UNITED STATES BANKRUPTCY COURT DISTRICT OF ARIZONA

In Re) Chapter 7
RICHARD JAMES KUDLICKI, SR. and MICHELLE KUDLICKI,) No. 02-06640-GBN
Debtors.)))
J.E. SCHELLER PLUMBING, INC., D/B/A JOEL'S QUALITY POOL & SPA PLUMBING,) Adversary No. 02-00893)
Plaintiff, vs.)) FINDINGS OF FACT,) CONCLUSIONS OF LAW) AND INTERIM ORDER
RICHARD JAMES KUDLICKI, SR. and MICHELLE KUDLICKI,) AND INTERIM ORDER)
Defendants.)))

The adversary complaint of J.E. Scheller Plumbing, Inc., d/b/a Joel's Quality Pool and Spa Plumbing ("Plaintiff") seeking a declaration of nondischargeability of its bankruptcy claim against Michelle Kudlicki and her marital community property interest ("Defendant" or "Debtor") was tried to this court as a bench trial on November 5 and December 9, 2004. Post trial briefing was completed on December 23, 2004. An interim order was entered on January 14, 2005 announcing the court's decision.

The court has considered sworn witness testimony, admitted exhibits and the facts and circumstances of this case. The following findings and conclusions are now entered:

FINDINGS OF FACT

1. Debtor and her co-debtor husband, Richard James Kudlicki, Sr., ("Defendants") scheduled an unsecured claim held by Joel's Quality Pool and Spa Plumbing of \$19,035.10 in their personal Chapter 7 bankruptcy case filed May 2, 2002. Schedule F at p. 8. The Kudlickis' sworn schedules indicated this claim was not contingent, unliquidated or disputed. *Id.* at p. 1. Plaintiff's complaint, seeking a determination of nondischargeability of its debt was timely filed against both debtors on August 13, 2002.

2. On August 1, 2003, the court granted plaintiff's motion for partial summary judgment against the defendant husband, ruling that plaintiff's debt was nondischargeable¹. Minutes of August 1, 2003, adversary docket entry ("dkt") 27. At the same hearing, the court denied plaintiff's motion as to debtor, finding a dispute of material facts. *Id.* Plaintiff's renewed motion for summary judgment of January 16, 2004 was denied on April 9, 2004. The court ruled that an evidentiary

¹ The court ruled that funds received from customers for pool work, held in trust for subcontractors, was not paid to them but instead was used as working capital. Mr. Kudlicki, as president and an owner of Canyon, with the power to direct how funds were allocated, was declared liable under 11 U.S.C. §523(a)(4). Oral ruling of August 1, 2003.

hearing was required to determine the liability of debtor and her community property interest. Dkt. 47.

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3. Debtor and her husband were the only owners and officers of Canyon State Pools, Inc. Debtor was also a full time Canyon employee, responsible for scheduling pool construction work by subcontractors, such as plaintiff. This employment was her primary income source. She would maintain a flow chart, reflecting each pool project, owner, contract amount and construction status. Debtor would monitor the status, contact subcontractors and schedule their work as the project progressed. Plaintiff's office manager would usually ask for debtor to discuss jobs or payment, as she was considered their contact person. It was vital for debtor, as scheduler, to know which subcontractors were paid, so she would know who could be called upon to subsequently work on a project. She would pay some construction bills, which the company accountant would later allocate to a particular project. She spoke to subcontractors daily and knew that a number were unpaid. This had been occurring for some time. She had access to the company checkbook, was a signatory on the business account and would have the authority and ability to access paper and computerized company financial records².

²Debtor's testimony regarding her actual ability to use the "Quick Book" program to access Canyon computerized records was confused. Mr. Kudlicki testified debtor received "some" training on Quick Books from him. Debtor's denial on direct that she could use Quick Books was impeached. On cross, she again appeared to assert she could not use the product. Whether she actually (continued...)

Debtor would deposit checks into the company banking account.

Her salary was \$ 2,200 monthly. Her husband was paid \$ 4,000 net monthly. The Kudlickis received their full salary and would also pay their employees, even when subcontractors were unpaid. They also took salary and paid employees when state sales taxes were delinquent. The Kudlickis did not miss a paycheck until they closed Canyon on November 12, 2001. They would also take personal loans from Canyon at 10% interest. Sometimes the loans would be repaid and sometimes not. Canyon's business declined in July and August of 2001, when pool sales dropped by one-half. Debtor was impeached a number of times during her trial testimony with her prior deposition testimony. Testimony ("test.") of Michael J. Szobosan, Test. of Michelle Kudlicki, Test. of Stacy Scheller, Test. of Daniel M. Merjil, Test. of Janine Vance, Admitted exhibit ("Ex.") 6 at p. 3 (reflecting a Department of Revenue levy of \$48,923.34 on August 29, 2001), Ex. 3 (Payroll checks for Richard and Michelle Kudlicki, June-August 2001), Ex. 31 (Company checks signed by debtor), Ex. 14 at admission 9, p.10.

4. Debtor would contact pool owners for payment and would talk to subcontractors about payment issues. She would be the person to receive complaints from subcontractors about not being paid. However, her husband, who was always Canyon's president, made the decisions regarding which subcontractors

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accessed computerized records is unimportant. See legal conclusion 5.

would be paid and when. She did not exercise independent payment judgment. The company had unpaid subcontractors in July of 2001, but continued to operate and pay salaries, until the business closed in November of 2001.

During July of 2001, the Kudlickis made \$350 per month payments on a 26' boat they earlier purchased and bought \$3,699.99 in new bedroom furniture for a \$425,000 Chandler, Arizona home nearing completion. Debtor signed a number of personal checks for additional home furniture, including \$7,360.65 and \$2,084.52 to furniture vendors and \$6,054.31 for appliances on July 11, 2001. Ms. Diana Glynn in deposition testimony³, characterized defendants' behavior as "spending money right and left" at this time, including acquiring "... (a) whole house full of furniture" and "breast augmentation surgery." Debtor and her husband deeded the Chandler home back to mortgagee First Arizona Mortgage and left the residence in mid November of 2001. They did receive and retain \$8,000 cash for a television left at the residence.

Mr. Kudlicki had no employment or income other than from Canyon Pools. Defendants' response to plaintiff's second request to produce contains no documents establishing that Scott Glynn of the Lariat Group, LLC, builder of the Chandler residence, provided money for to defendants that was not Canyon revenue. Defendants' answers to plaintiff's second set of

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³The Glynn depositions were admitted without objection on December 9, 2004. Ex.19.

interrogatories stated the furniture, appliances and home furnishing purchases were funded in part from personal construction draws on the Chandler home. However, the documents defendants produced to establish this assertion do not support their testimony. Homebuilder Scott Glynn's deposition testimony is that Canyon State Pools was the Lariat Group's swimming pool subcontractor and built the pool at the Chandler residence. Ultimately Defendants purchased the home. Mr. Glynn produced copies of Lariat checks representing July of 2001 payments of \$9,300 and \$6,000 for pool and fence landscaping work done by Canyon, but made payable to Mr. Kudlicki. Subcontractor's lien releases were signed by Mr. Kudlicki on behalf of Canyon State Pools. Although denying that the funds expended for personal expenses came from payments made to Canyon, Mr. Kudlicki cannot explain why he signed subcontractor lien releases for Lariat on behalf of Canyon. It is clear to this fact finder that Canyon constructed the pool at the Chandler residence. Debtor even recalls being the scheduler for that job. The September 24, 2001 settlement statement for the Kudlicki \$366,000 mortgage note for the home does not contain a line item allocation providing funding for furniture or appliance purchases.

Mr. Kudlicki does not exactly know the source of funding for the July furniture and appliance purchases. On cross-examination he suggested funding could be from yard sales, for which he has no receipts. He could not recall if the Lariat checks were used as well. On redirect examination he testified

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were made to friends over time. This information was not previously provided in defendants' responses to plaintiff's discovery requests. He denied the Lariat checks were payments to Canyon, although he signed lien waivers on Canyon's behalf. Canyon had a half dozen unpaid subcontractors in July of 2001. In response to questions from the court, he testified money for household furnishings also came from personal savings. Up to \$10,000 of the savings were kept at home in a gun safe, rather in the couple's banking accounts. This than particular explanation was not provided in defendants' pretrial discovery Debtor testified the monies used for her July responses. cosmetic surgery came from her personal savings. No documentary evidence of such savings was presented. Debtor has no idea where the money for the spending on the house came from, how much money was raised from a yard sale or how much money was put into the house by the couple. The fact finder does not find defendants' testimony regarding the source of funds for personal expenditures to be credible.

only one yard sale was conducted, although additional asset sales

This fact finder further determines that defendants' testimony that no money derived from Canyon State Pool operations was used to pay personal expenses during the time subcontractors were going unpaid is not credible. The Court finds that the source of funding for defendants' personal spending was their community interest in the revenue from Canyon State Pools. Szobosan test., Debtor test., Test. of Richard James Kudlicki,

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Sr., Ex. 12, Ex. 17 at construction project agreement, p.2, Ex. 4, Ex. 16 at p.3, Ex. 15 at pgs. 1-4, Ex. 17, Ex. 19 at pgs. 12-15 and 22-24 of deposition of Diana Glynn. *Also*, see Ex. 19 at Pgs.5-15, 26, 30-31, 33 and exhibits for Scott Glynn deposition.

5. On August 24, 2001, a month after spending at least \$25,000 on the new Chandler home, Richard Kudlicki sent a letter on Canyon State letterhead to plaintiff and other unpaid subcontractors. He indicated a lack of working capital meant "...we have in effect 'borrowed' the operating capital from our partner businesses, such as yours..." and requested patience as "Michelle and I have retained the services of a management consultant..." Debtor "supposes" she saw this letter before it went out. She recalls sitting in on some of the meetings with the management consultant. Debtor test., Ex. 32.

6. To the extent any of the following conclusions of law should be considered findings of fact, they are hereby incorporated by reference.

CONCLUSIONS OF LAW

- 1. To the extent any of the above findings of fact should be considered conclusions of law, they are hereby incorporated by reference.
- 2. Jurisdiction of defendants' bankruptcy case is vested in the United States District Court for the District of Arizona. 28 U.S.C. §1334(a) (1994). That court has referred all cases under Title 11 of the United States Code and all adversary proceedings and contested matters arising under Title 11 or

related to a bankruptcy case to the United States Bankruptcy Court for the District of Arizona. 28 U.S.C. §157(a) (1994), Amended District Court General Order 01-15. This adversary proceeding having been appropriately referred, this court has core bankruptcy jurisdiction to enter a final order determining the dischargeability of plaintiff's claim. U.S.C. \$157(b)(2)(I).

3. This court's conclusions of law are review de novo and its factual findings are reviewed for clear error. Rule 8013 F.R.Br.P., Hanf v. Summers (In re Summers), 332 F.3d. 1240, 1242 (9th Cir. 2003). The appellate court accepts the bankruptcy court's findings, unless upon review, it is left with the definite and firm conviction that a mistake has been committed. Ganis Credit Corp. v. Anderson (In re Jan Weilert RV, Inc.), 315 F.3d 1192, 1196 (9th Cir.) amended by 326 F.3d 1028 (9th Cir. 2003).

4. This court previously determined that the husband's failure as president and an owner of Canyon to ensure that subcontractors were paid from proceeds received from residential pool construction contracts resulted in nondischargeability of plaintiff's claim as to him personally and his marital community property interest. Fn. 1, supra. Mindful that a court must be careful in analysis of a spouse's liability, as assumption of business functions by a spouse may not carry the weight that such conduct on the part of a stranger would imply, this court required an evidentiary hearing. The purpose was to determine the

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precise nature of debtor's relationship and activities in Canyon and the source of funds for household expenses during the time plaintiff was unpaid. See, Tsurukawa v. Nikon Precision, Inc. (In re Tsurukawa), 287 B.R. 515, 522 (Bankr. 9th Cir. 2002) ("Tsurukawa II"). The relationship, activities and source of funds are now clear.

5. Debtor's marital status alone does not create an agency relationship sufficient to attribute her husband's wrongful conduct to her for \$523(a) liability purposes. Tsurukawa v. Nikon Precision, Inc. (In re Tsurukawa), 258 B.R. 192, 198 (Bankr. 9th Cir. 2001). A debt may be excepted from discharge either when (1) debtor personally commits the act creating nondischargeability or (2) the wrongdoing of another is imposed on debtor through agency or partnership principles. Tsurukawa II at 525. Where there are no facts showing individual culpability on the part of an "innocent" spouse, liability can still be imputed under partnership or agency principles, if debtor is the business partner of the culpable spouse. Id. at 527. Further, the "innocent" spouse's knowledge of the culpable spouse's conduct can be relevant, depending on the circumstances, to infer culpable intent on her part. Taylor Freezer Sales of Arizona, Inc. v. Oliphant (In re Oliphant), 221 B.R. 506, 511 (Bankr. D. Az. 1998).

Debtor was an actual, functioning full business partner of her husband, well aware of the developing crisis involving unpaid subcontractors and large contemporaneous

expenditures for marital household purposes. She did not merely hold a "paper title" as an officer of Canyon. Debtor had authority and ability to access company books and records. Whether and how often she actually exercised this authority is unclear, but unimportant. Insofar as the events precipitating the company's crisis are concerned, she knew what was happening, as it happened, where money was going and where it wasn't going.

She worked full time as the company scheduler, dealing daily with subcontractors and by her own admission, well aware of whom had not been paid. Debtor was also well aware of large personal expenditures for the new Chandler home at the same time. Indeed, she was the signatory on many of the personal checks issued in payment. In August of 2001, when the company admitted in writing that funds entrusted for subcontractor payments were diverted for working capital, 4 debtor was specifically listed as involved in the effort to deal with the situation. She made no being expressly included objection to in this communication and participated in some of the subsequent consulting meetings . More importantly, there is no indication she objected to or resisted her husband's practice of not compensating all subcontractors. Debtor was apparently content with allowing her husband to make these payment decisions. Her acquiescence to his decisions in this particular area does not mean she was not a married business partner. See Tsurukawa II at

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⁴Uses of working capital included payment of full salaries to debtor and her spouse.

522. As a signatory on the company banking account, who actually wrote company checks, she could have made payment to subcontractors, such as plaintiff. She instead chose to write personal checks for household furnishings.

The court concludes plaintiff's claim against debtor is nondischargeable under *Tsurukawa II* on both an agency theory, as a marital business partner and on her own personal conduct. As an active officer and co owner of the business, she tolerated, ratified and participated in her husband's improper use of subcontractor trust funds in violation of 11 U.S.C. § 523(a)(4).

6. Community property is not liable for a debt unless it is shown to be a community claim. Case v. Maready (In re Maready), 122 B.R. 378, 381 (Bankr. 9th Cir. 1991). A marital community whose actions do not conform to the standards imposed by law should not earn the discharge received by joint debtors who did not engage in the proscribed conduct. Valley National Bank v. LeSueur (In re LeSueur), 53 B.R. 414, 416 (Bankr. D.Az. 1985). This is such a community. In this case the court has concluded there is no "innocent spouse." Accordingly the tests established for liability of the community based on the acts of only one spouse are inapplicable. See F.D.I.C. v. Soderling (In re Soderling), 998 F. 2d 730, 733 (9th Cir. 1993). The court

⁵Even assuming debtor had been an "innocent" spouse, her husband's tortious acts committed with the intent of benefiting the community by keeping the family pool business operating, would still impose liability on the marital community, regardless of whether the community actually received a benefit. In re Monroe, 282 B.R. 219, 221 (Bankr. D.Az. 2002), Selby v. Savard, (continued...)

concludes plaintiff's nondischargeable claim is a marital community obligation, as well as debtor's separate obligation.

7. Once it has been established that money has been obtained by fraud, the full liability for the debt is excepted from the bankruptcy discharge. Cohen v. De La Cruz, 523 U.S. 213, 217-23, 118 S.Ct. 1212, 1216-19 (1998) (Treble damages, attorneys fees and costs awarded by the bankruptcy court pursuant to New Jersey law held nondischargeable under § 523(a)(2)). nondischargeable debt may include prejudgment interest, attorneys fees and costs and even punitive damages, awarded under state law. Roussos v. Michaelides (In re Roussos), 251 B.R. 86, 94 (Bankr. 9th Cir. 2000), aff'm. 33 Fed. Appx. 365, 2002 WL 726489 $(9^{th}$ Cir. 2002)(§ 523(a)(4) liability set at full amount of California state court judgment, including attorneys fees). See also, AT & T Universal Card Services Corp. v. Hung Tan Pham (In re Hung Tan Pham), 250 B.R. 93, 96-99 (Bankr. 9th Cir. 2000) (award of attorneys fees, if available under California law in fraud action, would be nondischargeable). If state law does not permit such an award, attorneys fees cannot be awarded in the nondischargeability action. Redwood Theaters, Inc. v. Davison (In re Davison), 289 B.R. 716, 720-26 (Bankr. 9th Cir. 2003).

Arizona law provides that in any contested action arising out of an express or implied contract, the court may award the successful party reasonable attorneys fees. A.R.S. §

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^{27 134} Ariz. 222, 229, 655 P.2d 342, 349 (1982).

12-341.01(A), Galam v. Carmel (In re Larry's Apartment, L.L.C.), 249 F.3d. 832, 836-37 (9^{th} Cir. 2001). Fees may be awarded under the statute, even though a single act constitutes both a tort and a breach of contract, as long as the tort action could not exist but for the breach of contract. Ford v. Revlon, Inc., 153 Ariz. 38, 45, 734 P.2d 580, 587 (1987) (Attorneys fees awarded in sexual harassment case, as tort could not occur but for the breach of the implied contract created by Revlon's policies and procedures). Sparks v. Republic National Life Insurance Co., 132 Ariz. 529, 543-44, 647 P. 2d 1127, 1141-42 (1982) (Attorneys fees awarded as tort for breach of implied covenant of good faith could not arise but for existence of the insurance contract). See, Barmat v. John and Jane Doe Partners A-D, 155 Ariz. 519, 522-24,747 P. 2d 1218, 1221-23 (1987) (No fees awarded when legal malpractice action does not arise from contract). Plaintiff's cause of action for fraud or defalcation while acting in a fiduciary relationship could not arise but for defendants' breach of the underlying plumbing services contract. 11 U.S.C. § 523 (a) (4). Accordingly, plaintiff's nondischargeable debt will include reasonable attorneys fees and costs.

ORDER

IT IS ORDERED no later than ten days from the date of these findings and conclusions, plaintiff will serve and file a detailed attorneys fee application. Defendants will have seven days from the date of service of the application to serve and file objections. The court will thereafter resolve any disputes

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regarding the application and enter a final judgment. 1 2 DATED this 26th day of January, 2005. 3 George B. Nielsen, Jr. 5 United States Bankruptcy Judge 6 Copies mailed this 26th day 7 of January, 2005, to: William R. Richardson 8 WILLIAM R. RICHARDSON, P.C. 1745 S. Alma School Rd., #100 Mesa, AZ 85210-3010 10 Email: wrichlaw@aol.com Attorneys for Plaintiff 11 Anthony Giammarco 12 GIAMMARCO LAW OFFICE 50 S. Power Rd. Mesa, AZ 85206 13 Email: agiammarco@aol.com Attorneys for Defendants/Debtors 14 By /s/ Rachael M. Stapleton 15 Deputy Clerk 16 17 18 19 20 21 22 23 24 25 26

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