

**IN THE UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF ARKANSAS
FAYETTEVILLE DIVISION**

In re: Rock and Dianna Spencer, Debtors

**No. 5:09-bk-75459
Ch. 7**

Donny and Lori Edwards

Plaintiffs

v.

Adv. Proc. No. 5:10-7006

Rock and Dianna Spencer

Defendants

ORDER

Before the Court is a complaint to determine the dischargeability of a debt under § 523(a)(2) and (6), filed by Donny and Lori Edwards on January 17, 2010, and an answer filed by Rock and Dianna Spencer, the debtors, on February 17, 2010. The underlying debt is based primarily on a state court judgment against Rock and Dianna Spencer, trustees of Dianna L. Spencer Living Trust and Rock E. Spencer Living Trust. At trial, held on July 1, 2010, the Court granted the debtors' motion for judgment as a matter of law and denied the § 523(a)(6) cause of action for the reasons stated on the record. After a careful review of the evidence and testimony presented at trial, for the reasons stated below, the request for relief under § 523(a)(2) is denied and the complaint is dismissed.

The Court has jurisdiction over this matter under 28 U.S.C. § 1334 and 28 U.S.C. § 157, and it is a core proceeding under 28 U.S.C. § 157(b)(2)(I). The following opinion constitutes findings of fact and conclusions of law in accordance with Federal Rule of Bankruptcy Procedure 7052.

Findings of Fact and Conclusions of Law

On June 18, 2009, the Circuit Court of Washington County entered a judgment for rescission, restitution damages, costs, and attorney fees against defendants Rock E. Spencer and Diana L. Spencer in their capacity as trustees of their respective living trusts [Spencers as trustees] and in favor of plaintiffs Donny and Lori Edwards. The Edwardses are asking that this Court find that Spencers, individually, cannot discharge the debt embodied in the state court judgment. Because the Spencers, as individuals, are the debtors in the above-captioned bankruptcy case and because the judgment was entered

against the Spencers as trustees, the Edwardses must show that the Spencers, *as individuals*, are liable on the debt.

A debt is defined as “liability on a claim.” 11 U.S.C. § 101(12). A claim is defined, in relevant part, as a “right to payment.” 11 U.S.C. § 101(5). The judgment awarded against the Spencers as trustees and in favor of the Edwardses gives the Edwardses a right to payment of damages, fees, and costs. However, under Arkansas law, a trustee has limited liability and is not individually liable on debts incurred in connection with the duties of a trustee unless the trustee is proven to have committed certain acts. Ark. Code Ann. § 28-73-1010 (West July 1, 2010). For instance, a trustee is not “personally liable on a contract properly entered into in the course of administering a trust if the trustee in the contract disclosed the fiduciary capacity.” Ark. Code Ann. § 28-73-1010(a). Similarly, a trustee is only personally liable for torts “committed in the course of administering a trust, or for obligations arising from ownership or control of trust property . . . if the trustee is personally at fault.” Ark. Code Ann. § 28-73-1010(b).

The state court judgment does not find that the Spencers failed to disclose their fiduciary capacity, that the Spencers were personally at fault, or that the Spencers did not properly enter into the subject contract. However, the Court recognizes that the state court judgment states that the Spencers *as trustees* “induced the Edwards [sic] to purchase the property based upon false representations . . .[,] intended to cause the [Edwardses] to rely upon the false representations concerning the suitability of the real property . . . [, and] fraudulently induced the [Edwardses] to purchase the property.” Regardless, based on the evidence presented and this Court’s record, the Spencers were not parties to the state court action in their individual capacity. The judgment against the Spencers as trustees does not automatically render the Spencers personally liable on the judgment in a subsequent action brought against them individually. *See Citizens Bank v. Disanto*, 2006 WL 1652670, *2 (Mich. App. 2006) (acknowledging precedent that a judgment against a person sued in a representative capacity does not “conclude” that person in a subsequent proceeding brought against the person in an individual capacity). The Edwardses would have to have proven in the state court or this Court that the Spencers as individuals were not entitled to the protection afforded trustees under Arkansas state law. Neither the state court judgment nor the complaint before this Court addresses the issue of whether the Spencers are entitled to a trustee’s limited liability or mentions the relevant Arkansas

statute. Further, Edwardses' counsel did not argue the issue at hearing such that this Court could conform the pleadings to the evidence. While it may be that a trustee found to have fraudulently induced another party to enter into a contract did not "properly enter into the contract," the Spencers have not had the opportunity to defend the critical issue of whether the Spencers in their individual capacity are entitled to limited liability under Arkansas law regarding the subject debt. Because the issue was not reduced to judgment in state court and has not been brought before this Court either in pleadings or at the July 1 hearing, the Edwardses have not met their burden to show that they have a claim against the Spencers in their individual capacity.

Conclusion

Because this Court cannot find that the Spencers are individually liable on the debt embodied by the state court judgment, there is no debt at issue as contemplated under § 523(a). Accordingly, the request for relief under § 523(a)(2) is denied and the complaint is dismissed.

IT IS SO ORDERED.

August 26, 2010

DATE



BEN T. BARRY
UNITED STATES BANKRUPTCY JUDGE

cc: Stanley V. Bond, attorney for the debtors
Cindy L. Hawkins, attorney for the Edwardses
U.S. Trustee

EOD 8/26/2010
by A. Penrod