UNITED STATES BANKRUPTCY COURT
For the Southern District of Iowa

In Re:	:	**Case No. 00-2930-CH**
DONNA JOAN STROUD,	:	**Chapter 7**
Debtor.	:	
PATRICK L. STROUD, **Parent and next friend of** **JACOB L. STROUD,** **A minor child,**	:	**Adv. No. 00-20160**
Plaintiffs,	:	
v.	:	
DONNA JOAN STROUD,	:	
Defendant.	:	

ORDER— COMPLAINT TO DETERMINE DISCHARGEABILITY OF DEBT

This matter came on for trial on July 2, 2001, the parties appearing in person and with their attorneys of record. Attorney Jerrold Wanek represented Plaintiff Patrick L. Stroud, and Mark J. Rasmussen represented Defendant Donna J. Stroud. At the conclusion of the hearing, the court took the matter under advisement. The court considers the matter fully submitted.

The court has jurisdiction of this matter pursuant to 28 U.S.C. § 157(b)(1) and § 1334 and order of the United States District Court for the Southern District of Iowa. This is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(I). The court, upon review of the briefs, pleadings, evidence, and arguments of counsel, now enters its findings and conclusions pursuant to Fed. R. Bankr. P. 7052.

FINDINGS OF FACT

The parties agree that the following facts are not in dispute.

1. On August 9, 2000, Defendant Donna Joan Stroud filed a petition for relief under chapter 7 of title 11, the Bankruptcy Code.

2. Plaintiff Patrick L. Stroud is the former spouse of Defendant. He is a representative for Jacob L. Stroud, the parties' minor child.

3. Defendant scheduled Plaintiff as a creditor on Schedule F – Creditors Holding Unsecured Nonpriority Claims. Defendant valued the claim at $5,300.00.

4. Prior to December 1, 1996, Defendant was a custodian of two investment accounts with Princor Financial Services Corporation. Account number 8091852-1 was a Princor Capital Accumulation Fund account (hereinafter the Capital account), and account 8091827-1 was a Princor Emerging Growth Fund account (hereinafter the Growth account).

5. Jacob L. Stroud, a minor child, owned the two investment accounts. The accounts were owned and held pursuant to the Uniform Gifts to Minors Act.

6. As custodian, Defendant was a fiduciary on behalf of Jacob L. Stroud.

7. Plaintiff raised these issues in a small claims action entitled, Patrick L. Stroud on behalf of Jacob L. Stroud, plaintiff versus Donna J. Stroud, defendant, docketed as case number 5046 in the Iowa District Court for Greene County, Small Claims Division. The court received a true and correct copy of the relevant state court documents designated Plaintiff's Exhibit A.

8. The Iowa District Court for Greene County, as part of the dissolution decree proceedings between Plaintiff and Defendant, entered a ruling in the small claims case. The ruling was in favor of Plaintiff for the sum of $4,000.00 plus interest at the statutory rate (10%) from the date that the small claims petition was filed (December 2, 1996). The court received a true and correct copy of the ruling designated Plaintiff's Exhibit B.

The court further finds the following facts.

9. On November 29, 1995, Defendant redeemed shares of the Capital account amounting to $956.63.

10. On November 29, 1995, Defendant redeemed shares of the Growth account amounting to $1074.60.

11. Defendant testified that she used the funds acquired from the investment accounts to purchase a furnace for the house in which she and Jacob lived at the time.

12 Defendant and Jacob no longer live in the house. It is currently rented, and the rental payments are retained by Defendant's friend who "looks after" the property.

13. Defendant was not authorized to use funds in the investment accounts for personal expenditures.

DISCUSSION

Plaintiff asks this court to except from discharge Defendant's obligation to repay funds that she took from investment accounts established for Jacob Stroud, their minor child. Plaintiff contends that Defendant overstepped her authority as custodian of the

accounts when she withdrew funds and used them to purchase a furnace for the house where she and Jacob lived. Plaintiff argues that the debt is nondischargeable under 11 U.S.C. §§ 523(a)(2)(A), (a)(4), (a)(5), (a)(6), and (a)(15).

Defendant argues that the new furnace was a necessary expense, and its purchase directly benefited Jacob. As such, its purchase constituted an appropriate use of the funds. Defendant states that she inquired of representatives of the investment company who told her that she could use the funds for the purchase. Defendant maintains that the she acted within her authority and the debt should not be excepted from discharge.

After reviewing the facts, the court concludes that the proceeding is properly brought pursuant to 11 U.S.C. § 523(a)(4). Because the court agrees that the debt is nondischargeable pursuant to that section, it will not address the alternate theories.

Statutory exceptions to discharge are strictly construed against the party seeking the exception. Geiger v. Kawaauhau (In re Geiger), 113 F.3d 848, 853 (8th Cir. 1997) (en banc), affirmed, 523 U.S. 57 (1998); Werner v. Hofman, 5 F.3d 1170, 1172 (8th Cir. 1993). The party opposing has the burden under § 523 of proving the exception by a preponderance of the evidence. Grogan v. Garner, 498 U.S. 279, 286-287 (1991). "It is the evidence which, when weighed with that opposed to it, has more convincing force and is more probably true and accurate." Smith v. United States, 557 F. Supp. 42, 51 (W.D. Ark. 1982) aff'd, 726 F.2d 428 (8th Cir. 1984). The party with the burden of proof must provide evidence to prove his or her position is reasonably probable, not merely possible. Sherman v. Lawless, 298 F.2d 899, 902 (8th Cir. 1962).

The Bankruptcy Code provides that a discharge under section 727 does not discharge an individual debtor from any debt for "fraud or defalcation while acting in a fiduciary capacity…." 11 U.S.C. § 523(a)(4). In order to prevail under § 523(a)(4), a plaintiff must establish two elements. First, the plaintiff must prove the existence of a fiduciary relationship, and second, that Defendant committed fraud or defalcation in the course of the fiduciary relationship. Jafarpour v. Shahrokhi (In re Shahrokhi), 266 B.R. 702, 707 (B.A.P. 8th Cir. 2001).

Whether a "fiduciary relationship" exists is determined by federal law. Tudor Oaks Limited Partnership v. Cochrane (In re Cochrane), 124 F.3d 978, 984 (8th Cir. 1997). Federal law limits fiduciary relationships to express trusts or technical trusts that are imposed by statute. Id. The fiduciary relationship must have existed before and apart from the incident that created the debt. Id. Mere contractual relationships are insufficient to establish a fiduciary relationship. In re Shahrokhi, 266 B.R. at 708. Courts may look to nonbankruptcy law to determine whether an express or technical trust exists. Dutton v. Kondora (In re Kondora), 194 B.R. 202, 208 (Bankr. N.D. Iowa 1996).

In this case, the parties agree that a fiduciary relationship existed between Defendant and Jacob vis-à-vis the investment accounts. The accounts were owned by Jacob, and as named guardian on the accounts, Defendant was under a duty to administer them for Jacob's benefit. The parties disagree as to whether Defendant committed defalcation, thereby satisfying the second element under § 523(a)(4).

The Eighth Circuit defines "defalcation" as

> the "misappropriation of trust funds or money held in any fiduciary capacity; [the] failure to properly account for such funds." Under section 523(a)(4), defalcation

> "includes the innocent default of a fiduciary who fails to account fully for money received." …An individual may be liable for defalcation without having the intent to defraud.

In re Cochrane, 124 F.3d at 984 quoting Lewis v. Scott, 97 F.3d 1182, 1186 (9th Cir. 1996). Defalcation is evaluated objectively and "does not necessarily involve misconduct." In re Kondora, 194 B.R. at 208.

In this case, the court finds that Defendant committed defalcation in her fiduciary capacity. It is undisputed that Defendant redeemed shares from Jacob's investment accounts and used the funds to purchase a furnace for the house in which she and Jacob lived. Notwithstanding the fact that Jacob derived some benefit from the furnace, the court finds Defendant used the investment funds for her personal benefit. The furnace was placed in Defendant's house in Jefferson, Iowa. There is no indication in the record that Jacob has any property or security interest in the home which would protect his "investment." Defendant and Jacob no longer reside in the house. It is rented, and the proceeds are paid to a caretaker. None of the rent is paid into the investment fund.

Defendant argues that she contacted representatives from the investment firm, and they indicated that she could use the funds to purchase the furnace. She argues that she relied on the statements and purchased the furnace in good faith. However, it is revealing that she did not seek legal counsel regarding this matter.

The court does not find that Defendant possessed fraudulent intent when she withdrew the funds, nor does it question her stated desire to replace the funds when she feels that she is financially able. However, as stated earlier, bad faith or malice is not

requisite for a finding of defalcation under § 523(a)(4). "An individual may be liable for defalcation without having the intent to defraud." In re Cochrane, 124 F.3d at 984.

For all the foregoing reasons, the court concludes that Defendant committed defalcation in a fiduciary relationship when she removed funds from Jacob's investment accounts. Accordingly, the debt will be excepted from discharge pursuant to 11 U.S.C. § 523(a)(4).

ORDER

IT IS THEREFORE ORDERED that the plaintiff, Patrick L. Stroud, parent and next friend of Jacob L. Stroud, a minor child, shall have judgment against the defendant, Donna Joan Stroud, declaring that the judgment ordered by The Iowa District Court for Greene County, D.M. No. 1147-1049, against Donna J. Stroud, in favor of Patrick L. Stroud, on behalf of Jacob L. Stroud, in the amount of $4,000.00, plus interest, is nondischargeable.

RUSSELL J. HILL, JUDGE
U.S. BANKRUPTCY COURT