

January 23, 2001

Barbara A. Schermerhorn
Clerk

NOT FOR PUBLICATION

**UNITED STATES BANKRUPTCY APPELLATE PANEL
OF THE TENTH CIRCUIT**

IN RE D. RICHARD WHITE,
Debtor.

BAP No. KS-00-039

BRUCE DUTY,
Plaintiff – Appellee,

Bankr. No. 97-42097
Adv. No. 97-7118
Chapter 7

v.

D. RICHARD WHITE,
Defendant – Appellant.

ORDER AND JUDGMENT*

Appeal from the United States Bankruptcy Court
for the District of Kansas

Before McFEELEY, Chief Judge, CLARK, and MICHAEL, Bankruptcy Judges.

McFeeley, Chief Judge.

Defendant/Appellant D. Richard White (“Debtor”) appeals two judgments of the United States Bankruptcy Court for the District of Kansas (“court”). First, Debtor argues that the court erred when it granted summary judgment to Bruce Duty (“Appellee”), arguing that the record did not support the court’s holding that the Debtor’s debt to Appellee was nondischargeable under 11 U.S.C. § 523(a)(4).¹

Alternatively, Debtor contends that the court erred in finding that the Debtor met

* This order and judgment has no precedential value and may not be cited, except for the purposes of establishing the doctrines of law of the case, res judicata, or collateral estoppel. 10th Cir. BAP L.R. 8010-2.

¹ Future references are to Title 11 of the United States Code unless otherwise noted.

the requirements of § 523(a)(4) on the grounds that the Debtor never had the requisite fiduciary relationship with the Appellee, or, if the necessary fiduciary relationship existed, the Debtor did not commit a defalcation. Second, the Debtor argues that the court erred in its calculation of the nondischargeable debt due Appellee.

We affirm on the first issue. However on the second issue, we reverse and remand for a determination of the correct amount of nondischargeable debt under § 523(a)(4).

I. Appellate Jurisdiction

The Bankruptcy Appellate Panel has jurisdiction over this appeal. The court’s judgment disposed of the adversary proceeding on the merits and is subject to appeal under 28 U.S.C. § 158(a)(1). See Quackenbush v. Allstate Ins. Co., 517 U.S. 706, 712 (1996). The Debtor timely filed his notice of appeal pursuant to Fed. R. Bankr. P. 8002. The parties have consented to this Court’s jurisdiction by failing to elect to have the appeal heard by the United States District Court for the District of Kansas. 28 U.S.C. § 158(c)(1); Fed. R. Bankr. P. 8001; 10th Cir. BAP L.R. 8001-1.

II. Standard of Review

“For purposes of standard of review, decisions by judges are traditionally divided into three categories, denominated questions of law (reviewable *de novo*), questions of fact (reviewable for clear error), and matters of discretion (reviewable for ‘abuse of discretion’).” Pierce v. Underwood, 487 U.S. 552, 558 (1988); *see* Fed. R. Bankr. P. 8013; Fowler Bros. v. Young (In re Young), 91 F.3d 1367, 1370 (10th Cir. 1996).

A bankruptcy court’s grant of summary judgment is reviewed *de novo*. Spears v. St. Paul Ins. Co. (In re Ben Kennedy and Assocs., Inc.), 40 F.3d 318, 319 (10th Cir. 1994). The issue of what constitutes a defalcation under § 523(a)(4) is an issue of law that we review *de novo*. Merrill v. Merrill (In re

Merrill), 252 B.R. 497, 501 (10th Cir. BAP 2000).

A bankruptcy court's calculation of what is owed under a fee agreement is a question of fact that we review under the clearly erroneous standard. "A finding is 'clearly erroneous' when although there is evidence to support it, the reviewing court on the entire evidence is left with the definite and firm conviction that a mistake has been committed." United States v. United States Gypsum Co., 333 U.S. 364, 395 (1948).

III. Background

Following a 1994 automobile accident in which Appellee suffered injuries, Appellee hired Debtor, an attorney, to represent him in pursuing a personal injury claim. Debtor and Appellee apparently entered into an employment contract providing that the Debtor would represent the Appellee on a contingency fee basis in the amount of one third of sums collected prior to trial. Appellee settled the claim for the following sums: \$9,000 cash from ITT Hartford; \$37,000 cash and an annuity that would pay out \$61,500 over time but had a present cash value of \$21,000, from Alliance Insurance Company. The actual present value of the settlement was approximately \$67,000. Debtor received all cash monies, totaling \$46,000.

From the \$46,000 cash, Debtor paid \$7,000 to State Farm Insurance Co. to reimburse it for personal injury protection benefits paid as a result of the automobile insurance policy with the Appellee. From this amount, Debtor retained attorney fees of \$2,333.33. LaHood, Inc. received \$8,507.56 for its payment of medical bills. From this amount, Debtor retained attorney fees of \$2,835.35. From the remaining cash, Debtor paid an additional \$2,560.04 directly to the Appellee's health care providers. After all of the payments, in addition to the sums he had already been paid, Debtor retained attorney fees in the amount of

\$27,932.40. The total attorney fee received by Debtor was \$33,101.58.² Debtor's claimed expenses with respect to the lawsuit were \$2,716. At some time after the settlement, the Appellee indicated that he needed money, and Debtor paid him \$2,000.

On July 30, 1997, the Debtor filed for bankruptcy. The Appellee filed an adversary proceeding in November, seeking a judgment for the difference between the attorney fee received by the Debtor and one-third of the value of the settlements at the time the fee was received (approximately \$67,000), alleging that this debt was nondischargeable under §§ 523(a)(2)(A), (a)(4), and (a)(6).³ Although the Debtor filed an answer, admitting and denying the allegations of the complaint and generally asserting "any and all applicable affirmative defenses," he did not participate in the drafting of a pretrial order. Subsequently, the Appellee filed a motion for summary judgment, relying on the factual stipulations included in the proposed pretrial order. The Debtor responded by complaining of the form of the Appellee's motion. On December 14, 1998, the court sent a letter to the Debtor advising that the Appellee had properly relied on the stipulated facts in the proposed pretrial order and setting a deadline for controverting any disputed facts. On December 31, the Debtor responded to the Appellee's summary judgment motion. He disputed only proposed stipulations, asserting: 1) he had advised the Appellee that his fee was to be one-third of the \$107,500; 2) he had demanded and received \$33,101.58. The Debtor also asserted that any error in calculating the fee had been unintentional.

On February 3, 1999, the court entered an order Granting Summary

² We note that there is a difference of fifty cents between the sum of the numbers stated above (\$33,101.58) and the sum that is given in the settlement statement (\$33,101.08).

³ The Appellee also filed a complaint with the Attorney Disciplinary Board. The Debtor had the option of accepting informal admonition or proceeding to an adversary proceeding. The Debtor accepted the informal admonition.

Judgment on Dischargeability Question But Directing Parties to Confer About Amount Owed. The Order held that the Appellee had established that there was a debt owed to him by the Debtor that was nondischargeable under § 523(a)(4). Thirteen days later, the Debtor filed a Motion to Reconsider, indicating that a memorandum would follow. On March 1, 1999, the Debtor filed the Memorandum, which argued that his Motion should be granted on the grounds that under § 523(a)(4) the Appellee had not established the following necessary elements: 1) a fiduciary relationship; 2) a failure to account for entrusted funds; 3) a defalcation. On March 10, 1999, the court denied the Debtor's Motion.

On March 22, 1999, the Debtor filed a Second Motion for Reconsideration on the grounds that the court erroneously granted the Appellee's Motion for Summary Judgment. He restated all of his previous arguments and argued the following additional points: 1) the court's application of present day value was a reformation of the contract between the Debtor and the Appellee; 2) the stipulated facts did not support the Appellee's request for summary judgment; 3) the facts established that the Debtor lacked the intent to improperly calculate his fees. We do not have a record of the court's response to this Second Motion.

On March 7, 2000, the court filed a Memorandum Determining Amount of Nondischargeable Debt, finding that the Debtor wrongfully retained \$11,621.60 more than his proper fee and owed that amount to the Appellee.

On March 16, 2000, the Debtor filed a Motion for Reconsideration. In this Motion the Debtor alleged that the court erred in its fee calculation for the following reasons: 1) the court neglected to deduct case expenses from the total settlement before calculating the amount owed; 2) the court erred when it did not deduct medical bills paid by the Debtor before calculating the Debtor's fee; 3) the court failed to account for the \$2,000 that the Debtor had paid to the Appellee.

On May 23, 2000, the court entered an Order Amending Amount of Nondischargeable Judgment. It found that there was not sufficient evidence of

the Debtor's expenses, as the expenses were undocumented and the attorney-client contract was never before it.⁴ However, the court found that it had erred when it did not deduct the medical bills before calculating the fee. It amended the amount that the Debtor owed the Appellee to \$10,768.25. The court did not address the Debtor's third argument that the amount of the judgment should be reduced by \$2,000 to reflect the prepetition cash payment that he made to the Appellee.

This appeal timely followed.

IV. Discussion

The Bankruptcy Code provides for summary judgment through Federal Rule of Bankruptcy Procedure 7056, which adopts the Federal Rule of Civil Procedure 56.⁵ Pursuant to Rule 56(c), summary judgment is appropriate when after a consideration of the record, the court determines 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). Summary judgment may be rendered on the "issue of liability alone although there is a genuine issue as to the amount of damages." *Id.*

The Debtor argues that summary judgment was inappropriate in this case. He contends that the issue of whether the Appellee agreed that the Debtor should be paid out of the "up front" money is a controverted fact that should have precluded summary judgment. The Debtor is wrong. A controverted fact that will preclude summary judgment must be material to the summary judgment motion. *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 247-48 (1986) (holding

⁴ In the Appendices offered to this court, both the Debtor and the Appellee have submitted the attorney-client contract. However because this contract was never part of the record before the court, it will not be considered here.

⁵ Rule 7056 provides: "Rule 56 F.R.Civ.P. applies in adversary proceedings. Fed. R. Bankr. P. 7056.

that the “mere existence of some alleged factual dispute between the parties will not defeat an otherwise properly supported motion for summary judgment; the requirement is that there be no genuine issue of material fact.”). The factual question the Debtor alleges should have prohibited summary judgment is not material to the legal issue of whether the Debtor violated § 523(a)(4) by inaccurately assessing attorney fees.⁶ The record before the court was adequate to allow it to determine the issue of summary judgment.⁷

Alternatively, the Debtor argues that the court erred when it found that his debt to the Appellee was nondischargeable on the grounds that he had committed a defalcation under § 523(a)(4). Section 523(a)(4) provides that a chapter 7 debtor is not discharged from any debt resulting from “fraud or defalcation while acting in a fiduciary capacity.” 11 U.S.C. § 523(a)(4). The creditor bears the burden of establishing nondischargeability by a preponderance of the evidence. Holaday v. Seay (In re Seay), 215 B.R. 780, 785 (10th Cir. BAP 1997). As required by § 523(a)(4), the creditor must show the following: “1) the existence of a fiduciary relationship between the debtor and the objecting party, and 2) a defalcation committed by the debtor in the course of that fiduciary relationship.” Antlers Roof-Truss & Builders Supply v. Storie (In re Storie), 216 B.R. 283, 286 (10th Cir. BAP 1997) (citing Fowler Bros. v. Young (In re Young), 91 F.3d 1367, 1371-72 (10th Cir. 1996)).

The existence of a fiduciary relationship is a threshold issue. Id. The Tenth Circuit has narrowly construed the phrase “fiduciary capacity.” Young, 91 F.3d at 1371-72. In cases where the debtor is an attorney and the creditor is a client, the Tenth Circuit requires more than a general attorney-client relationship

⁶ We found nothing in the record suggesting that this was a controverted fact.

⁷ Although the trial judge stated that he never had the employment contract before him, both parties stipulated that they had agreed that the Debtor would receive a contingency fee of one third the value of the settlement.

to establish a fiduciary relationship under § 523(a)(4). Id. at 1372.⁸ Such a fiduciary relationship will exist only where there is an express or technical trust. Id. at 1371. Although the question of fiduciary status is one of federal law, state law is important when determining whether a trust relationship exists. Id.

In the absence of any evidence of an express trust, the court reviewed whether there was a technical trust between the Debtor and the Appellee. A technical trust is a trust imposed by law that arises by statute. Allen v. Romero (In re Romero), 535 F.2d 618, 621-22 (10th Cir. 1976). Such a technical trust may exist where a state licensing scheme has created a trust relationship. Id. In Romero, the Tenth Circuit found that “a comprehensive scheme for the issuance of licenses” imposed the fiduciary duty required under § 523(a)(4). Id.

Here the court held that the Kansas Rules of Professional Conduct (“KRPC”) imposes a technical trust when an attorney is entrusted with a client’s money or property because as part of the KRPC’s licensing scheme it mandates the following: 1) when an attorney is entrusted with client property, the attorney must keep client property in a separate account entitled a “trust account”; and 2) the attorney has certain duties with respect to that account. In this case, it is undisputed that the Debtor-attorney was entrusted with client property.⁹ Consequently, the court held that there was a fiduciary relationship as defined by § 523(a)(4) between the Debtor and the Appellee.

The Debtor responds that by its own terms, the KRPC cannot create a new cause of action. He focuses on language in the KRPC that provides that the violation of “a Rule should not give rise to a cause of action nor should it create

⁸ But see Andy Warhol Found. for Visual Arts v. Hayes (In re Hayes), 183 F.3d 162, 170 (2d Cir. 1999) (holding “that the attorney-client relationship, without more, constitutes a fiduciary relationship within the meaning of Section 523(a)(4).”).

⁹ Furthermore, the Debtor admitted below that he was acting as a fiduciary. Appellee’s App., p. 10.

any presumption that a legal duty has been breached.” Kan. R. Prof. Conduct, Scope. The Debtor argues that pursuant to this Rule, the court erred when it referred to the KRPC as the basis for a technical trust. The Debtor concludes that because there was no technical trust, there can be no fiduciary relationship beyond that of a general attorney-client, and therefore, the elements of § 523(a)(4) have not been met. The Debtor’s argument fails because it confuses the creation of a technical trust under KRPC 1.15 with the creation of a cause of action. The KRPC is not creating a cause of action; the basis for finding the debt nondischargeable is § 523(a)(4) of the Bankruptcy Code. As explained above, the existence of the fiduciary relationship required by § 523(a)(4) hinges on whether there is either an express or technical trust in existence prior to the debt in controversy. Young, 91 F.3d at 1371-72. The KRPC defines an attorney’s role in accepting and maintaining client funds. Basically Rule 1.15 puts the attorney in the position of a trustee. In fact, Young indicated that the Rules may define such a relationship. Id. at 1372. As the bankruptcy judge correctly held, a technical trust arose from the interaction of Rule 1.15 of the KRPC, the trustee’s acceptance of the money on behalf of the client, and the attorney-client relationship.

Under the second prong of the § 523(a)(4) test, a fiduciary-debtor commits a defalcation when he or she fails to account for any entrusted funds “due to any breach of a fiduciary duty, whether intentional, wilful, reckless, or negligent.” Storie, 216 B.R. at 288. The fiduciary-debtor is charged with knowledge of the law and its duties. Id. Once the creditor establishes that the debtor is a fiduciary and that its debt has arisen because the fiduciary-debtor has not paid it the entrusted funds, the burden shifts to the fiduciary-debtor to render an accounting to show that it complied with its fiduciary duties. Id.

The court concluded that Debtor had committed a defalcation when he inappropriately retained the Appellee’s funds based on an inaccurate assessment

of his fees resulting from his failure to reduce the amount of the settlement to its present value. The Debtor argues that the court committed error on the ground that there is no legal authority for the proposition that an award of future benefits must be reduced to present value.

We are not persuaded by the Debtor's argument. While we have found no Kansas case on point, Kansas statutes,¹⁰ the Restatement of Torts,¹¹ as well as related case law¹² clearly indicate that when there is a structured settlement, contingency fee determinations are to be computed in one of the following ways: the present value method, the at cost method, or by awarding a percentage of each payment as it comes due.¹³ The present value method and the at cost method

¹⁰ Several Kansas statutes recognize the present value concept and apply it in various contexts. See, e.g., Kan. Stat. Ann. §§ 20-2621(1) (purchase of additional future retirement benefits by certain judges), 23-201(b) (present value of future military retirement benefits are part of marital estate created when divorce petition is filed), 59-2240 (demands against probate estate that are not yet due may be allowed at present value), and 84-2a-103(u)(defining "present value" for purposes of Article 24, Leases of the Kansas UCC)(1998 Supp.) .

¹¹ In assessing the value of future payments, The Restatement (Second) of Torts states: "The measure of a lump-sum award for future pecuniary losses arising from a tort is the present worth of the full amount of the loss of what would have been received at the later time." Restatement (Second) of Torts, § 913A (1977).

¹² While there are no Kansas cases dealing with this specific issue, there is a body of case law from other states. See, e.g., Robinson, Bradshaw & Hinson, P.A. v. Smith, 532 S.E.2d 815, 824 (N.C. App. 2000) (applying the present value approach); Ravsten v. Department of Labor and Industries, 736 P.2d 265 (Wa. 1987) (en banc) (applying the present value approach); Florida Bar v. Gentry, 475 So.2d 678 (Fla. 1985) (holding that an attorney who based his forty percent contingent fee on the total amount to be received by the client in a structured settlement was excessive and violated Florida's Disciplinary Rules.); In re Muccini, 460 N.Y.S.2d 680 (1983) (applying the when received approach); Merendino v. FMC Corp., 438 A.2d 365 (N.J. Super. 1981) (applying the at cost approach).

¹³ Additionally, we observe that The Restatement (Third) of Law Governing Lawyers recognizes only two manners in which a lawyer may claim fees in a structured settlement. In pertinent part it provides:

(1) A lawyer may contract with a client for a fee the size or payment of which is contingent on the outcome of a matter, unless

(continued...)

establish guidelines for assessing attorney fees that are to be paid immediately rather than in the future. The present value method evaluates a settlement's total present value through the use of expert witnesses who assess the market and attempt to determine the present value of future payments. The "at cost" method determines the present value of a settlement by determining its total present cost: the settlement is worth present payments plus the cost of the annuity that will be used to fund the future payments.¹⁴ Both methods require that a settlement paid out over a period of years be reduced to its present value when assessing attorney fees. Furthermore, KRPC 1.5 requires that all contingent fees be reasonable and that an attorney assess fees in a manner consistent with the fee customarily

¹³ (...continued)
the contract violates section 34 or another provision of this
Restatement

. . . .

(2) Unless the contract construed in the circumstances indicates otherwise, when a lawyer has contracted for a contingent fee, the lawyer is entitled to receive the specified fee only when and to the extent the client receives payment.

Restatement (Third) of the Law Governing Lawyers § 35 (1988).

The comment to this section further explains that when there is a structured settlement, the lawyer may receive the contingency fee in one of the following manners: 1) through the "stated share of each such [future] payment if and when it is made to the client . . . unless the client-lawyer contract provides otherwise"; or 2) through a calculation based on the present value of the settlement if the contract provides that the fee is to be paid at once if there is a structured settlement. Restatement (Third) of the Law Governing Lawyers § 35 cmt. e (1998).

Because this section was not adopted until 1998, the Debtor would not have been aware of it when assessing his fee in 1995. However, this section does codify accepted practice.

¹⁴ Although the court stated that it adopted the present value method when computing the fees, it really used the at cost method, because it calculated the fees based on the present value of the settlement.

charged in the locality.¹⁵ The court did not err when it found that the Debtor calculated his fee unreasonably and in a manner inconsistent with the locality by assessing his fee based on the settlement's future value. Additionally, the Debtor's intent is immaterial. As we have observed, intent is not an element of the defalcation prong of § 523(a)(4), and the fiduciary-debtor is charged with knowledge of the law. The court correctly found that the Debtor committed a defalcation when the Debtor assessed the Appellee more than the one-third fee upon which the Debtor agreed.

In his final argument, the Debtor maintains that the court miscalculated the amount of the nondischargeable judgment. First, the Debtor argues that the court failed to include medical fees that he paid on the Appellee's behalf as part of the final award. The Debtor is attempting to get paid twice here. In its calculations, the court correctly excluded the medical fees the Debtor paid on the Appellee's behalf because the Debtor received attorney fees for these monies.

Next, the Debtor argues that the court should have subtracted the case

¹⁵ Rule 1.5 provides in pertinent part:

- (a) A lawyer's fee shall be reasonable. The factors to be considered in determining the reasonableness of a fee include the following:
 - (1) the time and labor required, the novelty and difficulty of the questions involved, and the skill requisite to perform the legal service properly;
 - (2) the likelihood, if apparent to the client, that the acceptance of the particular employment will preclude other employment by the lawyer;
 - (3) the fee customarily charged in the locality for similar legal services;
 - (4) the amount involved and the results obtained;
 - (5) the time limitations imposed by the client or by the circumstances;
 - (6) the nature and length of the professional relationship with the client;
 - (7) the experience, reputation, and the ability of the lawyer or lawyers performing the services; and
 - (8) whether the fee is fixed or contingent.

Kan. R. Prof. Conduct 1.5(a)(1999 Kan. Ct. R. Annot. 312).

expenses of \$2,731, plus the sum of \$2,000 given to the Appellee by the Debtor. With respect to the case expenses, the court found that it did not have a sufficient record in the absence of the contract and a detailing of the expenses to determine whether the fees were justified and deductible under the contract. This finding is supported by the record.

Finally, the Debtor contends that the \$2,000 that he gave to the Appellee prepetition should be deducted from the nondischargeable judgment. The court made no findings with respect to this sum. Based on the record, we conclude that the amount of the court's judgment should be reduced by \$2,000. In an affidavit, the Debtor asserted that he gave \$2,000 to the Appellee from the cash sums he received as part of Appellee's settlement. The Appellee did not controvert this fact, and in oral argument before this Court the Appellee agreed that the amount had not properly been credited. Therefore, we must assume that this sum was delivered to the Appellee as part of his cash settlement and should be deducted from the amount of fees retained by the Debtor. On this issue we reverse and remand to the court for the entry of a judgment consistent with this order.

V. Conclusion

For the reasons set forth above, the court's summary judgment for the Appellee on the issue of whether the Debtor's debt to the Appellee is nondischargeable under § 523(a)(4) is AFFIRMED. However, we REVERSE and REMAND for the entry of a judgment consistent with this order on the issue of the amount of such nondischargeable debt.