

The Defendant cites Umholtz v. Brady, 27 F.3d 564 (4th Cir 1994) (Unpublished opinion.) as support for the proposition that it was sufficient for the Defendant to apprise Sara Jane Frazier of his intent to invest in his own businesses. In that opinion, the Fourth Circuit Court of

Appeals affirmed both the judgment and the reasoning of the United States District Court in its published opinion, Umholtz v. Brady (In re Brady), 169 B.R. 569 (E.D.N.C. 1993).

Both Umholtz and Brady were shareholders in a corporation with Brady being the dominant shareholder. The business floundered and Umholtz, as well as other shareholders, loaned cash to the corporation to sustain operations. Brady, who was experiencing financial difficulties owing to other failed investments, borrowed money from the corporation without advising Umholtz of that fact. Brady filed a chapter 7 petition in bankruptcy and Umholtz filed an adversary proceeding under Section 523(a)(4)[46] against Brady asserting that he had breached a fiduciary duty to him by failing to inform him of the fact that he, Brady, had borrowed money from the corporation.

The Bankruptcy Court first held that Brady owed a fiduciary duty to Umholtz, but that he had not breached it under the then-existing applicable North Carolina statute which provided that "corporate officers and directors shall be deemed to stand in a fiduciary relation to the corporation . . ." and "officers and directors . . . shall discharge the duties of their respective positions in good faith, and with that diligence and care which ordinarily prudent men would

[46] The opinion of the United States District Court does not indicate which paragraph of Section 523 the complaint was filed under. The Appellate's Brief to the Fourth Circuit as well the Fourth Circuit's opinion, however, clearly indicate that the original complaint was brought and considered under Section 523(a)(4).

exercise under similar circumstances in like positions." See N.C. Gen. Stat. § 55-35 (1955).

The Bankruptcy Court held, and the District Court affirmed, that there was no North Carolina law that required a fiduciary in Brady's position to disclose to a fellow shareholder that he withdrew money from the corporation or that he was unable to make cash contributions equal to the other shareholders.

Umholtz does not support the Defendant's argument. In Umholtz, the Court held that the defendant *had no duty to disclose* that he borrowed money from the corporation to the detriment of the plaintiff. In the case at bar, the Defendant argues that he is absolved of breaching his fiduciary duty to the Plaintiff *because he did disclose* that he was borrowing money from a trust. The Defendant's duty to the Sara Jane Frazier was to make prudent investment decisions, not to inform her of the investment decisions that he made.

Further, the opinion in Umholtz gives no guidance because the relationship between the party owing the fiduciary duty and the beneficiary of that duty in Umholtz is entirely different from the relationship in this case. In Umholtz, both parties were sophisticated businessmen that had engaged as equals in a joint venture for profit which was effected through the formation of a corporation in which the both were shareholders. Each had the capacity to evaluate the effect of the business decisions of the other on the profitability of the joint venture. In the case at bar, the Defendant was sophisticated in investment, tax and accounting matters. The Plaintiff was unsophisticated in business matters and was deemed by the settlor of the Trust to be incapable of making prudent investment decisions. It was for this reason that the Defendant, not the Plaintiff, was chosen to manage the Trust assets.

The Trust Agreement prohibited Sara Jane Frazier from pledging, assigned, selling,

transferring, alienating, or encumbering her interest in the Trust.[47] It further provided that the Trust would not be liable for any of her debts. It was clearly the intent of the settlor to prohibit her from being involved in the Trust's investment decisions. The Trust is the classic spendthrift trust. As such it is not sufficient for the Defendant, as trustee of the Trust, to assert that he is absolved of his decision-making duties by acquiring the beneficiary's permission.

Fourth, the Defendant asserts that some of the business ventures were successful. It is not the success or failure of the individual business ventures that is at issue. Even if the Court accepts this assertion, it is the decision of the Defendant to invest all of the Trust assets in his own risky ventures.

Finally, the Defendant argues that he attempted to repay some of the money that he borrowed from the Trust. From 1999 to 2005, the Defendant paid Sara Jane Frazier approximately $51,000.00. In or about 1999, the Defendant quit claimed the Residence to Ms. Frazier. The Residence was sold for about $265,000.00. The Defendant did not know whether the net proceeds, if any, inured to the benefit of Sara Jane Frazier. These facts taken together constitute nothing more than a red herring. After seven years under the Defendant's trusteeship, the Trust held no assets. The Defendant has failed to provide an adequate explanation for the missing assets. His efforts to pay something to Sara Jane Frazier cannot substitute for an adequate explanation.

This Court agrees with the language in the Georgia Judgment. The evisceration of the Trust was due to the "willful and deliberate conduct of Defendant Barrientos, in his capacity as a Trustee, which was calculated and intended to cause harm and loss to the Plaintiff . . . " The

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[47] Plaintiff's Exhibit No 1, Trust Agreement at Article III C.

Defendant has not adequately explained his decision to invest the trust assets in his own high-risk small businesses.

IV. Conclusion

Judgment shall be granted in favor of Alan R. Hartman, Administrator of the Estate of Sara J. Frazier. The debt owed to him as Administrator of the Estate of Sara J. Frazier by Lawless J. Barrientos is non-dischargeable.

An appropriate judgment shall issue.

Upon entry of this Memorandum the Clerk shall forward copies to Marshall M. Slayton, Esq., counsel for the Defendant, and to Douglas E. Little, Esq., counsel for the Plaintiff

Entered on this 25th day of September, 2007

William E. Anderson
United States Bankruptcy Judge