Honorable Mike K. Nakagawa
United States Bankruptcy Judge

Entered on Docket
June 15, 2016

UNITED STATES BANKRUPTCY COURT

DISTRICT OF NEVADA

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In re: GORDON DOUGLAS BROOKS, Debtor.	Case No.: 13-18852-MKN Chapter 7
RUTH L. CARNEY, Plaintiff, vs. GORDON DOUGLAS BROOKS, Defendant.	Adv. No.: 14-01006-MKN Date: April 20, 2015 and May 4, 2015

MEMORANDUM DECISION AFTER TRIAL[1]

A trial was conducted in the above-referenced adversary proceeding on April 20, 2015, and May 4, 2015. The appearances of counsel were noted on the record. Closing arguments were presented at the end of the trial, and the matter was taken under submission.

This Memorandum Decision constitutes the court's findings of fact and conclusions of law pursuant to FRBP 7052 and FRCP 52.

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[1] In this Memorandum Decision, all references to "ECF No." are to the numbers assigned to the documents filed in the above-captioned bankruptcy case as they appear on the docket maintained by the clerk of the court. All references to "AECF No." are to the numbers assigned to the documents filed in the above-captioned adversary proceeding. All references to "Section" or "§" are to provisions of the Bankruptcy Code, 11 U.S.C. §§ 101–1532, unless otherwise indicated. All references to "FRBP" are to the Federal Rules of Bankruptcy Procedure. All references to "FRCP" are to the Federal Rules of Civil Procedure.

FACTUAL AND PROCEDURAL BACKGROUND

On October 17, 2013, Gordon Douglas Brooks ("Debtor") filed a voluntary Chapter 7 petition, along with his schedules of assets and liabilities ("Schedules") and statement of financial affairs ("SOFA"). (ECF No. 1). In his current income Schedule "I," Debtor describes his occupation as the owner of an entity named Diversified Stochastic Investments ("DSI"), which he then describes in his SOFA as an investment advisor. In his creditor Schedule "F," he listed Ruth Carney ("Plaintiff") as having an unsecured claim in an unknown amount arising from a lawsuit. In his statement of financial affairs, Debtor disclosed a collection lawsuit pending in the Ninth Judicial District Court, Douglas County, Nevada, entitled Ruth Carney v. Gordon Brooks, an individual, and Diversified Stochastic Investments, Inc., a California Corporation, denominated Case No. 13-CV-192 ("State Action").

On January 15, 2014, Plaintiff commenced the instant adversary proceeding by filing an adversary complaint ("Complaint"). (AECF No. 1). The Complaint generally alleges that the Debtor mismanaged the investments included in the Plaintiff's individual retirement account ("IRA") and a separate trust account ("Trust Account"). The Complaint alleges that the State Action was commenced on July 19, 2013, and that default was entered on September 3, 2013. The Complaint also alleges that on October 11, 2013, a default judgment was entered in the State Action against the Debtor, as well as DSI, in the total amount of $1,037,770.[2] The Complaint seeks to determine the dischargeability of the Plaintiff's claim against the Debtor pursuant to Sections 523(a)(2), 523(a)(4), and 523(a)(6). The Complaint alleges causes of action on the following legal theories: (1) breach of fiduciary duty, (2) fraud, (3) fraudulent concealment, (4) exploitation of an older or vulnerable person, (5) willful and malicious injury to another entity or

[2] Issue preclusion applies in dischargeability proceedings, see Brown v. Felsen, 442 U.S. 127, 139 n.10 (1979), and bankruptcy courts generally apply the preclusion rules of the state where the judgment is entered. See Gayden v. Nourbakhsh (In re Nourbakhsh), 67 F.3d 798, 800 (9th Cir. 1995). In Nevada, issue preclusive effect is not given to default judgments, however, because the legal and factual issues underlying the judgment are not actually litigated. See In re Sandoval, 126 Nev. 136, 232 P.3d 422, 425 (Nev. 2010). Under these circumstances, the court has not been requested to enter judgment in the dischargeability proceeding based on the default judgment entered in the State Action.

to the property of another entity, and (6) violation of the Nevada Deceptive Trade Practices Act.

On March 4, 2014, Debtor filed his answer. (AECF No. 7).

On July 29, 2014, an order was entered scheduling a pretrial conference for February 11, 2015, and a trial to commence on February 23, 2015. (AECF No. 17).

On July 29, 2014, an order was entered scheduling a settlement conference and status conference. (AECF No. 19).

On November 7, 2014, an order was entered approving a stipulation to vacate the settlement conference. (AECF No. 32).

On January 22, 2015, an order was entered approving a stipulation between the parties that rescheduled the trial to commence on April 20, 2015. (AECF No. 35).

On January 26, 2015, an amended order was entered rescheduling the pretrial conference for April 9, 2015. (AECF No. 37).

On March 26, 2015, Plaintiff filed her Trial Statement ("Plaintiff's Trial Statement"). (AECF No. 46). On the same date, Debtor filed his Trial Statement ("Debtor's Trial Statement"). (AECF No. 48).[3]

THE EVIDENCE PRESENTED

Twenty-four exhibits were admitted into evidence and five witnesses testified at trial. All of the witnesses were subject to cross-examination.

A. <u>**The Exhibits.**</u>[4]

1. Trust Account Statements dated May 2007[5] through September 2012

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[3] At the court's direction, both parties submitted additional legal memoranda concerning a recent decision by the Bankruptcy Appellate Panels for the Ninth Circuit ("BAP") entitled <u>In re Heers</u>, 529 B.R. 734 (2015). On May 1, 2015, Plaintiff submitted her brief (AECF No. 56) and Debtor submitted his supplemental brief. (AECF No. 57).

[4] Parties stipulated to the admissibility of all of the exhibits. In addition to their numerical identification, some of the exhibits have page numbers while other exhibits are divided by separately numbered tabs. In this Memorandum Decision, the exhibits will be cited as "Ex." and then by any "Page" number or any "Tab" number, if applicable.

[5] The IRA Statement for the period May 1, 2007 through May 31, 2007, indicates that it is a new account. The court therefore assumes that management of the IRA was transferred from

2. IRA Account Statements dated March 2007[6] through September 2012
3. Michael Hume's Expert Report
4. Howard Buchler's Expert Report
5. Donald Parker's Expert Report
6. Vanguard Asset Allocation Models
7. Plaintiff's Responses to Brooks's First Set of Interrogatories
8. Plaintiff's Supplemental Responses to Brooks's First Set of Interrogatories
9. Plaintiff's Responses to Brooks's First Set of Request for Admissions
10. Defendant's Responses to Plaintiff's First Set of Interrogatories
11. Performance Sheets
12. 2007 Wells Fargo Forms
13. Fax to C. Iverson Regarding Withdrawals for Remodeling of Woodside, CA Home dated January 12, 2010.
14. Fax to Plaintiff Regarding Attempts to Contact dated February 12, 2008.
15. JFS Promissory Notes Payment Schedule
16. New Account Paperwork
17. Trading Authorization for Plaintiff's IRA Account
18. Trading Authorization for Plaintiff's Trust Account
19. Growth Strategy Exchange Traded Fund Performance Study
20. Charts of Performance of Plaintiff's IRA Account
21. Charts of Performance of Plaintiff's Trust Account
22. Wall Street Journal DIJA Losses
23. Default Prove-up DVD dated September 30, 2013
24. Default Judgment

B. <u>The Witness Testimony.</u>

1. <u>Ruth Carney ("Plaintiff").</u>

Plaintiff testified that she is a high school graduate and attended two years of junior college. She testified that after her husband died, she helped wind down his semi-conductor business in Silicon Valley, and was guided by accountants and attorneys to ensure she complied with state laws.

Plaintiff testified that her knowledge of investments was obtained from information disclosed by companies in the brochures and pamphlets that they provided to investors. She testified that the Debtor did not explain to her the investments that she made. Plaintiff further testified that her investment knowledge broadened from reading the Wall Street Journal ("WSJ") and conversing with friends who were avid readers of the WSJ. She also gained knowledge from watching Fox News and Fox Business channels. Plaintiff testified that she had some familiarity

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Wells Fargo to DSI as of May 1, 2007.

[6] The IRA Statement for the period March 1, 2007 through March 31, 2007, indicates that it is a new account. The court therefore assumes that management of the IRA was transferred from Wells Fargo to DSI as of March 1, 2007.

with blue-chip stocks, including Apple, Johnson & Johnson, and other pharmaceutical companies.

Plaintiff testified that she considers herself a very conservative investor and that Debtor knew that she wanted to maintain safe and conservative investment accounts. She testified that she always reminded the Debtor that she wanted to invest safely and conservatively, and that she never told the Debtor that she changed her investment approach. Plaintiff believed that her monies were invested in blue chip stocks or S&P 500 stocks and bonds while being managed by the Debtor.

Plaintiff testified that she gave Debtor trading authority, i.e., discretion to buy and sell without consulting with her first. She testified that Debtor charged her a monthly percentage fee based on the overall balance of her accounts, which she authorized him to charge to her credit card.

Plaintiff testified that she moved her accounts over the years to where Debtor was employed, including when Debtor was employed by Wells Fargo. She also testified that Debtor did not provide her any explanation prior to his departure from Wells Fargo, but Debtor later told her that he left because he did not agree with the way Wells Fargo was investing her monies. Plaintiff testified, however, that Debtor did not manipulate her to move her accounts to DSI. She testified that upon moving her accounts from Wells Fargo to the Debtor, they had a face-to-face meeting.

Plaintiff testified that during the period of 1999 to 2009, she took care of her oldest son who had a terminal illness, including paying for medical expenses not covered by her son's health insurance. Plaintiff acknowledged that she withdrew $3,600,000 from her accounts and that she used some of those funds to pay doctors' fees and medical costs for her son. She testified that she was not aware that the earning potential of her investment accounts decreased due to her withdrawals, but she acknowledged that it is reasonable that her investments would be affected due to substantial cash withdrawals.

Plaintiff testified that in 2007, her younger son suddenly passed away from pneumonia. She testified that soon thereafter, she suffered from major depression and was unable to personally keep track of her expenses. As a result, she had to hire people to conduct her business on her behalf, including the Debtor who handled her investments. During the period of 2007 to 2011, she spoke with the Debtor twice a month. Plaintiff testified that when she inquired on matters she did not understand, Debtor did not provide explanations, but assured her that her accounts were doing fine. She also testified that the Debtor never informed her that her investments were not profitable and that he flowed monies between her IRA and Trust Account. She testified that she never told the Debtor in 2011 that it was okay to convert her stocks and bonds into cash. Plaintiff also testified that the Debtor never informed her how "stochastics" worked[7] or that the Debtor would be investing her monies in leveraged ETFs. Plaintiff testified that in addition to periodic phone calls from the Debtor, she received statements on her accounts.

Plaintiff testified that when the Debtor began to manage her account under DSI in 2007, she owned seven real properties, held $2,330,000 in her IRA and held $3,278,000 in her Trust Account. At the time she moved to DSI, she testified that she owned an A-frame house in Incline Village, a condominium in Reno, a beach house in Aptos, California, a small lot in Gardnerville, Nevada, a Las Vegas motorcoach pad, and, a house in Woodside, California.

Plaintiff testified that she held a promissory note ("JFS Note") as part of a managed IRA that was serviced through Wells Fargo. Wells Fargo agreed to receive payments on the note and to deposit the monies to that managed IRA. Plaintiff testified that when there were only ten payments remaining on the JFS Note, Wells Fargo decided it no longer wanted to service the JFS Note because of a disagreement between the Debtor and Wells Fargo. This meant that monies received from the JFS Note would be distributed to the Plaintiff in 2012, and she would be liable for taxes on the distribution, which included penalties, fees, and interest for the life of the note. Plaintiff testified that when she confronted the Debtor, he claimed that Wells Fargo made an independent decision to discontinue managing the JFS Note. She testified that this complication motivated her to contact an ERISA attorney, who then advised her to consult with a securities attorney. Plaintiff testified that only after her current attorney, Thomas Bradley, examined her

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[7] Plaintiff also testified that she called someone at Wells Fargo and the person she spoke to in the investment department was unfamiliar with the term stochastics.

investment accounts did she discover the losses she incurred. As a result, Plaintiff hired an acquaintance named Jacqueline Caldwell to collect information on her accounts from the Debtor and Wells Fargo.

Plaintiff also testified that she held a Charitable Remainder Uni-Trust ("CRUT") account, which was managed by a separate trustee. She testified that the Debtor charged her $150,000 in fees to manage the CRUT account from 2007 through 2012, even though he was not the trustee. Plaintiff testified that she never gave the Debtor permission to do so. Plaintiff testified that she never told the Debtor that $3,000 per month was unimportant because she "pissed away" that amount each month. She acknowledged that in her response to the Debtor's request for admissions, see Ex. 9, she admitted that although Debtor overcharged for fees, she had previously agreed not to seek reimbursement for the CRUT fees. Plaintiff then testified that she did, in fact, seek reimbursement and that the Debtor agreed to pay it back. She testified, however, that the Debtor made very few payments.[8]

Plaintiff testified that she brought the State Action against the Debtor for breach of fiduciary duty and fraud, and obtained a default judgment against him.

2. Howard Buchler ("Buchler").

Buchler testified that he is a certified financial manager, with 32 years of experience in the securities industry, holding positions as a manager, financial advisor, and lecturer at Merrill Lynch and at Financial Securities. He also has 20 years of experience as an arbitrator, and serving as an expert currently is his sole source of income, with the vast majority of that being in

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[8] Plaintiff testified that she is attempting to recover these unauthorized CRUT fees through the current adversary proceeding. It is undisputed that the CRUT fees had nothing to do with the management of any investments in that account because the Debtor was not the trustee of that trust. Moreover, the Plaintiff asserts that the Debtor did not provide any services to justify charging any fees in connection with the CRUT. Recovery of the unauthorized CRUT fees, however, is not alleged nor sought in the Complaint. Perhaps the recovery of those fees was not sought in the Complaint because of Plaintiff's prior agreement not to seek reimbursement. Whatever the reason, neither the CRUT fees nor a theory on which such fees would be excepted from discharge under Section 523(a) are discussed in Plaintiff's Trial Statement. Likewise, no theory for exception of the CRUT fees from discharge was presented at closing argument.

plaintiffs work. Buchler testified, however, that he has not been certified as an expert in federal court and that he does not currently hold any securities licenses.[9]

Buchler testified he has a bachelor's degree in business administration. He also has a juris doctor degree from Chicago-Kent University, and certificates in European Legal Studies and in securities.

Buchler testified that a market timing strategy is to guess or bet the direction of the stock market within a period of time, which he testified is the complete opposite of a buy and hold strategy. Buchler testified that a market timing strategy is generally unsuccessful.

Buchler defined a technical analysis as the use of charts and formulas, based on the past performances of stocks and bonds, to predict future performance. Buchler testified that although this strategy provides indicators of buy and sell based on a purely mathematical analysis, this strategy does not recognize the quality and suitability of investments to a particular client, and therefore, a technical analysis approach also cannot guarantee successful results.

Buchler testified that the most important rule in securities investment is asset allocation, that is, diversification and allocation of assets in different lines, i.e., stocks, bonds, and cash equivalents. Asset allocation reduces the risk of investment through diversification. Buchler testified that reducing investment risk is important because nobody really knows, including the Debtor, where the market is going to go. He further testified that the asset allocation depends on the suitability to the client.

Buchler testified that the suitability of an individual security or investment strategy is based on the individual client's age, experience, risk tolerance, and tax situation. As to the Plaintiff, Buchler testified that he did not know Plaintiff's net worth and values of her other investments when he made an analysis and reached the conclusion that Debtor's investments were not suitable to the Plaintiff. He testified that a financial manager must understand the investment and its risks, ensure that the client understands the investment and its related risks, ensure that the client is financially able to assume the risk, and most important, ensure that the

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[9] Buchler prepared a report ("Buchler Report") that was admitted into evidence by stipulation as Exhibit 4.

client accepts the risk. Buchler testified that an investment is deemed unsuitable for the client if the client is unwilling to accept such risk. He testified that none of the other suitability considerations make a difference if the client does not want the risk.[10] Buchler also acknowledged that in determining suitability according to FINRA,[11] a financial manager is only required to have a reasonable basis to recommend an investment.

Buchler testified that the general rule in determining the appropriate asset allocation is to use the "Age in Bond Rule," i.e., to take the client's age and use that as the percentage of investments in bonds. He testified that in 2007, Plaintiff was 68 years old, which meant that the suitable allocation of her investment in bonds would be sixty to seventy percent. Buchler testified that the rule was in place in the Spring of 2007, when Plaintiff's asset allocation was sixty percent in bonds and forty percent in stock ("60/40"). He testified that well-known, big-name stocks were included in the portfolio, such as Apple, Johnson & Johnson, and perhaps Procter & Gamble. Buchler testified that the 60/40 asset allocation objective must be met at all times and that obtaining the average of the allocation over time does not work because it defeats the risk reduction purpose of diversification.

Buchler testified that he reviewed the Plaintiff's investment account statements, including the stocks and bonds transferred from Wells Fargo to the WellsTrade accounts managed by DSI. Based on that review, he testified that Plaintiff's asset allocation was not in the 60/40, and that the risks in her investments were too high. In support of this conclusion, Buchler testified that the Debtor invested Plaintiff's portfolio in Exchanged Traded Funds ("ETFs"), using leveraged, inverse, and short term trading mechanics.

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[10] This viewpoint is not expressed anywhere in the Buchler Report. Buchler acknowledged on cross-examination that at the time he prepared his written report, he had never met with the Plaintiff, had never spoken to her, had never communicated with her, was not aware of any communications that she had with the Debtor, and believed her to be an unsophisticated investor. He also acknowledged that at one point the Plaintiff told him that she did not want to take <u>any</u> risk in her investments. Buchler further acknowledged that no investment manager could meet a client's expectation of investing without risk.

[11] "FINRA" is the Financial Industry Regulatory Authority, a private corporation that provides oversight of securities firms in the United States.

Buchler testified that ETFs are funds that track an index of stocks, such as mutual funds, that are held for longer time frames. He explained that leveraged ETFs are larger investments purchased on a margin and therefore come at a higher risk of loss if the market declines. Buchler also explained that inverse ETFs are investments that profit when the market declines, i.e., shorting the market. He testified that either approach is highly complex and speculative. Buchler testified that the Securities and Exchange Commission ("SEC") and FINRA have issued warnings of the speculative and complex nature of leveraged and inverse ETFs. He also testified that short term trading also increases the level of risk because trading too soon, based on a faulty speculative market performance, could potentially miss an uptrend in the market. As an example, Buchler testified that in April 2008, the IRA included Proshares Trust Ultra Real Estate, for which the Debtor was increasing the margin by betting twice the risk that the underlying index would improve. He testified that such a position is inconsistent with a conservative objective, since increasing the margin only increases the risk. In addition, Buchler testified that Debtor held an investment in Proshares Trust Ultra Real Estate for only forty-three days in the IRA, which constitutes short term trading that is not in line with a conservative investor's objective.

Buchler testified that the Plaintiff's accounts were not held in a 60/40 allocation. As an example, he testified that in October 2008, the IRA investments included Proshares Trust Proshares Ultra S&P 500, Proshares Trust Powershares Ultrashort Lehman Brothers 20-Year, and Proshares Trust Powershares Ultrashort Lehman Brothers 7-10 Year, which represented sixty percent of the IRA. Buchler testified that both securities are betting against the performance of the underlying index. He testified that the Proshares Trust Powershares Ultrashort Lehman Brothers 20-Year, as well as Proshares Trust Powershares Ultrashort Lehman Brothers 7-10 Year investments, should not be considered bond allocations even though the underlying investments are bonds. For that reason, Buchler concluded that the IRA did not meet the 60/40 requirement. Buchler further testified that an investment portfolio consisting of cash equivalents such as money market funds, are, in his experience, the riskiest investments and unsuitable for a conservative investor such as the Plaintiff.

Buchler testified that the same trading practices took place in the Trust Account. He testified that he reviewed the account statements and did not find a discernable strategy or underlying tactic in Debtor's management of Plaintiff's accounts. Instead, Buchler characterized it as in and out trading, which is not suitable for a conservative investor. In performing his review, he testified that he did not see any charts, research reports, or notes that would indicate Debtor's strategy, and the lack of documentation would not comply with industry standards.

Buchler also questioned Debtor's overall trading practices and testified that most of the trades made in DSI's accounts would not have passed muster if the accounts were managed by Wells Fargo or Merrill Lynch, where both companies employ daily trade reviews to ensure investor's objective is met. Buchler testified to being familiar with and to having used a stochastic analysis himself as a technical process in the securities industry. He emphasized, however, that a stochastic analysis is not used as a sole determining factor in investment decisions.

Buchler further testified that he believed elder abuse was present in this case, but he does not know Plaintiff's age and the elements of an elder abuse claim. Likewise, he did not identify the Nevada law, FINRA regulation, or SEC rule that he relied on to reach that conclusion.

Buchler acknowledged that securities trading carries an inherent risk, which cannot be entirely eliminated. Additionally, Buchler testified that the market condition in 2008 to 2009 was very volatile, which resulted in significant financial impact on investments, and that a lot of people lost money. His ultimate conclusion, however, was that the Debtor's investment strategy was not suitable for the Plaintiff.

3. <u>Michael Hume ("Hume").</u>

Hume testified that he has been employed with an entity called Loss Recovery Center ("LRC") for 20 years, providing litigation support primarily to plaintiffs' securities attorneys. Hume also was employed by Merrill Lynch as a stock broker trainee, securities industry manager, and sales person. Hume represented that his only experience as an expert in court was when he testified in the State Action in this matter.[12]

Hume testified that he has a bachelor's degree in business administration with a finance major from California Polytechnic State University.

Hume testified that one of his primary duties at LRC is to interview prospective clients to determine if he thinks the clients have legitimate securities claims. If so, he asks the prospective clients to send him their monthly statements and then he performs an account analysis to determine whether there were any losses. Hume estimated that he reviews an average of 100 accounts per year, totaling up to 2,000 accounts while employed at LRC. He testified that approximately 1,000-1,500 accounts were formally litigated, arbitrated, or mediated, including Plaintiff's account.

Hume testified that he created a cash flow analysis[13] of Plaintiff's account by comparing the monthly net equity[14] with the monthly ending equity to obtain the monthly profit and loss, to which he determined the annual cumulative profit and loss. He testified that he created a monthly securities transaction analysis[15] by listing each bond and stock traded in Plaintiff's accounts. Hume concluded that the accounts held more stocks than a 60/40 bond to stock ratio[16], and were actively traded, which is inconsistent with a conservative portfolio. He further testified that only when there is a fundamental change in the security, should a security be traded.

Hume also created an analysis showing the holding period for each security.[17] Again,

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[12] Hume prepared a report ("Hume Report") that was admitted into evidence by stipulation as Exhibit 3.

[13] Ex. 3, Tab 1 for the IRA, and Tab 2 for the Trust Account.

[14] Net equity is obtained by subtracting cash and security withdrawals from the sum of the beginning equity and cash and security deposits.

[15] Ex. 3, Tab 3 for the IRA, and Tab 4 for the Trust Account.

[16] During his testimony, Hume occasionally referred to a 60/40 stock to bond ratio as being a conservative approach for the Plaintiff. He acknowledged that as the values of stocks and bonds fluctuate, there occasionally would be instances where a greater percentage value would be held in one type of security or the other.

[17] Ex. 3, Tab 5 for the IRA, and Tab 6 for the Trust Account.

Hume concluded that based on this analysis, Plaintiff's account was actively traded and inconsistent with a conservative portfolio. Hume testified that as an example in the IRA, Debtor held and traded a leveraged ETF, Proshares Ultra S&P 500, within a period of six days, resulting in a net loss of $520,000. He concluded that the loss would have been avoided if Debtor did not actively trade securities. Hume further testified that Plaintiff suffered a net loss of $825,000 in both the Trust Account and the IRA as a result of short-term trading of Proshares Ultra S&P 500 securities.

Hume testified that he created a summary of profit and loss on each stock and bond in Plaintiff's accounts.[18] He stated that the top four securities that incurred losses were identical in the IRA and Trust Account, which Hume concluded is a result of Debtor's incorrect prediction of market performance. Hume further testified that the combined losses from trading leveraged inverse ETFs alone were $1,524,000.

Hume testified that the overall market decline during 2007 to 2012, did not cause Plaintiff's losses. To support this, Hume created a market adjusted damages report, which would show monthly net equity if Plaintiff's monies were invested in accordance with her investment objectives. As an example, Hume used Vanguard Life Strategy Conservative Growth Fund[19] and a 60/40 asset allocation portfolio as a comparison. The Vanguard portfolio incurred losses in 2008, but bounced back in 2012. He testified that he chose this particular fund because its fees were low and therefore more closely tracks a pure 60/40 portfolio. Hume concluded that if Debtor had in fact invested Plaintiff's monies in accordance with her investment objectives, she would have profited by a total of $261,652, rather than losing $750,007, in both accounts. Hume therefore concluded that even in a volatile market the Plaintiff would have made money if Debtor had maintained a 60/40 portfolio.[20]

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[18] Ex. 3, Tab 7 for the IRA, and Tab 8 for the Trust Account.

[19] Ex. 3, Tab 9.

[20] Hume testified that in connection with the default prove up proceeding in the State Action, he submitted a declaration attesting that there were several 60/40 allocations that were "all over the place." He also acknowledged that many 60/40 allocations have suffered losses

Hume further testified that securities in the IRA and Trust Account were similarly traded, on short-term basis, mainly with leveraged and inverse ETFs. However, Hume represented that the Trust Account did not incur as many losses as the IRA due to the $1,362,594.00 worth of securities that the Plaintiff deposited in the Trust Account from a source that Debtor had nothing to do with. One of those securities was Apple stock that was held until August 2011 that was sold for $452,000.[21] Because the Debtor had nothing to do with the purchase of Apple stock, Hume testified that any profit from the sale of the Apple stocks was independent of Debtor's management of Plaintiff's accounts.

Hume opined that the Debtor did not have an investment strategy. He testified that the Debtor did not follow a 60/40 asset allocation, but handled Plaintiff's investments as a speculative trading account by buying and selling securities on a short-term basis.

Hume testified that he disagreed that leveraged inverse ETFs should be allocated as bonds. He testified that securities betting against bonds should not be treated as an allocation to meet the 60% bond requirement, which contradicts Debtor's expert report. Hume also testified that the average asset allocation reflected in that expert report is incorrect. When asked whether he agreed with the view of Blackrock, an institutional asset management firm that sponsors ETFs and mutual funds, that investment allocations should be determined by their underlying assets, Hume testified that he disagreed with Blackrock's view.

Hume also testified that the investments made by the Debtor were not suitable for Plaintiff. As an example, the 1,940 shares of Color Kinetic Inc. that the Debtor purchased were a bad investment. Hume testified that the investment was bad because he has never heard of the company. He also testified that even if the investment was profitable, it was still not suitable for

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over the last eighty or ninety years. Hume acknowledged that a Vanguard savings and investment sheet showed a worst-year loss of 18.4% in 1931 for a 60/40 portfolio and a best-year gain of 27.9% in 1933, see Ex. 6, both during the Great Depression.

[21] On cross-examination, Hume acknowledged that the Debtor had purchased shares of stock in Apple in April 2007 and August 2007, see Ex. 3, Tab 3, but testified that those shares were different than the Apple stock that the Plaintiff had deposited from another source.

Plaintiff's objective since profit and loss have no effect on suitability determination.[22]

Hume represented that to determine suitability, a client's experience, financial resources, tax bracket, investment objectives, and risk tolerance are considered. He testified that in making the suitability determination, he considered Plaintiff's investment experience and concluded that Plaintiff was not a sophisticated investor. Hume acknowledged, however, that he previously testified in his deposition that he was not familiar with Plaintiff's other investments, other than her IRA and Trust Account. Similarly, while he testified that he considered Plaintiff's financial resources in determining suitability, he acknowledged on cross-examination that he previously testified in his deposition that he did not know Plaintiff's net worth and that he made the suitability determination based on the total value of her IRA and Trust Account.[23]

Hume testified that he disagrees with virtually all of the investments made by the Debtor and every investment decision made by the Debtor were bad.[24] To support this conclusion, Hume testified that he did not see any evidence of technical or fundamental analysis made by the Debtor and concluded that the reckless and crazy manner of trading showed that the Debtor in fact, did not make an analysis prior to making investment decisions. He also testified that at the time he made the report, he did not know the meaning of "stochastic."

Hume also testified that the fees charged by the Debtor from April 2007 through December 2008, varied based on the total value of the accounts he managed, but the charges were switched to a flat fee basis beginning January 2009. He testified that because the Plaintiff began withdrawing large cash amounts in February 2009, the fees the Debtor charged did not go down sufficiently to reflect the reduced value of the accounts he was managing. Hume testified that the Debtor essentially was charging a flat fee each month rather than a percentage as

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[22] Hume's specific testimony was that "just because you make money on something that was bad, doesn't make it right."

[23] When confronted with his prior deposition testimony that he did not consider the Plaintiff's net worth in reaching his suitability conclusion, Hume glibly testified that because the Plaintiff had $5.7 million in the accounts, he "knew she was rich."

[24] It is not clear whether this categorical rejection of every investment decision by the Debtor included the purchases of Apple stock in April and August of 2007. See note 21, supra.

illustrated by a chart that he prepared. See Ex. 8. Based on his chart, Hume testified that it was "not true" that Debtor's fees went down when the Plaintiff's investment portfolio lost value due to the Plaintiff's cash withdrawals. Hume also testified that the Debtor was not telling the truth if he had informed the Plaintiff, as Plaintiff had stated, that the Debtor's fees were based on the value of the investments. On cross-examination, however, Hume admitted that the calculations in his chart reflected average monthly fees determined from annual fee summaries that would never reflect fluctuations based on actual account values each month. Hume retracted his testimony on the realization that the chart he prepared could not possibly support his testimony where he essentially accused the Debtor of lying to the Plaintiff.

Hume also testified that Plaintiff's withdrawals, totaling $3.6 million, had no effect on the profitability of her investments, nor on the trading strategy Debtor had put into effect. He testified that because the Debtor treated the Plaintiff's portfolio as a trading account, he could not determine the asset allocation. Hume testified that he tried but could not figure out an average asset allocation based on reviewing the monthly statements.

Hume also testified that he did not perform a dollar-weighted analysis of the Plaintiff's account performances because he thought that the withdrawal of $3.6 million had no effect. He testified that Plaintiff's accounts had enough cash holdings to allow her to withdraw as much money as she needed. Hume disagreed with Debtor's assertion that he needed to use short term trading to ensure there were assets that he could easily liquidate to meet Plaintiff's cash needs.

Hume testified that Debtor maintained a speculative trading account, with particularly risky investments such as leveraged ETFs, as demonstrated by the losses sustained by the Plaintiff. He testified that the selection of securities, such as complex, leveraged ETFs and inverse leveraged ETFs, was unsuited to most retail investors. He testified that the Plaintiff is not a sophisticated investor based on her testimony and that she placed her trust in the Debtor due to the tragedies going on in her life. Hume acknowledged that any monthly statements that the Plaintiff would have received would have reflected increases and decreases in the value of her accounts.

Hume testified that he disagreed with the conclusion reached by the Debtor's expert, Mr.

Parker, that the investment strategy was appropriate because Hume does not believe that there was an investment strategy. He testified that the investments were not consistent with the Plaintiff's wishes. Hume testified that the investment portfolio transferred from Wells Fargo to DSI included the type of blue chip stocks and bonds consistent with a diversified and conservative portfolio.

4. Gordon Brooks ("Debtor").

Debtor is a certified financial analyst, licensed by FINRA in Series 7,[25] 63,[26] and 65.[27] Debtor also received a chartered financial analyst[28] ("CFA") designation in 1982. Debtor testified that he has a bachelor's degree in mathematics, and a master's in business administration from Syracuse University, along with a finance major and tax and accounting minor from Pace University.

Debtor testified that he met Plaintiff in late 1984 or early 1985 when he worked as Vice President and Senior Portfolio Manager at Securities Pacific Central Group, where he managed 225 portfolios, consisting of accounts worth approximately $2.7 billion. He testified that Plaintiff's investments goal and asset allocation objective was to maintain a 60/40 portfolio.

Debtor then transferred to Chase Manhattan, where he managed approximately 200 portfolios, consisting of accounts worth approximately $500 million. He further testified that sixteen of his clients from Securities Pacific Central Group, including Plaintiff, transferred their accounts to Chase Manhattan. Debtor worked at Chase Manhattan from 1989 to 1995. Debtor then transferred to a firm named Bailey Beal & Kaiser, where he managed approximately 150 portfolios, consisting of accounts worth approximately $200 million. Again, the same clients

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[25] Series 7 deals with securities law following state securities act and investments.

[26] Series 63 deals with ethics and state law.

[27] Series 65 deals with securities sales.

[28] Debtor testified that to receive a CFA designation, the financial analyst is required to complete a three-year program and to pass an examination. Ethics and continuing education requirements also must be met. He testified that because of the rigorous requirements, CFA designations are perceived highly in the securities industry.

transferred their accounts to Bailey Beal & Kaiser. He worked there from 1995 to 2000. Debtor then transferred to Wells Fargo, where he managed approximately 200 portfolios, consisting of accounts worth approximately $400 million. The same clients transferred their accounts to Wells Fargo. He worked there from 2000 to 2006.

Debtor testified that after he left Wells Fargo in 2006, he started his own firm named Diversified Stochastic Investments ("DSI"). He testified that he left Wells Fargo because he disagreed with the investment strategy[29] that Wells Fargo encouraged its clients to take. When he left Wells Fargo, he was instructed to inform each one of his clients that he was leaving Wells Fargo and who would be replacing him, but he was barred from disclosing the reason for his departure. Debtor further testified that he did not solicit his clients at Wells Fargo to transfer their accounts to his new firm, and that clients needed to call him after he left Wells Fargo if they intended to follow him. Debtor testified that Plaintiff did just that. Debtor further stated that a total of 25 clients followed him to DSI, including Plaintiff.

Debtor testified that after he departed Wells Fargo, Plaintiff asked him to review various documents to assess how her accounts were being handled by Wells Fargo. Plaintiff eventually transferred her account to DSI[30], after which he asked for a face to face meeting in early 2007. He testified that the meeting lasted approximately two hours. Debtor testified that they went

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[29] Debtor opined that Wells Fargo acted more like a brokerage firm than an investment advisory firm, because it required 20% of every client's portfolio to be in hedge funds and 20% in private equity funds. He testified that he thought hedge funds and private equity to be inappropriate investments. Debtor testified that hedge funds lost 90% of their value and that private equity funds also were not profitable. He stated that Wells Fargo was forced to reimburse monies to their clients, but ultimately incurred losses.

[30] DSI opened a new WellsTrade account for the IRA in February 2007, see Ex. 16, and a new WellsTrade account for the Trust Account in March 2007. See Ex. 18. WellsTrade apparently is an investment brokerage service that allows for individuals and entities to trade securities and other investment vehicles. Investments made through a WellsTrade account can be managed by individuals and parties not affiliated with Wells Fargo or its related entities. Thus, even though the management of Plaintiff's investment portfolio went from Wells Fargo to DSI, the new accounts were with WellsTrade.

over the fees[31] he would charge, and the Plaintiff assented and understood. Also during this meeting, Debtor explained, or made an attempt to explain to Plaintiff about leveraged ETFs,[32] but Plaintiff stated that she did not understand the science behind investments, and that was the reason she hired the Debtor. Debtor further represented that Plaintiff instructed him to keep doing what he has been doing.

Debtor testified that he discussed managing Plaintiff's living trust and IRA accounts and that they agreed that he could charge her a percentage fee for his services. Debtor asserted that this fee arrangement meant that he had financial motivation to increase her funds, which would ultimately increase the fees he could collect.

Debtor testified that in 2007, he had multiple discussions with the Plaintiff about transferring the management of the CRUT over to him because the current trustee no longer wanted to manage the account. Debtor testified that in order to transfer the CRUT, Plaintiff had to sign a power of appointment naming Debtor as manager and Plaintiff as trustee of CRUT. That power of appointment, however, was never signed by the Plaintiff because she required a full audit of the CRUT account before releasing the current trustee. Despite the failed transfer of the CRUT, Debtor testified that Plaintiff authorized him to charge her $3,000 a month, which was the fee he would have charged her to manage the CRUT account, as compensation for assisting the Plaintiff in other unrelated matters.[33] Debtor further testified that he had another conversation with the Plaintiff in 2008, regarding the CRUT fees, where Plaintiff reiterated that she was comfortable paying Debtor a $3,000 fee even if he was not managing the CRUT

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[31] Debtor testified that the fees charged would be 1% of market value of the assets being managed.

[32] Debtor testified that stochastics illustrate the momentum of the market, and explained that when it is positive, there is potential to earn twice the amount invested. He testified that when the market is negative, however, the Plaintiff would incur losses and the strategy is to sell the security to prevent further losses.

[33] Debtor assisted Plaintiff with her sister, with buying equipment for Plaintiff's significant other, with finding an attorney for Plaintiff's friend, and with assisting Plaintiff to be reimbursed for assets that were escheated in Florida that Debtor got back.

account, and that it was for compensation for other work[34] he did for the Plaintiff.

Debtor testified that "stochastics" entails the use of a five-year period market performance as an indicator of the market direction, which he used in conjunction with other economic variables. Debtor testified that along with stochastics, he looked into the underlying earnings expectation for markets, the direction of interest rates for bonds markets, internal economic forecasts, and business journals, including the WSJ, Investment Business Daily, and the O'Neil charts. Debtor testified he has been using stochastics in all of his investment decisions since 1982.

Debtor testified that in determining the suitability of the investments, he considered the risks involved in the security and the Plaintiff's other investments, financial resources and situation, tax bracket, objectives, time horizon, liquidity needs, and risk tolerance. As an example, Debtor considered Plaintiff's investment in a limited partnership high technology fund, which was considered to be a very risky investment because of its volatility due to the unavoidable changes in the underlying technology.

Debtor testified that in March 2007, when he started managing Plaintiff's portfolio under DSI, the IRA account had a starting balance of $2.3 million, and the Trust account had $3.2 million. He also testified that when the portfolio was initially transferred from Wells Fargo, both accounts were not in a 60/40 asset allocation and were, in fact, fifty percent in stocks. He further represented that he periodically communicated with the Plaintiff about her accounts, and testified that Plaintiff received confirmation statements for every transaction made in her accounts and a monthly summary statement.

Debtor testified that at the end of 2007, the market was at or near its peak, but by the end of 2008, the market was in disarray due to the "Great Recession." He testified that at the end of 2008, stochastics indicated that the market would continue to drop, and that it was in her best interest to sell some of her securities, including ETFs. Debtor stated that he explained this to

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[34] As an example, Debtor testified that he assisted Plaintiff with estate planning, obtaining attorneys, helping with her family members, and assisted her in real estate transactions, i.e., to purchase the three mobile lots in Las Vegas.

Plaintiff, to which she responded that the Debtor should keep doing what he was doing. Debtor testified that at the end of 2008, the Federal Treasury bought $600 billion of asset-backed securities at face value, in an attempt to stabilize the markets. He testified that around March 2009, an additional $1.5 billion securities were bought back by the Federal Treasury, which in effect, raised bond prices dramatically and dropped yields precipitously. Debtor testified that no one could have predicted the drastic move by the Federal government. Debtor testified that these buy outs attributed to the losses that the Plaintiff suffered.

Debtor testified that he attempted to maintain a 60/40 portfolio. As an example, he testified that sixty percent of Plaintiff's account consisted of bonds, including Ultra Short 7-10 years and Ultra Plus 20 years. Debtor acknowledged that in December 2008, Plaintiff's portfolio did not maintain a 60/40 asset allocation, but stated that it was not due to his investment decisions. Instead, he asserted that the skewed allocation was the result of the Debtor transferring $1.3 million worth of stocks into her accounts.

Debtor testified that in early 2009, Plaintiff informed him that she would be renovating her Woodside property and would need to withdraw large amounts of cash from time to time to fund the renovation. When asked for an estimated total and time horizon, Plaintiff said she had none, and requested Debtor to maintain $300,000 available at all times and to transfer funds into her checking account when told. Debtor represented that withdrawals began approximately in February or March 2009, and that by June 2009, Plaintiff had withdrawn $1.7 million.

Debtor testified that because of Plaintiff's recurrent withdrawals in high amounts, he changed his management tactics. He began selling off securities to satisfy Plaintiff's withdrawal requirements, because there was not enough cash in the account. Debtor sold high technology securities that would build capital tax losses while the Plaintiff was living. He testified that securities with promising earnings outlooks and earnings expectations were retained, which he determined by using information from an institutional broker estimate service.

Debtor testified that Plaintiff informed him that she planned to make a loan to an individual, and he advised her that it would be better to obtain a loan from her IRA to avoid being taxed personally. Debtor stated that Plaintiff followed his advice and requested from

Wells Fargo, her account manager during that time, to accept payments for the loan and have the monies deposited automatically to her IRA. Tax issues ensued at the end of 2009, when there were only seven payments left to be collected in 2010. Debtor testified that Wells Fargo Private Client Services ("WFPCS") stated that it needed to close the account, and instructed Debtor to draft a letter to transfer the remaining payments to Plaintiff's living trust and to have Plaintiff pay the remaining balance of $22,000 on the note to WFPCS. Debtor further represented that after the account was dormant for one year, WFPCS decided that the previous instruction it provided to Debtor was, in fact, an improper transaction in an IRA and that it had no choice but to distribute the balance in the IRA to her personally. As a result, Plaintiff incurred a tax liability of $70,000.

5. <u>Donald Parker ("Parker").</u>

Parker testified that he has been working in the investment industry for thirty years. He also testified, like the Debtor, that he has earned a CFA designation. His work experience includes being a director of research, global equities strategist and portfolio manager for an investment counseling company in Florida. Prior to that, he worked for Griffin Capital Management Company, where he managed global portfolios. Parker testified that he also is a certified valuation analyst with a Series 7 license. Parker testified that he has a bachelor's degree in business management with a minor in computer science.[35]

Parker testified that he was retained by Debtor to examine the investment strategy employed by the Debtor in managing Plaintiff's accounts. Parker confirmed that his written report concluded that the investment strategy used by the Debtor was prudent, reasonable, and suitable for the Plaintiff's objectives. Additionally, he concluded that Debtor did not deviate that much from a 60/40 asset allocation requirement, and that the class and individual securities were suitable and appropriate within the context of the Debtor's investment strategy. Parker testified that one of the reasons asset allocation is important is that no one can accurately predict the future performance of each asset class.

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[35] Parker prepared a rebuttal expert's report ("Parker Report") that was admitted into evidence by stipulation as Exhibit 5.

In creating his report, Parker testified that he looked at individual securities, reviewed account statements, and applied performance measurement techniques.

Parker testified that he disagreed with the categorization of assets found in various brokers' statements. He explained that a brokerage company improperly treats a security as a stock if it trades like a stock, regardless of the underlying asset. Parker stated that he reclassified the one mutual fund that traded like the S&P 500 as stock. Two mutual funds that traded like municipal bonds were reclassified as bonds, and ETFs were classified as bonds since the underlying assets were treasury bonds. When properly classified based on the underlying asset, Parker testified that the Debtor, in fact, maintained a stock allocation of 45.1% on average, which was a 5.1% variance from a 60/40 objective. Parker attested that such a variance is acceptable given the amount of withdrawals Plaintiff took, and other factors, such as the market performance and any other deposits made by the Plaintiff. Parker asserted that in a trailing twelve months, on average, Debtor maintained a stock allocation of 43.2%.

Parker attested that the Debtor only invested in stocks and bonds, and limited himself to instruments that are traded in major exchanges, and are liquid. Parker opined that he believed the Debtor maintained a well-diversified portfolio, which allowed Debtor to include non-blue chip stocks from time to time, and that inclusion of risky securities does not necessarily mean the portfolio itself was risky, so long as it was diversified. Parker testified that a stochastic investment strategy is a technical application of statistical measures to determine when to buy or sell securities. Parker represented that Debtor has applied this strategy for a long period of time, and that the strategy has been used in the industry, including by Parker himself. Parker further represented that a stochastic analysis must be applied in concert with fundamental, economic, and market research, which he believes the Debtor did.[36]

Parker testified that in determining suitability, factors such as the client's age, financial status, liquidity concerns, and the client's objectives must be considered. Parker also considered

[36] On cross-examination, Parker was confronted with his deposition testimony regarding the Debtor's use of stochastics, but the deposition testimony was not inconsistent with Parker's testimony at trial.

Plaintiff's other assets as well as factors not included in the portfolio, such as net worth, investment objectives, liquidity needs, tax status, investor's experience and types of investments, risk tolerance, and time frame of investments.

Parker further testified that the securities in Plaintiff's portfolio were suitable to her, including leveraged ETFs,[37] because the Debtor took into account Plaintiff's other investments, i.e., the JFS Note, high technology funds,[38] and real estate holdings. He also testified that the leveraged ETFs, in fact, broadened Plaintiff's portfolio, which was beneficial to her accounts overall.[39] Parker concluded that the Debtor's investment strategy had a reasonable basis, including a stochastic analysis and market analysis.[40]

Parker further testified that when activity in Plaintiff's portfolio is graphed, see Appendix "D" to Parker Report, it would show a great correlation between the volatility in the accounts and the Plaintiff's withdrawals. Parker testified that on September 2008, the stock market plummeted, which coincided with the largest loss in Plaintiff 's accounts. He further testified that there were three periods of market recoveries during the periods of: (1) March 2009 through March 2010; (2) mid-2010 through August 2011; and (3) post-2012. The graph showed that the timing of Plaintiff's withdrawals affected her investment performance.

Parker testified, for example, Plaintiff withdrew $2.6 million during the period of March 2009 through end of 2009, which was when the market was at the bottom. He testified that soon after her withdrawals, the market hit its first recovery, but because there were fewer funds in her

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[37] Parker testified that, as illustrated in Appendix C to the Parker Report, only 7.2% of the stocks and 6.2% of the bonds in the Plaintiff's portfolio from March 2007 through September 2012, were in leveraged instruments.

[38] Parker testified that in order to qualify to invest in high technology fund investments, you need to be an accredited investor, which implied some level of sophistication and acceptance of inherently higher risk by the Plaintiff.

[39] On cross-examination, Parker was asked whether his view of the suitability of leveraged ETFs would change based on criticisms of leveraged ETFs by other sources, and Parker responded that his opinion would not change based on the context of the Plaintiff's case.

[40] Parker's testimony, like Hume's, was occasionally combative.

account, there was no opportunity for her accounts to recover. Then Plaintiff withdrew $1.4 million during the period of March 2010 through the end of 2010. Parker testified that, again, soon after her withdrawals, the market hit its second recovery, but because there were less funds in her account, there was no opportunity for her accounts to recover. Parker concluded, based on this analysis, that Plaintiff's withdrawals were a major contributor to her losses, and that it was the Plaintiff's actions that turned unrealized gains into realized losses.

In short, Parker concluded that Debtor's management of Plaintiff's investments was suitable and within the reasonable variance range from 60/40 asset allocation. Moreover, Parker concluded that a prudent and suitable approach was used in picking individual securities, and that multiple factors contributed to Plaintiff's losses, including the timing of her withdrawals during historically high volatility in the market.

BURDEN OF PROOF

Prebankruptcy debts are discharged under Section 727(b), unless an exception exists under Section 523(a). In determining whether an exception applies, the court must construe the evidence against the objecting creditor and in favor of the debtor. <u>See</u> <u>Mele v. Mele (In re Mele)</u>, 501 B.R. 357, 363 (B.A.P. 9th Cir. 2013). The objecting creditor bears the burden of proving each element of a nondischargeable claim by a preponderance of the evidence. <u>See</u> <u>Grogan v. Garner</u>, 498 U.S. 279, 286-291 (1991).

DISCUSSION

Plaintiff seeks a determination that her claim is nondischargeable under Sections 523(a)(2), 523(a)(4), and 523(a)(6). The court will address each one of these provisions.

1. <u>Plaintiff's Claim under Section 523(a)(2)(A).</u>

Under Section 523(a)(2)(A), an individual may not discharge debts resulting from "false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition." The objecting creditor must establish five elements: (1) the debtor's misrepresentation, fraudulent omission or deceptive conduct, (2) debtor's knowledge of the falsity or deceptiveness of the representation, (3) debtor's intent to deceive, (4) justifiable reliance by the creditor on the debtor's representations or conduct, and (5) damage to the creditor proximately caused by reliance on the representation or conduct. See Ghomeshi v. Sabban (In re Sabban), 600 F.3d 1219, 1222 (9th Cir. 2010). A debtor's silence or omission of a material fact can constitute a false representation if there is a duty to disclose. See Apte v. Romesh Japra, M.D., F.A.C.C., Inc. (In re Apte), 96 F.3d 1319, 1323 (9th Cir. 1996); Citibank (S.D.), N.A. v. Eashai (In re Eashai), 87 F.3d 1082, 1089 (9th Cir. 1996).

"Intent to defraud is a question of fact" and "intent to deceive can be inferred from the surrounding circumstances." In re Kennedy, 108 F.3d 1015, 1018 (9th Cir. 1997). Knowing falsity requires that a party either knew at the time he made the representation that it was false or that he recklessly disregarded its truth. See Rubin v. West (In re West), 875 F.2d 755, 759 (9th Cir. 1989). Fraudulent intent may be established by circumstantial evidence, or by inferences drawn from a course of conduct. See McCrary v. Barrack, 217 B.R. 598, 607 (B.A.P. 9th Cir. 1998).

A plaintiff asserting that he or she was misled must have justifiably relied upon the debtor's misrepresentation. See Field v. Mans, 516 U.S. 59, 74-75 (1995).[41] "Justification is a matter of the qualities and characteristics of the particular plaintiff, and the circumstances of the particular case, rather than of the application of a community standard of conduct to all cases." Id. at 71. The justifiable reliance standard generally does not entail a duty to investigate, and a person may be justified in relying on a representation of fact even if he or she might have ascertained the falsity of the representation upon investigation. Id. at 70. "Justifiability is not without some limits, however." Id. at 71. A duty to investigate is imposed on a creditor by virtue of suspicious circumstances. See id. Thus, justifiable reliance does not exist where a creditor ignores red flags. See Anastas v. Am. Sav. Bank, 94 F.3d 1280, 1286 (9th Cir. 1996). "[A] person cannot purport to rely on preposterous representations or close his eyes to avoid discovery of the truth." Eashai, 87 F.3d at 1090–91.

(a) Misrepresentations.

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[41] Before the validity of a plaintiff's reliance is determined, the plaintiff must demonstrate, of course, that she or he actually relied on the debtor's misrepresentations or omissions. Without proof of actual reliance, any alleged reason for the plaintiff's reliance is immaterial.

According to Plaintiff's testimony, she spoke to the Debtor twice a month between 2007 and 2011. Debtor testified that shortly after Plaintiff's investment portfolio was moved from Wells Fargo to DSI in early 2007, he had a two-hour meeting with the Plaintiff to explain, inter alia, the investment in leveraged ETFs. He testified that the Plaintiff declined his offer to explain the use of leveraged ETFs and authorized him to continue his investment strategy. Plaintiff does not deny that the two-hour meeting occurred in early 2007, but testified that the Debtor represented that he would invest her funds in the same manner as he did at Wells Fargo.

Debtor testified that he sent confirmation statements to the Plaintiff for every transaction he made in her IRA and Trust Account, as well as monthly summary statements. Plaintiff did not testify to the contrary and also acknowledged that she received the account statements. Plaintiff testified that Debtor gave her assurances that her investments were doing fine, but Plaintiff did not specify what those assurances were or when those assurances were given.

Plaintiff also testified that the Debtor did not disclose certain information, such as the reduced investment in blue chip or S&P 500 stocks and bonds, the profitability of her investments, the Debtor's use of stochastics, and the investment in leveraged ETFs. As previously noted, Debtor testified that he attempted to explain the use of leveraged ETFs at the two-hour meeting, but that the Plaintiff turned down his offer to explain.

This diametrically opposing testimony regarding the affirmative representations allegedly made by the Debtor, as well as the information allegedly omitted by the Debtor, is not surprising. Apparently, no one else was present during these exchanges between the Plaintiff and the Debtor, and no witnesses were available to corroborate either party's version of the events. Likewise, there is no correspondence, emails, or other documentary evidence to support what "she said" nor what "he said." Assuming the representations were made or the omissions actually occurred, it is critical for the Plaintiff to establish when the representations or omissions occurred.

(i) Affirmative Representations.

As to the representation in early 2007 that the Debtor would continue to invest the portfolio funds in the same manner, the Plaintiff did not testify as to specifically when, if ever, the Debtor thereafter repeated or continued to make that affirmative representation. The confirmation transaction statements, as well as the monthly summary statements, would have disclosed whether the Debtor was pursuing an investment strategy different from what was used at Wells Fargo. Plaintiff acknowledged that she received all of the statements. In this case, however, Plaintiff's documentary evidence begins with the account statements generated when the Trust Account and IRA were newly opened under the management of DSI, see Ex.1, Page 1 (May 2007) and Ex. 2, Page 1 (March 2007), which Plaintiff's experts described as a conservative, 60/40 investment allocation. Similarly, the Hume Report examines the losses that occurred from March 2007 to September 2012, see Ex. 3 and Tabs 1-10, and the Buchler Report critiques the Debtor's management of the portfolio for the same period, see Ex. 4 and Tabs 1-13, but neither of the Plaintiff's experts addressed when the Debtor allegedly assured the Plaintiff that her investments were "doing fine."[42] In other words, Plaintiff has not established that the Debtor changed the management of the Trust Account and IRA after he provided the allegedly misleading, affirmative representations to her.[43]

This is a distinction with an actual difference. If the assurances were given at the initial two-hour meeting early in 2007, there is nothing in the record to establish that the investments were underperforming because even the Plaintiff's experts testified that Wells Fargo transferred a properly invested, conservative portfolio to DSI.

If the Debtor gave assurances that the investments were "doing fine" at a later date, the actual condition of the Plaintiff's investment accounts at the time of the specific assurance would

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[42] According to the Plaintiff, the Debtor's description of her investment portfolio as "doing fine" was a false or misleading statement. Obviously, the words "doing fine" have no specific meaning and can be widely construed or misconstrued. At trial, neither the Plaintiff nor the Debtor was asked to explain what those words meant.

[43] Likewise, the Parker Report examines the Debtor's management of the Plaintiff's investment portfolio over the same period of time, but does not address when any alleged assurances were provided by the Debtor. Additionally, Exhibits 6 through 24, all admitted into evidence, do not address the timing of any alleged assurances that the Debtor may have provided to the Plaintiff. While the testimony of both the Plaintiff's experts and the Debtor's expert might be germane to the issue of damages, it is not material to establishing any alleged misrepresentations.

have been important. For example, the Trust Account statements for 2007 indicated that the portfolio value increased from an initial value of $3,277,761.34 as of May 1, 2007, to a value of $3,311,433.54 as of December 31, 2007. See Ex. 1, Pages 1 and 60. For 2008, the statements indicated that the portfolio value of the Trust Account increased to $3,526,949.24 as of December 31, 2008 (apparently due to a transfer of money market funds). See Ex. 1, Pages 66 and 130. For 2009, the statements indicated that the portfolio value of the Trust Account decreased to $1,620,632.02 as of December 31, 2009. See Ex. 1, Pages 143 and 249. There is no evidence at all whether the alleged affirmative assurances were given during any of these periods, nor at any time in 2010, 2011, or 2012.

With respect to the IRA, the same evidentiary gap exists. The IRA statements for 2007 indicated that the portfolio value went from a value of $2,332,949.02 as of March 1, 2007, to a value of $2,494,574.01 as of December 31, 2007. See Ex. 2, Pages 1 and 74. For 2008, the statements indicated that the portfolio value of the IRA decreased to $1,407,754.75 as of December 31, 2008 (with significant swings in value between January and October). See Ex. 2, Pages 81, 91, 96, 105, 112, 120, 127, 136, 142, and 149. For 2009, however, the statements indicated that the portfolio value of the IRA increased to $1,551,030.39 as of December 31, 2009. See Ex. 2, Pages 163 and 214.

Based on the evidence presented, Plaintiff has failed to demonstrate that the affirmative representations allegedly made by the Debtor were actually false or deceptive at the time they were made.

(ii) Omissions.

As to the information allegedly omitted by the Debtor, the documentary record also does not support Plaintiff's claim.

The uncontradicted evidence is that the Debtor sent confirmation statements for every transaction that he made in the IRA and Trust Account, as well as monthly summary statements. All of the monthly statements for the IRA and Trust Account show a mailing address for the Plaintiff in Incline Village, Nevada. See Ex. 1, Pages 1-341; Ex. 2, Pages 1-441. The monthly statements disclose the date, amounts and descriptions of any transactions, as well as the gains, losses, and estimate income from each transaction. Any reduced investment in blue chip or S&P 500 stocks and bonds, any decline in the profitability of the Plaintiff's investments, and any investment in leveraged ETFs, would have been revealed in those statements. Not even Hume or Buchler suggested that the statements did not provide complete or accurate information about how the Debtor was managing the IRA and Trust Account on a monthly basis.

Plaintiff testified that she received the monthly statements for the IRA and Trust Account, and did not assert that there was any month in which the statements were not provided. All of the material information that the Debtor allegedly omitted could be found in the statements that were in Plaintiff's possession. If the Plaintiff did not read or review the monthly and annual statements due to her unfortunate emotional state, it simply was not because the Debtor failed to provide or attempted to conceal the information.

Based on the evidence presented, Plaintiff has failed to demonstrate that the Debtor omitted the information that the Plaintiff alleges to be material to her claim.

(b) <u>Knowledge.</u>

As the Plaintiff has not identified specifically when the Debtor assured her that her investments were doing fine, there is no basis for the court to determine whether the Debtor had knowledge that those representations were false or deceptive. While Hume testified that every investment decision made by the Debtor was bad, neither Hume nor Buchler testified that the IRA and Trust Account were in an improper condition at every point of the Debtor's management.

As to the Debtor's alleged failure to disclose information, that failure simply did not occur because the information apparently desired by the Plaintiff was included in the monthly statements she admittedly received.

Based on the evidence presented, Plaintiff has failed to demonstrate that the Debtor had knowledge of any representations or omissions that were false or deceptive.

(c) <u>Intent to Deceive.</u>

Because there is no direct evidence presented nor testimony from the Debtor that he intended to deceive the Plaintiff, the court has considered whether the surrounding circumstances infer that intention. The evidentiary deficiencies that exist with respect to the misrepresentation requirement of Plaintiff's claim, however, also plague the intent element.

As to the alleged misleading assurances that Plaintiff's investments were doing fine, the court can draw no inferences of an intent to deceive without evidence of when such assurances were given. For example, if the assurances were given by the Debtor upon the initial transfer of the portfolio from Wells Fargo, there was no change at all and the portfolio would have been "doing fine" even under the view of Plaintiff's experts. Additionally, if such assurances were given during the twice-monthly discussions that occurred subsequent to the initial meeting, such assurances may have been accurate because the monthly statements for 2007, 2008 and 2009 indicate that the value of the IRA and the Trust Account had increased. In other words, if the Debtor's only affirmative representation to the Plaintiff was that her investments were "doing fine," it may not have been inaccurate at all at the time it was made[44] and therefore was not made with the intention to deceive.[45]

As to the alleged misleading statement that the Debtor would manage the portfolio as he did when he was at Wells Fargo, a similar evidentiary deficiency exists. Plaintiff has not established specifically when the Debtor agreed or represented that there would be no change in the management of the portfolio. The uncontradicted evidence is that the Plaintiff voluntarily withdrew more than $3,600,000 from her investment portfolio during an extremely volatile time in the market. Debtor concedes that changes in the portfolio occurred sometime after management of the Trust Account and IRA was transferred to DSI. Even Plaintiff testified, however, that it was reasonable to expect that her investments would be impacted by the substantial cash withdrawals. All of the changes to the portfolios were reflected in the monthly statements that the Debtor admittedly provided and that the Plaintiff indisputedly received from

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[44] As previously discussed at 28-29, the evidentiary record suggests that Trust Account increased in value in 2007, 2008 and 2009, and the IRA increased in value in 2007 and 2009.

[45] Plaintiff also testified that the Debtor told her that Wells Fargo independently decided that it would discontinue servicing the JFS Note. Even if the Debtor's statement to the Plaintiff was false, there is no evidence that the statement was the actual or proximate cause of any losses sustained by the Plaintiff.

WellsTrade. Plaintiff has not identified any specific instance when the Debtor subsequently represented that the portfolio was being managed in the same manner as it originally was handled by Wells Fargo, when he in fact had, or was in the process of, changing the investment strategy. The court simply cannot infer an intent to deceive without first establishing when the Debtor changed the investment strategy.

As to the information that the Debtor allegedly did not disclose, the uncontradicted evidence is that the Debtor sent confirmation statements for every transaction that he made in the IRA and Trust Account, as well as monthly summary statements, and that the Plaintiff actually received the account statements. There is no evidence or testimony that the Debtor sent the statements to the Plaintiff by mistake or accident. The monthly account statements admitted at trial were all addressed to the Plaintiff at a post office box located in Incline Village. In other words, the information was sent directly by WellsTrade to the Plaintiff, rather than to the Plaintiff in care of the Debtor.[46] There is no testimony to the effect, nor inference that can be drawn, that the Debtor attempted to conceal the information from the Plaintiff.

Under these circumstances, Plaintiff has not met her burden of proof as to the Debtor's alleged intent to deceive.

(d) <u>Justifiable Reliance.</u>

Plaintiff testified that after one of her sons suddenly passed away in 2007, she was depressed and hired the Debtor, along with other persons, to conduct her business and to handle her investments. That Plaintiff came to rely on the assistance of various professionals, however, does not satisfy her burden of proving her reliance, both actual and justifiable, on an identifiable representation or omission attributable to the Debtor. On this requirement, Plaintiff's evidence suffers some of the same deficiencies as the other elements of her claim.

Arguably, Plaintiff actually relied on affirmative representations that her investment portfolio was "doing fine" and that the Debtor would continue what was done at Wells Fargo.

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[46] It might be a different situation if the statements had been addressed by WellsTrade to the Plaintiff in care of the Debtor, and the Debtor then failed to provide them to the Plaintiff. That did not happen in this case.

As previously discussed, the evidentiary record is insufficient to establish that those representations were false or misleading at the time they were made. Even if those representations were false or misleading at the time, however, Plaintiff's additional hurdle is that her reliance on those representations is difficult to justify when she admittedly received account statements each month that disclosed the date, amounts and descriptions of any transactions made by the Debtor, as well as the gains, losses, and estimate income from each transaction. She was not required to conduct an investigation, but simply had to review the information in her possession. Moreover, any reduced investments in the quality of stocks and bonds she favored, any decreases in the overall profitability of her investments in both the Trust Account and the IRA, and any investments by the Debtor in leveraged ETFs, were fully ascertainable if Plaintiff had compared the information to her portfolio at Wells Fargo. She specifically testified that she was familiar with the blue chip stocks she apparently wanted, e.g., Apple, Johnson & Johnson, and other pharmaceutical stocks, and therefore could have discerned whether her investment portfolio had changed.

For the same reason, Plaintiff cannot justifiably rely on omissions of material information when she actually had the information in her possession.

While Plaintiff arguably has satisfied one part of the reliance requirement, she has not met her burden of proving that her reliance was justifiable under the circumstances.

(e) <u>Damage Proximately Caused.</u>[47]

Plaintiff alleges that she sustained approximately $750,000 in losses to her Trust Account and IRA as a result of Debtor's management of her investment portfolio. <u>See</u> Complaint at ¶ 21. Buchler testified that the Debtor's investments were unsuitable to the Plaintiff even though he

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[47] The uncontradicted testimony is that the Debtor used stochastics as a tool in his investment advice long before he established DSI. Additionally, he testified that his investment strategies are not based solely on the concept. Plaintiff allegedly knew nothing about the concept and her expert, Hume, apparently had never heard of it. Although the Plaintiff testified that she knew nothing about stochastics, she, along with her experts, also testified that the Debtor properly invested the IRA and Trust Account while he was at Wells Fargo. Under these circumstances, no persuasive argument has been made that the Debtor's nondisclosure of the stochastics concept was material in any way, nor that the nondisclosure of his use of stochastics was the proximate cause of any damage sustained by the Plaintiff.

had no knowledge of the Plaintiff's net worth or the values of her other investments. Buchler's report concluded that the Trust Account lost in excess of $400,000 and the IRA lost $786,430. See Buchler Report at 16-17.[48] Hume also testified that the Debtor's investments were unsuitable even though he, too, had no knowledge of the Plaintiff's net worth or the values of her other investments. Hume's report concluded that the Trust Account had a net gain of $36,422.69 and the IRA had a net loss of $786,429.72, for a combined net loss of $750,007.03. See Hume Report at 3. Hume also concluded that if Plaintiff's accounts had been suitably and conservatively invested in 60% bonds and 40% stocks, her portfolio would have generated $261,652.35 in profits rather than sustaining losses of $750,007.03. Id. at 4-5.[49]

For at least two reasons, the court does not find the testimony of either of Plaintiff's experts to be particularly reliable.[50] First, the Buchler Report and Hume Report are deficient in that neither expert discloses that he had no information about and never considered the other assets owned or controlled by the Plaintiff. Both express an opinion that the Debtor's investment decisions were unsuited to the Plaintiff, yet neither of them disclosed until their testimony in court that: (1) an individual client's total net worth must be considered in determining a suitable investment strategy for the particular client, and (2) they had no knowledge of the Plaintiff's net

[48] At trial, Buchler testified that he relied entirely on the damage analysis prepared by Hume.

[49] As a basis for the suggested profit, Hume used as an example the performance of the "Vanguard Life Strategy Conservative Growth Fund" during the same period. That fund apparently was allocated 60% to bonds and 40% to stocks. See Hume Report at 4.

[50] The parties' expert witnesses were allowed to testify as a result of stipulations between counsel. Hume testified that his only experience as an expert in court was when he testified as an uncontested prove-up witness for the default taken in the State Action. Given Hume's apparent direct involvement primarily in investigating and developing the strategies for the plaintiffs' securities bar, it is not clear whether he would have qualified to testify as an expert witness if the Debtor had objected. Instead, Hume appears to be a securities analyst who benefits financially and professionally from pursuing securities claims. His active and overreaching role in the instant litigation was well illustrated when he testified regarding the actual deposition testimony of the Plaintiff and the Debtor, and then tried to corroborate that testimony by referring to an investment performance sheet, see Ex. 11, produced by the Debtor in discovery. Hume even testified as to his belief concerning the handwriting on the sheet.

worth or the values of her other investments. Second, the testimony from both witnesses in court revealed them to be advocates for the Plaintiff rather than objective witnesses offering expert opinions. This was made clear when both of them acknowledged that they did not have the Plaintiff's net worth information on which they could base an investment suitability determination. In spite of this inconsistency, Buchler's conclusion in court was consistent with his written report that was crafted as a plaintiff's brief rather than as an objective, reliable comparison of possible outcomes.[51] Likewise, Hume's testimony in court was result-driven, as well as defensive and combative, but perhaps consistent with his twenty years of experience providing litigation support primarily to plaintiffs' securities attorneys. While the court has no doubt as to the qualifications of each witness, neither of them provided sufficiently credible expert testimony tending to establish that the Debtor employed an unsuitable investment strategy that proximately caused damage to the Plaintiff. The court therefore concludes that the Plaintiff has failed to carry her burden of proof on the causation element of her claim. This conclusion is buttressed by Parker's testimony.

Parker agreed with Buchler and Hume that the suitability of investments for an individual client must take into account the client's age, financial status, liquidity concerns, client objectives, and other assets. Unlike Buchler and Hume, however, Parker testified that he did take into account the assets that were not included in the Trust Account and IRA investment portfolio.[52] Based on the Plaintiff's net worth, her twenty years of investing experience, and

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[51] In his report, Buchler appropriately discusses the importance of proper asset allocation in the performance of an investment portfolio. <u>See</u> Buchler Report at 4. After citing several authorities, he concludes as follows: "The reason asset allocation is so important is that <u>no one, including Mr. Brooks, can accurately predict the future performance</u> of each asset class or segment within each class." <u>Id.</u> (emphasis added.) As previously discussed at 9 and note 10, however, Buchler testified that a client's unwillingness to accept investment risk overrides all other suitability considerations. Under this approach, it appears to be possible that, for some investors, there may be no appropriate asset allocation consistent with a conservative strategy at all.

[52] Appendix "A" to the Parker Report lists a wide range of documentary information considered by Parker, including the Buchler Report and Hume Report, as well as discovery responses, tax returns and documents, preliminary title reports, promissory notes, and the like.

other suitability considerations, Parker concluded that the Debtor's investment strategy was suitable to the Plaintiff's portfolio. See Parker Report at 6. Moreover, due to the amount and timing of the Plaintiff's demands for cash withdrawals, during a period of unprecedented market volatility, Parker concluded that the Debtor was required to shift the Plaintiff's investments to make cash available rather than employing a long-term investment strategy. See Parker Report at 3-5. As a result, Parker concluded that the damages attributable to Debtor's management of the Trust Account and IRA are zero. Id. at 6.

Having considered the testimony of Buchler, Hume and Parker presented in open court, as well as their respective reports, the court agrees with Parker that volatility of the market militates against a conclusion that any particular investment strategy suitable to the Plaintiff would have yielded a better result. Even Buchler attested that no one can accurately predict the future performance of any particular asset class. See note 51, supra. Hume's analysis has the benefit of hindsight, but even the Vanguard funds that he championed illustrate that during years of extreme market volatility, a conservative investment strategy might not produce the results desired. See note 20, supra. To the extent that resolution of this issue comes down to a credibility determination, the court resolves that determination in favor of the Debtor, and therefore gives little weight to the testimony of the Plaintiff's experts.[53]

Under these circumstances, the court concludes that Plaintiff has not demonstrated by a preponderance of the evidence that the Debtor's management of her Trust Account and IRA was the proximate cause of the losses she sustained.[54]

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[53] Unlike Hume, it appears that Parker has significant experience as an expert witness or consultant in securities and business litigation, and testifies not only as a securities expert for the plaintiffs bar, but on behalf of all sides to various disputes. See Parker Report at Appendix "B."

[54] At closing argument, Plaintiff's counsel maintained that most of his client's cash withdrawals were from the Trust Account which made a slight profit over the relevant period, while very few withdrawals were from the IRA, which incurred substantial losses. As a result, counsel argued that the $3.6 million in cumulative withdrawals by the Plaintiff had no impact on the losses sustained. The argument, of course, simply invites additional speculation as to whether the Trust Account would have generated significantly greater returns had the Plaintiff not withdrawn any funds.

2. Plaintiff's Claim under Section 523(a)(4).[55]

Under Section 523(a)(4), a debt is nondischargeable if the creditor establishes that it was incurred through "fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny." A creditor alleging fraud or defalcation in a fiduciary capacity must establish the existence of an express or statutory trust giving rise to a fiduciary relationship. See Otto v. Niles (In re Niles), 106 F.3d 1456, 1459 (9th Cir. 1997)(A debt is nondischargeable under § 523(a)(4) only "where (1) an express trust existed, (2) the debt was caused by fraud or defalcation, and (3) the debtor acted as a fiduciary to the creditor at the time the debt was created.").[56] See also Mele, 501 B.R. at 367-68 (generalized descriptions of fiduciary duty between spouses under Washington law does not meet the express or technical trust standard required as an element of a

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[55] The Complaint alleges that the claim is nondischargeable under Section 523(a)(4) because "When Defendant repeatedly made risky and inappropriate investments with Plaintiff's assets, without her consent or knowledge, he breached his fiduciary duty to Plaintiff." Complaint at ¶ 29. There is no allegation of embezzlement or larceny. Under Section 523(a)(4), a claim for embezzlement does not require the existence of a fiduciary relationship, and involves "the fraudulent appropriation of property by a person to whom such property has been entrusted or into whose hands it has lawfully come." See Transamerica Commercial Fin. Corp v. Littleton (In re Littleton), 942 F.2d 551, 555 (9th Cir. 1991). To establish a claim for embezzlement under Section 523(a)(4), the plaintiff must establish three elements: (1) property rightfully in possession of the debtor, (2) the debtor's appropriation of the property to a use other than it was entrusted, and (3) circumstances indicating fraud. See Murray v. Woodman (In re Woodman), 451 B.R. 31, 41 (Bankr. D.Idaho 2011). Neither embezzlement nor larceny were asserted at trial, nor in the Plaintiff's written arguments.

[56] At closing argument, Plaintiff's counsel suggested that this court should follow the BAP's unpublished decision in Nassbridges v. Dimichle (In re Nassbridges), 464 B.R. 494 (July 15, 2011). See Plaintiff's Trial Statement at 6:26 to 7:2. In that opinion, the BAP affirmed a bankruptcy court judgment determining that an unlicensed investment broker was a fiduciary to his clients. The BAP found that the debtor acted in a fiduciary capacity under California law and then followed a 1991 bankruptcy court decision, see Lock v. Scheuer (In re Scheuer), 125 B.R. 584 (Bankr.C.D.Cal. 1991), which concluded that securities brokers are also fiduciaries for purposes of Section 523(a)(4) because a trust relationship was created under state law. It is evident, however, that the BAP incorrectly relied on the 1991 Scheuer bankruptcy court decision that preceded the 1997 Ninth Circuit decision in Niles. In Niles, the circuit panel concluded that the California statute imposed a specific duty on a real estate broker to remit rents directly to her clients or to hold them in a trust fund account, thereby establishing a technical trust relationship. 106 F.3d at 1459. Plaintiff has not identified any similar statutory obligations applicable in this case. That a creditor simply places her faith and trust in the debtor clearly does not create a fiduciary relationship within the meaning of Section 523(a)(4).

§ 523(a)(4) claim.).[57] See, e.g., Subich v. Verrone (In re Verrone), 277 B.R. 66, 71-72 (Bankr. W.D.Pa. 2002)(securities broker may have fiduciary duties to a client under state law, but is not a fiduciary to client for purposes of § 523(a)(4)). The express or technical trust must pre-date the asserted defalcation. See Lewis v. Scott (In re Lewis), 97 F.3d 1182, 1185 (9th Cir. 1996).

An innocent defalcation by a fiduciary is insufficient to prevent discharge of a claim. See Bullock v. BankChampaign, N.A., 133 S.Ct. 1754, 1759-60 (2013). Instead, actionable defalcation requires intentional, improper conduct, or reckless conduct that criminal law treats as the equivalent. Thus, even if the fiduciary lacks actual knowledge, intent can be shown if "the fiduciary 'consciously disregards' (or is willfully blind to) 'a substantial and unjustifiable risk' that his conduct will turn out to violate a fiduciary duty." Id.

In this instance, Plaintiff has failed to establish the existence of a fiduciary relationship within the meaning of Section 523(a)(4). Although the Debtor managed the Plaintiff's investment portfolio over a substantial period of time, none of the documentary evidence nor any of the testimony supports the existence of an express trust. The Trust Account statements, see Ex. 1, and the IRA statements, see Ex. 2, contain no language inferring the existence of, much less creating, an express trust between the Debtor and the Plaintiff. Similarly, the account paperwork and signed trading authorization forms for both the Trust Account and IRA, see Exs. 16, 17 and 18, make no reference to an express or even technical trust. Plaintiff's responses to the Debtor's interrogatories, see Exs. 7 and 8, also make no reference to documents supporting

[57] In Stalk v. Mushkin, 125 Nev. 21, 199 P.3d 838 (Nev. 2009), the Nevada Supreme Court concluded that a legal malpractice claim encompasses breach of contract and fiduciary duty elements because of the fundamental aspects of the attorney-client relationship. 199 P.3d at 843. Plaintiff cites Stalk in arguing that the Debtor has a fiduciary duty to the Plaintiff within the meaning of Section 523(a)(4). See Plaintiff's Trial Statement at 7:13-17. The mere existence of an attorney-client relationship, however, does not make the attorney a fiduciary under the discharge exception, see Braud v. Stokes, 142 B.R. 908, 910 (Bankr. N.D.Cal. 1992), unless, for example, the attorney places the client's property into a trust account. See Banks v. Gill Distribution Centers, Inc., 263 F.3d 862, 871 (9th Cir. 2001). Compare Kaufman v. Tallant (In re Tallant), 207 B.R. 923, 930 (Bankr.E.D.Cal. 1997), aff'd in part and rev'd in part, 218 B.R. 58 (B.A.P. 9th Cir. 1998)(attorney has fiduciary responsibilities to a client, but is not a fiduciary within the meaning of 523(a)(4)). Plaintiff's reliance on the Nevada Supreme Court's decision in Stalk therefore is misplaced.

the existence of a trust agreement between the Debtor and the Plaintiff. It is hardly surprising then, that Plaintiff did not testify at the trial as to the existence of an express trust between herself and the Debtor.

Likewise, the existence of an express or technical trust under any applicable statute has not been established. Not even Plaintiff's expert witnesses, Buchler and Hume, testified that an express or technical trust exists between an investment adviser and his client.[58] Thus, even if the Plaintiff could demonstrate intentional, improper or reckless conduct by the Debtor creating a substantial and unjustifiable risk, there still would not be the requisite fiduciary relationship within the meaning of Section 523(a)(4).[59]

Plaintiff having failed to meet her burden of proving the threshold requirement of a fiduciary relationship, her claim under Section 523(a)(4) must be denied.

3. <u>Plaintiff's Claim under Section 523(a)(6).</u>

Under Section 523(a)(6), a debt is nondischargeable if the creditor establishes that it was the result of "willful and malicious injury by the debtor to another entity or to the property of another entity." In determining whether an act is willful, a two-prong, subjective test is used. <u>See</u> <u>Carillo v. Su (In re Su)</u>, 290 F.3d 1140, 1143-44 (9th Cir. 2002). The first prong requires the creditor to establish that: "(1) the act that resulted in the creditor's injury was intentional and (2) the debtor actually intended the injury to occur, or at least, was substantially certain that it would occur." <u>In re Su</u>, 290 F.3d at 1143. <u>See also</u> <u>Jett v. Sicroff (In re Sicroff)</u>, 401 F.3d 1101, 1106 (9th Cir. 2005). The injury must be deliberate or intentional, "not merely a deliberate or intentional act that leads to the injury." <u>Kawaauhau v. Geiger</u>, 523 U.S. 57, 61 (1998). The second prong requires the creditor to establish a malicious injury. To establish a malicious injury, the creditor must prove: (1) a wrongful act, (2) done intentionally, (3) which necessarily causes injury, and (4) is done without just cause or excuse. <u>See</u> <u>Barboza v. New Form, Inc. (In</u>

[58] This is somewhat surprising given that Buchler characterized the Debtor's conduct as elder abuse without even knowing the statutory basis to support the accusation.

[59] If the Plaintiff did establish the elements under Section 523(a)(4), she would still have to demonstrate that any fraud or defalcation was the actual cause of damage.

re Barboza), 545 F.3d 702, 706 (9th Cir. 2008).

Plaintiff alleged in her pleading that the Debtor made intentional misrepresentations, see Complaint at ¶ 66, and that he had a subjective intent to harm the Plaintiff or had a subjective belief that harm was substantially certain to result from his conduct. Id. at ¶ 65. Plaintiff argues that a tortious breach of contract will suffice to establish the malicious injury prong of Section 523(a)(6). See Plaintiff's Trial Statement at 15:18-23, citing Petralia v. Jercich (In re Jercich), 238 F.3d 1202, 1209 (9th Cir. 2001). Plaintiff argues that while Nevada law does not recognize a cause of action for tortious breach of contract, see Plaintiff's Trial Statement at 16:2-3, a breach of the implied covenant of good faith and fair dealing may give rise to tort liability where there is a special relationship between the parties. Id. at 16:2-22, citing Hilton Hotels Corp. v. Butch Lewis Prods., 107 Nev. 226, 232 (Nev. 1991); United States Fidelity v. Peterson, 91 Nev. 617, 540 P.2d 1070 (1975); and K Mart Corp. v. Ponsock, 103 Nev. 39, 732 P.2d 1364 (Nev. 1987). Plaintiff argues that the Debtor intentionally misrepresented his management of her investments in conscious disregard of his fiduciary duties, resulting in investments that were substantially certain to cause harm to the Plaintiff. See Plaintiff's Trial Statement at 17:23-28.

Having considered the exhibits submitted by the parties as well as the testimony presented, the court concludes that the Plaintiff has failed to meet her burden of proof on both prongs required to prevail under Section 523(a)(6).

While the parties dispute the characterization of the Debtor's actions, there is no apparent dispute that his actions in connection with the Plaintiff, the Trust Account and the IRA, were intentional. In this instance, however, Plaintiff has not demonstrated that the Debtor intended to cause the losses sustained by the Trust Account and the IRA.

There is, of course, no direct evidence that Debtor intended such results: Debtor did not testify to having such an intention, nor is there any documentary evidence suggesting that he intended the Plaintiff's investments to lose value. In fact, Debtor testified that he had no such intent and his testimony was credible. Likewise, no witnesses were presented attesting that the Debtor ever expressed such an intent in their presence. Nor is there circumstantial evidence from which to infer that the Debtor, for whatever reason, intended to cause damage to the

Plaintiff, nor to the Trust Account and IRA investment portfolios. Inasmuch as the Debtor might have obtained greater fees and fostered his continuing relationship with the Debtor as a client, it is easy to conclude that he would not and did not have an intent to cause injury to the Plaintiff. This is consistent with the Debtor's actual testimony.

But has the Plaintiff demonstrated that the Debtor was substantially certain that his actions would result in injury to the Plaintiff? Having considered the testimony of Buchler, Hume and Parker, all of whom testified as experts, the court concludes that substantial certainty has not been demonstrated. The court begins, of course, with the Debtor's testimony that he believed his investment advice and portfolio management to be appropriate, based on the Plaintiff's age, sophistication, cash needs, and overall asset structure. Parker came to the same conclusion based on his knowledge of the Plaintiff's age, financial status, net worth, investment objectives, liquidity needs, experience, investment types, and risk tolerance. By contrast, Buchler and Hume evaluated the suitability of the investments based on the value of the Trust Account and IRA, but actually did not know the Plaintiff's net worth or the values of her other investments.

Debtor's use of "stochastics" to inform his advice and decisions apparently was not prohibited by any statute, rule or regulation applicable to investment advisors, nor any guidelines established by FINRA.[60] Buchler and Hume suggested that a 60/40 ratio of bonds to stocks was appropriate for the Plaintiff's portfolio, but neither of them attested that a mixture within a reasonable range of those percentages was prohibited. Parker testified, without contradiction,

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[60] Even if the Plaintiff was asserting that there is a standard of care for investment advisors that was violated by the Debtor, she has failed to even establish such a standard, much less prove that the Debtor was substantially certain that he was violating the standard with resulting injury to the Plaintiff. Indeed, Plaintiff asserts that "broker-dealers and investment advisors [in Nevada] are heavily regulated pursuant to NRS Chapter 90," see Plaintiff's Trial Statement at 7:4-5, but points to no provision of NRS 90.211 through NRS 90.860 establishing a standard of care. Nor does the Plaintiff even reference the Investment Advisors Act of 1940, 15 U.S.C. § 80b-1, et seq., or its rules and regulations, see 17 C.F.R. Part 275, et seq., as a possible source of analogous authority to establish a standard of care. A professional's mere breach of a standard of care, of course, is insufficient to constitute willful and malicious injury under Section 523(a)(6). See, e.g., Kawaauhau v. Geiger, 523 U.S. at 61-63 (malpractice judgment against physician based on negligently or recklessly inflicted injuries is not encompassed by 523(a)(6)).

that the average percentage of stocks in both the Trust Account and the IRA ranged from 43.2% to 45.1% during the investment period.

Both Buchler and Hume believe that the Debtor did not follow the Plaintiff's instruction to pursue a conservative investment strategy. The evidence is not clear when such an instruction was ever given by the Plaintiff. Assuming the instruction was given, however, both Buchler and Hume discounted the significance of the substantial cash withdrawals taken by the Plaintiff during the most volatile periods of the market. Debtor testified that the Plaintiff reduced the cash from her accounts at points of market recovery that were critical to the overall success of his investment strategy. Parker testified that the withdrawals were a major contributing factor to the losses sustained by the Plaintiff. In a sense, Debtor maintains that "it takes money to make money" and the Plaintiff's reallocation of her funds caused or contributed to her alleged injuries. Parker essentially concurred.

For reasons already discussed, the court has found Parker's testimony to be more credible than Buchler and Hume. But even giving their testimony weight equal to Parker's, the circumstantial evidence does not establish that the Debtor was substantially certain that his management of the Plaintiff's investment portfolio would result in injury. To paraphrase Plaintiff's own expert: no one can accurately predict the future performance of the stock and bond market. Based on this record, the court concludes that the Plaintiff has failed to meet her burden of establishing that willful injury was committed by the Debtor within the meaning of Section 523(a)(6).

Because willful injury has not be established, it is unnecessary to reach the malicious injury requirement of Section 523(a)(6). The evidence presented simply does not support a claim under this provision.

CONCLUSION

For the reasons discussed above, the court concludes that Plaintiff has failed to meet her burden of proof. Therefore, judgment in favor of the Debtor has been entered concurrently with this Memorandum Decision. Each side shall bear its own costs.

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