

UNITED STATES BANKRUPTCY COURT  
EASTERN DISTRICT OF MISSOURI  
EASTERN DIVISION

In re )  
 )  
MELANIE KARLIN, ) Case No. 04-55751-293  
 ) Chapter 7  
 )  
Debtor. )  
 )  
JUDITH DILLON, As Personal )  
Representative of the Estate of, )  
Alice Yactor, )  
Plaintiff, )  
 )  
-v- ) Adv. No. 05-4035-293  
 )  
MELANIE KARLIN, )  
 )  
 )  
Defendant. )

**MEMORANDUM OPINION**

Judith Dillon ("Plaintiff") brings this adversary complaint against Debtor in her capacity as the personal representative of the estate of Alice Yactor. Plaintiff alleges that Debtor incurred a \$ 43,358.38 debt to Alice's estate arising out of Debtor's defalcation while acting in a fiduciary capacity to the Estate. The Court holds, however, that Plaintiff failed to establish by a preponderance of the evidence that Debtor incurred the debt in question as a result of her defalcation while acting in a

fiduciary capacity. The Court, therefore, will enter judgment in favor of Debtor.

### **JURISDICTION AND VENUE**

This Court has jurisdiction over the parties and subject matter of this proceeding under 28 U.S.C. §§ 1334, 151, and 157 and Local Rule 9.01 (B) of the United States District Court for the Eastern District of Missouri. This is a core proceeding under 28 U.S.C. § 157(b)(2)(I), which the Court may hear and determine. Venue is proper in this District under 28 U.S.C. § 1409(a).

### **FACTUAL AND PROCEDURAL BACKGROUND**

Debtor met Martin Larsen and Alice Yactor sometime in the early 1990s when all three were residing near Chicago. Martin and Alice were elderly siblings and attended the same church as Debtor. Martin and Alice owned a one-half interest and lived in a two family flat. (the “Flat”). Martin and Alice leased the apartment in the Flat in which they did not reside.

Over time, Debtor and Martin and Alice became close friends. Debtor provided companionship and care for both of them. Eventually, Martin and Alice could no longer live independently and both moved into a nursing home in October, 1998.

By the time Martin and Alice moved into the nursing home, Debtor had moved into a two bedroom apartment near St. Louis with her family. After talking with Martin and Alice, Debtor and her family invited both Martin and Alice to move out

of the nursing home and live with them in the apartment. Martin and Alice accepted the offer and moved into the apartment in October, 1998.

Martin, Alice and Debtor's family were quite cramped in the apartment. As a result, Martin, Alice, Debtor and Debtor's husband decided to purchase a larger residence. Martin decided to facilitate that purchase by obtaining a loan, secured by his interest in the Flat, and use a significant portion of the loan proceeds as a down payment. Accordingly, Martin obtained a \$65,000.00 loan secured by his interest in the Flat in late 1999. ("the Loan").

Martin used approximately \$45,000.00 of the Loan proceeds for a down payment on a home in Jefferson County, Missouri. (the "Missouri Residence"). Martin used the remaining \$20,000.00 for living expenses and new furniture. Martin, Alice and Debtor and Debtor's family moved into the Missouri Residence in the fall of 1999.

Martin died in September, 2000. Alice still resided in the Missouri Residence with Debtor and her family after Martin's death. Alice also retained an attorney and executed a will on November 21, 2000. (the "Will"). Alice died in May, 2001 and The Probate Court of Jefferson County Missouri (the "Probate Court") appointed Debtor the personal representative of Alice's estate (the "Estate") in May, 2002.

With respect to the Flat, both apartments were occupied from the time Martin

and Alice moved to St. Louis in October, 1998 until Alice's death. Glenn Gilbert ("Gilbert") and his wife leased one of the apartments in the Flat. Gilbert testified that at the time of Alice's death in May, 2001, he was paying \$650.00 per month in rent. Gilbert remitted the rent payment to Debtor. Debtor then used the rent payment to make the payment on the Loan. Debtor continued this practice after she was appointed as personal representative of the Estate.

The other apartment was occupied by Cindy Williams, who is Debtor's sister. Cindy suffers from Lupus and could not work. Cindy, therefore, was unable to pay any rent during her occupancy of the one apartment. It is unclear from the evidence adduced at trial how long Cindy resided in the Flat after Debtor was appointed as personal representative of the Estate.

Vivian Dillon, Alice's sister, filed a will contest and a petition to discover assets against Debtor in the Probate Court in November, 2002. Vivian and Debtor entered into a stipulated judgment concerning the will contest in April, 2003. Under the terms of the agreement, Debtor agreed to resign as personal representative of the estate and disclaim any rights she had under the Will, including any rights to the Flat. The Probate Court also entered a judgment declaring that Vivian was the sole heir of Martin. Vivian individually, therefore, inherited Martin's one-half interest in the Flat.

Concerning the Gilberts' lease of the apartment in the Flat, Debtor instructed

them to cease making rent payments after Vivian initiated the will contest. Accordingly, Gilbert and his wife ceased making rent payments in either October or November, 2002. Because Debtor was no longer collecting rent on the Flat, she also ceased making the payment on the Loan, causing the Estate to default on its obligations. Accordingly, the holder of the Loan began foreclosing proceedings on the Flat sometime in early 2003.

Vivian individually and the Estate sold both of their interest in the Flat to the Gilberts in April, 2003 for approximately \$243,000.00. Vivian used the proceeds of the sale to satisfy the outstanding balance on Loan and pay the fees and penalties associated with the foreclosure proceedings.

Debtor did not file an answer with respect to the Estate's petition to discover assets. The Estate, therefore, filed Vivian's affidavit in support of its motion for judgment. The affidavit claimed that the Estate was damaged in the amount of \$43,358.38 because of Debtor's failure to properly account for the Estate's assets. The Probate Court entered judgment on July 8, 2003 in that amount against Debtor based entirely on the evidence contained in the affidavit. (the "Probate Court Judgment").

Debtor filed her petition for relief under Chapter 7 of the Code on December

13, 2004. The Estate filed this instant adversary complaint on February 17, 2005.<sup>1</sup> The Estate argues that Debtor incurred the \$43,358.23 debt contained in the Probate Court Judgment as a result of Debtor's fraud or defalcation while acting in a fiduciary capacity to the Estate. The Estate contends, therefore, that the entire debt contained in the Probate Court Judgment is excepted from discharge under 11 U.S.C. § 523(a)(4).

The Court finds that the Estate failed to establish by a preponderance of the evidence that Debtor incurred any of the debt in question as a result of her defalcation while acting in a fiduciary capacity to the Estate. The Court, therefore, will enter judgment in favor of Debtor.

## **CONCLUSIONS OF LAW**

### *A. Introduction*

Relevant to the issues in dispute here, section 523(a)(4) provides that any debt that a debtor incurs as a result of fraud or defalcation while acting in a fiduciary capacity is excepted from the debtor's general discharge. The plaintiff must show by a preponderance of the evidence both that the debtor incurred the debt as a result of either fraud or defalcation and that debtor was acting in a fiduciary capacity when she

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<sup>1</sup> At some point, Vivian died and Vivian's daughter, Judith Dillon, was appointed as the successor representative of the Estate.

incurred the debt. E.W. Wylie Corp. V. Montgomery (In re Montgomery), 236 B.R. 914, 922 (Bankr. D.N.D. 1999).

The determination of whether a debtor was acting in a fiduciary capacity for purposes of section 523(a)(4) is a matter of federal law. Tudor Oaks, L.P. v. Cochrane (In re Cochrane), 124 F.3d 978, 984 (8th Cir. 1997). The fiduciary relationship must arise from an express or technical trust that is imposed without concern for the alleged wrongdoing. Id. Further, although federal law ultimately controls, the issue of whether applicable state law creates an express trust relationship between the debtor and creditor is highly probative. Reliance Ins. Co. v. Wilson (In re Wilson), 127 B.R. 440, 443 (Bankr. E.D. Mo. 1991).

With respect to the defalcation element, the creditor need not establish that the debtor acted with any specific mental state. Cochrane, 124 F.3d at 984. Rather, even an innocent mistake that results in a technical breach of the debtor's fiduciary obligations may constitute defalcation under § 523(a)(4). Id.

*B. Debtor is not collaterally estopped by the Probate Court Judgment.*

The Estate first argues that the Probate Court Judgment collaterally estops Debtor from denying she incurred the debt as a result of her defalcation while acting in a fiduciary capacity to the Estate. Because the Probate Court Judgment was entered by a Missouri state court, Missouri's collateral estoppel law will apply. Hobson

Mould Works, Inc v. Madsen (In re Madsen), 195 F.3d 988, 989 (8th Cir. 1999) (per curiam).

Only judgments that are on the merits are entitled to preclusive effect under Missouri law. Metal Exchange Corp. v. J.W. Terril, Inc., 173 S.W.3d 672, 676 (Mo. Ct. App. 2005). Thus, a judgment obtained by default may not collaterally estoppel a party in subsequent litigation. Id. Here, it is uncontroverted that the Probate Court Judgment was entered as result of Debtor's default. The Probate Court Judgment, therefore, does not collaterally estop Debtor from litigating the issues currently in dispute here.

*C. Debtor was acting as a fiduciary to the Estate only during the time that she was the personal representative of the Estate.*

There is no question that Debtor was in acting in a fiduciary capacity to the Estate from the time the Probate Court appointed her as the personal representative on May 13, 2002 until Vivian filed the will contest on November 22, 2002. A personal representative of a decedent's estate is a fiduciary under Missouri law. Wilson, 127 B.R. at 443. Debtor, therefore, was acting in a fiduciary capacity in her role as personal representative of the Estate during the time she was the personal representative of the Estate.

Once Vivian filed the will contest, however, Debtor's duty as personal representative ceased under Missouri law. Missouri law provides that a personal



representative's duties are suspended automatically and without order from the probate court once a will contest is filed. In the Matter of the Estate of Wilde, 963 S.W.2d 336, 339-40 (Mo. Ct. App. 1997); Mo. Rev. Stat. § 473.137. Therefore, the filing of a will contest immediately suspends the personal representative's fiduciary relationship to the probate estate. Wilde, 963 S.W.2d at 40.

Here, once Vivian initiated the will contest on November 22, 2002, Debtor's duty as personal representative to the Estate was automatically suspended under Missouri law. Accordingly, under Missouri law, Debtor was not acting in a fiduciary capacity to the Estate once Vivian filed the will contest on November 22, 2002. The Court, therefore, finds that Debtor was not acting in a fiduciary capacity to the Estate for purposes of § 523(a)(4) after Vivian initiated the will contest.

*D. The Estate has failed to establish by a preponderance of the evidence that it suffered any damages as a result of Debtor's defalcation while acting in a fiduciary capacity.*

As illustrated above, the Probate Court entered judgment in the amount of \$43,358.38 in favor of the Estate and against Debtor. And there are four components to that amount: (1) one-half of the outstanding balance on the Loan ; (2) one-half of the unaccounted rent from Gilberts; (3) one-half of the costs associated with curing the default on the Loan; and (4) the Estate's attorney's fees in prosecuting the will contest and the petition to discover assets. The Estate failed to establish by a preponderance

of the evidence that Debtor incurred any of these liabilities as a result of committing defalcation in her fiduciary capacity to the Estate.

First, with respect to the outstanding balance on the Loan, the evidence adduced at trial indicated that Martin viewed the Loan as a gift and never intended Debtor to repay the Loan. The evidence indicates that Martin and Alice were living with Debtor and her family in a small two bedroom apartment at the time Martin obtained the Loan. Additionally, Debtor and her family were caring from both Martin and Alice at the time. Debtor testified that Martin desired to reside in a larger house with Debtor and her family and obtained the Loan to allow Debtor to purchase the Missouri Residence. The Court finds Debtor's testimony to be credible and the Estate produced no evidence that contradicts that testimony. Accordingly, the Estate has failed to establish by a preponderance of the evidence that Martin intended the Loan proceeds to be a loan to Debtor.

Concerning the uncollected rent from the Gilberts, a personal representative has a duty to collect the rent stemming from the probate estate's real property. State ex. rel. Dryden v. Thym, 282 S.W.2d 178, 186 (Mo. Ct. App. 1955). Both Debtor and Gilbert, however, testified that she ceased collecting the rent from Gilbert after Vivian initiated the will contest. Accordingly, because Debtor's duty as personal representative of the Estate was suspended by the will contest, Debtor was not acting in a

fiduciary capacity to the Estate at the time she failed to collect the rent from the Gilberts.

Third, with respect to the Estate's cost in curing the default proceedings on the Loan, the undisputed evidence shows that Debtor failed to remit payments to the holder of the Loan only after she had ceased collecting rent from Gilbert. Thus, the evidence establishes that Debtor failed to remit the payment on the Loan only after her duties as personal representative of the estate were suspended by Vivian's will contest. Accordingly, Debtor did not incur the debt to the Estate arising out of the Estate's default on the Loan as a result of her defalcation while acting in a fiduciary capacity to the Estate.

Finally, by definition, the Estate did not incur its attorney's fees in prosecuting the will contest and the discovery of assets action until after the will contest was filed. Debtor, therefore, did not incur that debt as a result of her committing defalcation while in fiduciary capacity to the Estate.

## **CONCLUSION**

The Estate failed to prove by a preponderance of the evidence that Debtor incurred any of the \$43,358.38 debt to the Estate contained in the Probate Court Judgment as a result of her defalcation while in a fiduciary capacity to the Estate. Debtor's liability on the \$43,358.38 debt to the Estate, therefore, does not fall within

the exception to her general discharge under 11 U.S.C. § 523(a)(4). Thus, the Court will enter judgment in favor of Debtor. An Order consistent with this Memorandum Opinion will be entered this date.

The above constitutes the Court's findings of facts and conclusions of law under Bankr. R. 7052.

DATED: May 1, 2006

St. Louis, Missouri



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David P. McDonald  
United States Bankruptcy Judge