Sunday, January 11, 1987

IN THE UNITED STATES BANKRUPTCY COURT

FOR THE NORTHERN DISTRICT OF CALIFORNIA

In re

ROBERT R. HENKELL, No. 1-82-01223

Debtor.

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SHIRLEY BURDON,

Plaintiff,

v. A.P. No. 1-84-0196

ROBERT L. HENKELL,

Defendant.

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Memorandum of Decision

Plaintiff Shirley Burden is a sixty-three-year-old widow. Her husband, a physician, died in 1979. In addition to some outstanding receivables from his medical practice, he left plaintiff $85,000.00 in a trust administered by a church. Plaintiff met debtor and defendant Robert

Henkell, who was then a real estate salesman, at an Amway presentation in his home in 1979. Plaintiff complained to Henkell about her money being tied up in the trust, and Henkell assisted plaintiff by drafting a letter to the church demanding that the trust be terminated and all trust funds be turned over to her. As a result of the letter, the church sent plaintiff all of the trust funds. Plaintiff was fairly unknowledgeable in financial matters, not even having balanced a checkbook since her marriage in 1946. Henkell agreed to advise her in financial matters and make sure that she made "safe and secure" investments. Although Henkell claims that he agreed to do this as a "friend," he did subsequently hold himself out to the public as a financial counselor and plaintiff gave him one payment of $2,000.00 for his services. At Henkell's direction, plaintiff made three real estate investments in February and March, 1980. These investments panned out well for plaintiff and were cashed out within a few months. Plaintiff and Henkell, at some time during the spring of 1980, discussed plaintiff's desire for an investment with a high rate of return and liquidity upon demand. Henkell got the idea to create a "loan fund" whereby plaintiff and a third party would invest their funds with him. Henkell promised them 18% interest and withdrawals on demand, in return for use of their money as he saw fit. Plaintiff was not sophisticated in financial matters and did not fully realize that in essence she was making an unsecured loan to Henkell. Henkell did not fully explain this to her. From April, 1980, to September, 1982, when Henkell filed his bankruptcy petition, plaintiff invested $94,190.00 in the "loan fund." During this time she withdrew $73,000.00. She claims that the balance of $21,190.00 is nondischargeable due to fraud and defalcation in a fiduciary capacity pursuant to sections 523(a)(2) and 523(a)(4) of the Bankruptcy Code. The record does not support a finding of an affirmative misrepresentation. Although plaintiff testified that Henkell told her that her investments would always be secured, he denied this and claims that he told plaintiff that the money was a loan to him. Henkell's version is given some credibility due to the facts that plaintiff knowingly signed over her funds directly to him and that he gave her monthly statements of her account. In addition, even someone totally naive in financial matters (which plaintiff was not) could not seriously believe that an investment in real estate could be completely secure, entirely liquid, and produce a high rate of return. Also, plaintiff was an employee of Henkell during this time and could have easily determined all of the facts had she desired to know them. In any event, the Court must resolve the issue in favor of Henkell, lacking clear and convincing evidence to support plaintiff's version of the facts. The failure to disclose relevant information with fraudulent intent may render a debt nondischargeable, especially where a special relationship between the parties exists. In re Haddad (9th Cir.B.A.P.1982) 21 B.R. 421, 423, aff'd 703 F.2d 575. When Henkell undertook to assist a widow in the withdrawal and reinvestment of her life's savings, he certainly created a relationship sufficient to render him liable for his failure to disclose the risks involved in an unsecured loan to him. While the Court is very close to finding nondischargeable conduct on this basis, in the final analysis it cannot do so. In order to render a debt nondischargeable, the court must find actual intent to defraud; constructive or implied fraud will not do. 3 **Collier on Bankruptcy**, sec. 523.08[4]. While the Court had no trouble finding actual fraud as to persons who were induced to give Henkell money later in his career as an investment counselor, plaintiff was one of the first persons he counseled. For a brief time in the early 1980's it was possible to pay 18% interest and make a profit on one's investments. This fact, together with plaintiff's withdrawal of $73,000.00 of her funds from Henkell over the few years of their relationship and Henkell's careful keeping of plaintiff's account show that Henkell reasonably intended to pay her as promised when he obtained her funds. Henkell had, of course, created a Ponzi scheme which required a continuous influx of new investment

funds to honor prior commitments; the Court has already found nondischargeable debts to subsequent investors based on Henkell's express written misrepresentations and nondisclosures which the Court found had been made with the intent to part the investors from their money. However, the Court cannot find such intent here. There is no evidence that Henkell intended to create a Ponzi scheme or that he understood what was bound to happen as inflation slowed and interest rates dropped. In any event, a Ponzi scheme is generally fraudulent as to late comers, not initial investors, and stupidity is not a ground for finding a debt nondischargeable.   The Court easily finds that by helping plaintiff get her funds out of the church trust and undertaking to direct her investments, a fiduciary relationship was created between the plaintiff and Henkell. Such a relationship is created where one party comes under the influence of another and is justified in assuming that the other is acting in the first party's best interests. 80 C.J.S., Trusts, sec. 151; Ogier v. Pacific Oil & Gas Dev. Corp. (1955) 132 Cal.App.2d 496. However, a breach of the fiduciary duty in such cases gives rise to a constructive trust. 60 **Cal.Jur.3d**, Trusts, sec. 293. Section 523(a)(4) of the Bankruptcy Code applies only to express trusts, not constructive trusts. In re Pedrazzini (9th Cir.1981) 644 F.2d 756, 758-59. Therefore, this breach of fiduciary duty cannot be the basis for a finding of nondischargeabilty. Any claim based upon Henkell's status as a real estate licensee fails for the same reason. In re Bernardelli (Bkrtcy.D.Nev.1981) 13 B.R. 656.
Although it is a close question, the Court must resolve any doubt in favor of Henkell. Accordingly, plaintiff can take nothing by her complaint and Henkell's debt to her must be determined to have been discharged. Each party shall bear his or her own costs.   Counsel for Henkell shall submit an appropriate form of judgment within ten days. This memorandum constitutes the Court's findings and conclusions pursuant to FRCP 52(a) and Bankruptcy Rule 7052.

Dated: January 11, 1987

ALAN JAROSLOVSKY

U.S. BANKRUPTCY JUDGE
