

**UNITED STATES BANKRUPTCY COURT
DISTRICT OF MINNESOTA
FOURTH DIVISION**

In re

James Scott Tordoff,

Debtor.

RJM Construction, Inc.,

Plaintiff,

v.

James Scott Tordoff,

Defendant.

Bky. No. 04-42018-RJK

Adv. No. 04-4204

Chapter 7

**PLAINTIFF’S MEMORANDUM OF LAW IN OPPOSITION TO
DEFENDANT’S MOTION TO DISMISS THE AMENDED COMPLAINT**

I. INTRODUCTION¹

RJM filed this adversary proceeding on its own behalf and as the assignee of claims held by subcontractors of Tordoff’s former business, Gruppo, Inc. (“Gruppo”). RJM and the subcontractors are creditors of Gruppo. In this adversary proceeding, however, these creditors seek relief against Tordoff in his individual capacity as a former officer, director and controlling shareholder of Gruppo. In this capacity, Tordoff allegedly (1) committed fraud or defalcation while acting in a fiduciary capacity of an insolvent corporation, and (2) obtained money or

¹This is defendant’s second motion to dismiss. Prior to the withdrawal of the first motion, RJM filed a memorandum of law. Rather than duplicate the same discussion here, Plaintiff requests that the earlier submission be incorporated by reference.

services by false pretense, false representation or actual fraud. See 11 U.S.C. §§ 523(a)(4), 523(a)(2)(a).

II. ARGUMENT AND AUTHORITY

A. Standard on a motion to dismiss for failure to state a claim.

A motion to dismiss for failure to state a claim should not be granted unless it appears beyond a reasonable doubt that the plaintiff can prove no set of facts that would entitle it to relief. Alexander v. Pepper, 993 F.2d 1348, 1349 (8th Cir. 1993). Stated in the affirmative, a motion to dismiss should be granted as a practical matter only in the unusual case in which a plaintiff includes allegations that show on the face of the complaint that there is some insuperable bar to relief. Id. quoting Bramlet v. Wilson, 495 F.2d 714, 716 (8th Cir. 1974).

B. Tordoff is a ‘fiduciary’ for purposes of 11 U.S.C. § 523(a)(4).

RJM’s Amended Complaint alleges that Tordoff breached his fiduciary duties as an officer, director and controlling shareholder of an insolvent corporation. *Amended Complaint*, ¶¶ 15-21. Under state common law, an officer and director of an insolvent corporation owes a fiduciary duty to creditors. Snyder Electric Co v. Fleming, 305 N.W.2d 863 (Minn. 1981). The duty is narrowly defined and simply prevents the officer or director from preferring himself to the detriment of other creditors while the corporation is insolvent. Id. Tordoff does not challenge this legal conclusion, but argues instead that this type of fiduciary duty under Minnesota common law is not the type contemplated by 11 U.S.C. § 523(a)(4).

RJM acknowledges that a fiduciary for purposes of 11 U.S.C. § 523(a)(4) is much narrower than the term is applied under state law. However, the “critical inquiry in determining whether a technical trust exists is whether the fiduciary obligation arose chronologically before

the wrongdoing or as a result of the wrongdoing.” In re Caretta at 73 *citing* In re Bruning, 143 B.R. 253, 254 (D.Colo.1992); *see also* Hunter, et. al. v. Philpott, 373 F.3d 873 (8th Cir. 2004)(fiduciary relationship must pre-exist the incident creating financial obligation); In re Reuscher, 169 B.R. 398 (S.D.Ill. 1994)(“the key to knitting the cases into a harmonious whole is the distinction between a trust or other fiduciary relation that has an existence independent of the debtor's wrong and a trust or other fiduciary relation that has no existence before the wrong is committed”).

Under Minnesota common law, the fiduciary duties imposed on an officer or director of an insolvent corporation arise independent of any specific wrongdoing by that officer or director, “for the right of the creditors does not depend upon fraud in fact.” Swanson v. Tomlinson Lumber Mills, Inc., 239 N.W.2d 216 (Minn. 1976). Instead, the fiduciary duty arises “when a corporation becomes insolvent” and, at that time, the officers and directors become fiduciaries “of the corporate assets” for the benefit of the creditors. Snyder at 869. As alleged in this case, Tordoff is not charged with causing the insolvency of Gruppo. Rather, Tordoff is charged with wrongdoing that arose after the business became insolvent, i.e. using corporate assets to eliminate or decrease his personal liability for corporate debts to the detriment of other creditors. *Amended Complaint*, ¶¶ 16, 19. These allegations are akin to acts by an officer who drains a corporation’s assets for his own personal benefit which “may create a bar to discharge.” See In re Long, 774 F.2d 875 (8th Cir. 1985) at fn. 3. As alleged in the Amended Complaint, therefore, Tordoff is a ‘fiduciary’ for purposes of § 523(a)(4) in that his fiduciary relationship with Gruppo’s creditors pre-existed, and had an existence independent of, his subsequent wrongful acts.

The allegations in this case are distinguishable from other decisions where the facts alleged, or proven at trial, involved a fiduciary duty that sprung solely from the alleged wrongful act. For example, in Hunter, et. al. v. Philpott, 373 F.3d 873 (8th Cir. 2004) the Eighth Circuit rejected the argument that a fiduciary for purposes of ERISA was also a fiduciary in bankruptcy. The court noted that “it is not enough that the trust relationship spring from the act from which the debt arose.” Id. at 877. The Eighth Circuit reviewed the district and bankruptcy courts’ findings of facts for “clear error” and made the factual determination that the debtor’s obligation “did not preexist the allegedly wrongful act complained of: that is, his failure to hold money to satisfy the employers owed contributions.” Id. at 877. “The debtors personal financial liability arose at the time the employer failed to satisfy its obligations.” Id. Thus, based on this factual finding, the Eighth Circuit determined that the debtor was not a fiduciary under § 523(a)(4). Id.

Notwithstanding the general rule that a ‘fiduciary’ is a question of federal law, the Eighth Circuit has opined that a “statute or state law rule may create fiduciary status in an officer which is cognizable in bankruptcy proceedings.” In re Long, 774 F.2d at 878. Presumably, therefore, the Eighth Circuit would recognize the fiduciary status of an officer or director of an insolvent corporation for purposes of bankruptcy, as set forth in Snyder Electric Co v. Fleming, so long as the fiduciary duty existed prior to the alleged wrongful act. In a footnote to the discussion in In re Long, the Eighth Circuit went on to write, in dicta, that it would not extend the fiduciary relationship to third party creditors “as Barclays would have us do.” Id. at fn. 3. The dispositive issue behind the court’s rejection of Barclay’s argument, however, was that Barclay was arguing for a *trust ex malaficio*. Id. at 878. The Eighth Circuit’s reference to “creditors” at footnote 3 must be understood in context and, moreover, is distinguishable from this case where the

allegations do not involve a *trust ex malaficio*. Tordoff's status as a fiduciary under common law does not grow or spring out of the alleged wrongdoing and, therefore, should be recognized as a 'fiduciary' for purposes of § 523(a)(4) as well.

Where RJM's allegations in the Amended Complaint do not seek to impose liability based a *trust ex malaficio*, and where the inquiry is necessarily fact specific, it would be improper to dismiss RJM's § 523(a)(4) claims for failure to state a claim pursuant to Rule 12. Therefore, this Court should deny Tordoff's motion to dismiss count one of RJM's Amended Complaint.

C. Plaintiff's Amended Complaints states a claim under 11 U.S.C. § 523(a)(2)(a).

While the payments at issue were made to Gruppo, Tordoff is independently liable for his own fraudulent conduct. Sullivan v. Ouimet, 377 N.W.2d 24 (Minn. Ct. App. 1985). Minnesota law holds agents liable for their own fraudulent representations. Sawyer v. Tildahl, 275 Minn. 457, 148 N.W.2d 131 (1967). Further, fraudulent conduct may be proven by showing either affirmative representations or silence regarding a material fact. In re Docteroff, 133 F.3d 210 (3rd Cir. 1997).

As to the second and third count of the Amended Complaint, the allegations are that Tordoff, as an officer and controlling shareholder of Gruppo, had no intent to pay Gruppo's subcontractors. *Amended Complaint*, ¶ 26. Rather, it is alleged that Tordoff executed a contract with RJM for \$248,050.00 on December 23, 2002, that substantially all of the contract work was farmed out to subcontractors, that Tordoff caused or directed employees of Gruppo to make written applications for discretionary progress payments to RJM in January and February of 2003, and that the payments were made by RJM in reliance on written representations in the

contract, two applications for payment and one lien waiver² that subcontractors were or would be paid and that Gruppo would save and protect the project from any liens. But Tordoff knew or should have known that Gruppo would never pay the subcontractors. It was Tordoff's intent that Gruppo would not pay the subcontractors and that RJM would be compelled to pay twice for the same work to save and protect the project owner from any lien claims by the subcontractors.

Tordoff does not dispute that progress payments made on February 28, 2003 and March 11, 2003 in the amounts of \$67,331.25 and \$21,966.75 were not used to pay Gruppo's subcontractors. The question to be litigated, therefore, is whether Tordoff had the intent to obtain payments from RJM, or services from the subcontractors, by false pretense, false representation or actual fraud. This issue is fact specific and cannot be decided without discovery and without a trial. Alexander v. Peffer, 993 F.2d 1348, 1349 (8th Cir. 1993).

The cases cited in Tordoff's motion to dismiss are similarly fact specific. *See e.g. In re King*, 68 B.R. 569 (Bankr. D. Minn. 1986)(summary judgment standard); In re Wyant, 236 B.R. 684 (Bankr. D.Minn. 1999)(order following trial). The discussion and analysis necessarily involves issues of fact. Tordoff argues that "by all appearances, Gruppo made completely accurate disclosure of all payments to subcontractors as of the time it submitted each application." *Tordoff's memorandum at p. 8*. Tordoff implicitly invites this Court to do something that it cannot do - weigh the evidence that may be introduced at trial. For all of the above reasons, this Court should deny Tordoff's motion to dismiss the § 523(a)(2)(a).

²The applications for payment by Gruppo are not dated, but were received by RJM on January 24, 2003 and February 24, 2003. The lien waiver was executed on February 28, 2003.

III. CONCLUSION

For all of the above reasons, as well the legal discussion contained in RJM's memorandum dated August 20, 2004, this Court should conclude that the allegations in RJM's Amended Complaint are legally sufficient.

LOMMEN, NELSON, COLE & STAGEBERG, P.A.

Dated: September 30, 2004

By /s/ Geraint D. Powell

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UNSWORN DECLARATION FOR PROOF OF SERVICE

Sheila S. DeMars, declares that on the 30th day of September, 2004, she served **Plaintiff's Memorandum of Law in Opposition to Defendant's Motion to Dismiss the Amended Complaint** upon each of the entities named below by mailing to each of them a copy thereof by enclosing same in an envelope with first class postage prepaid and depositing same in the post office at Minneapolis, Minnesota, addressed to each of them as follows:

Brian F. Leonard, Esq.
100 South Fifth Street, Suite 1200
Minneapolis, MN 55402

Office of the U.S. Trustee
1015 U.S. Courthouse
300 South Fourth Street

William I. Kampf, Esq.
Henson & Efron, P.A.
220 South Sixth Street, Suite 1800
Minneapolis, MN 55402

And I declare, under penalty of perjury, that the foregoing is true and correct.

Executed: September 30, 2004

Signed: /s/ Sheila S. DeMars