UNITED STATES BANKRUPTCY COURT
DISTRICT OF MINNESOTA

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In re:

DAVID R. MOE and VICKI L. MOE,

Debtors.

MEMORANDUM DECISION AND ORDER FOR JUDGMENT

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CHICAGO TITLE INSURANCE COMPANY, A MISSOURI CORPORATION,

Plaintiff,

BKY 04-32102

v.

ADV 04-3311

DAVID R. MOE,

Defendant.

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At Minneapolis, Minnesota, this 17th day of November, 2006.

This adversary proceeding for determination of dischargeability of debt came on before the Court for trial. The Plaintiff appeared by its attorneys, William P. Wassweiler and Samuel J.H. Sigelman. The Defendant appeared *pro se*. Upon the evidence received at trial and the arguments made, the Court enters the following memorandum of decision to incorporate its findings of fact and conclusions of law, pursuant to Fed. R. Civ. P. 52(a) and Fed. R. Bankr. P. 7052.

PARTIES

There are only two formal parties-litigant to this adversary proceeding. However, several other individuals and artificial business entities had roles in the events that led to the litigation.

The *Plaintiff* is a Missouri corporation. Its business is the facilitation of transactions in real estate, including the issuance of title insurance and other financial protections in connection

NOTICE OF ELECTRONIC ENTRY AND
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Filed and Docket Entry made on 11/17/06
Lori Vosejpka, Clerk, By jrb, Deputy Clerk

with residential real estate sales. It sells title insurance directly to members of the public and through agents. Nationally, the Plaintiff works through some 3,500 agents, 115 of which operate in its Upper Midwest Area.

Old Dominion Title Services, Inc. ("Old Dominion") was a corporation that provided closing services for residential real estate transactions in the Minneapolis-St. Paul area. It became an agent of the Plaintiff for the sale of title insurance under an "Issuing Agency Contract" ("IAC") entered on July 15, 1999. At some point in 2002, the agency services under the Old Dominion IAC began to be performed under the name of Profile Title & Escrow Corporation ("Profile"). The Plaintiff terminated the agency status under the IAC on December 12, 2003.

The *Defendant* was the president of Old Dominion and a holder of 50% of its outstanding shares at the time when the IAC was entered. In 2001 he became Old Dominion's sole shareholder, and he remained so at all times relevant to this matter. On July 15, 1999, the Defendant personally guaranteed Old Dominion's performance under the IAC. As part of that guaranty, he agreed to indemnify the Plaintiff from all losses that the Plaintiff might incur in consequence of Old Dominion's default under the IAC.

Molly Heise ("Heise") was an employee of Old Dominion at some point prior to calendar year 2001. Under the assumed business name of "Integrity Title Services," she began performing various services on residential real estate transactions, "working with" Old Dominion and other agencies that were licensed to issue title insurance. On November 13, 2001, Heise and the Defendant executed a "Stock Purchase Agreement" ("SPA"). Under the terms of the SPA the Defendant was to transfer his full shareholding in Old Dominion to Heise on that date. The consideration was to be the payment of $150,000.00, plus the Defendant's employment by Old Dominion in the position of vice president for a period of two years thereafter. After they executed the SPA, Heise and the Defendant both worked in Old Dominion's operations. Each performed client services and managerial and administrative tasks. Heise continued to use checking accounts previously opened under the Integrity Title Services name to process client funds for this work.

DISCUSSION

We start with the only fact to which the Plaintiff and the Defendant stipulated before trial, the existence of a debt. By May, 2005, the Plaintiff had paid $1,921,072.62 to obtain the satisfaction of mortgage liens and other related costs as a result of claims made on title insurance policies that it had issued on real estate transactions handled by entities under the names of Old Dominion and/or Profile.[1]

In 2004, the Plaintiff sued Old Dominion, Profile, Integrity, Heise, the Defendant, and other individuals and entities in the Minnesota State District Court for the Fourth Judicial District, Hennepin County. It sought to recover damages in two components. The first was the amount of money it had paid on account of claims made under the previously-identified title insurance policies. The second was other monies that the Plaintiff alleged that the state-court defendants had received as a result of their breach of their fiduciary duties under the IAC and Minnesota statute and their conversion of funds belonging to clients and other parties to various real estate transactions.

As against the Defendant, the litigation was stayed by the filing of his bankruptcy petition under Chapter 7.

On August 11, 2005, the Hennepin County District Court (M. Rosenbaum, J.) granted the Plaintiff's motion for summary judgment against all the other defendants. This resulted in the entry of a money judgment in favor of the Plaintiff against Old Dominion, Profile, and Heise, in the amount of $2,286,422.21, plus interest. As against Old Dominion and Profile, it was granted by default. The amount of the judgment subsumed the amount noted in the stipulation of fact between

[1]This is the text of the written stipulation of facts, polished a bit in conformance with the uncontroverted evidence to make it more precise. The significance of Profile in the history of events will be revealed later.

the Plaintiff and the Defendant here. At trial before this court, the Defendant again acknowledged that the Plaintiff had had to make good to parties under title insurance policies issued after the SPA was executed, and thus had "lost money" in the amount to which he had stipulated.

After recognizing this basic undisputed fact--the Plaintiff's incurring of a substantial loss, giving rise to *a* debt--we get to the two large points of controversy between the Plaintiff and the Defendant. The following discussion contains mixed findings of fact and conclusions of law on them.

I. Is the Defendant Liable to the Plaintiff on Account of this Debt?

Throughout this adversary proceeding, the Defendant denied that he is personally liable to the Plaintiff on account of this debt. His position at trial[2] was that he made an outright sale of his shareholding in Old Dominion to Heise under the November, 2001 SPA, and that after that date she was in control of Old Dominion until she personally undertook to perform the IAC under the business name of Profile or through a corporation by that name. Thus, he maintains, the wrongdoing behind the liability adjudicated in the Hennepin County District Court has to be attributed solely to Heise, to the extent it occurred through the instrumentality of Old Dominion's corporate form, and to a completely separate entity, Profile, after Profile "took over" the IAC.

In the most general application of the law, the Defendant's first point is without merit. He ignores the ongoing effectiveness of his personal guaranty of Old Dominion's continuing performance. That guaranty continued to affix liability in him for any shortfall in Old Dominion's account with the Plaintiff, regardless of the identity of the individual who was acting to perform the IAC on behalf of Old Dominion. *Borg Warner Acc. Corp. v. Shakopee Sports Center, Inc.*, 431

[2]Though the Defendant was required to file a trial brief and other pretrial documents to set forth his final theory of defense, he did not do so. To some extent, a theory of defense had appeared in his answer, filed by counsel while the Defendant was still represented. For the most part, though, the Plaintiff and the Court were relegated to hearing out the Defendant in person, at trial, for his take on the issues. Given that he stood to be adjudged liable for over $2,000,000.00, the Defendant's dereliction was not prudent.

N.W.2d 539, 541 (Minn. 1988).[3] Thus, for all debt to the Plaintiff that was accrued as long as Old Dominion was responsible for agency performance under the IAC, the Defendant is liable in the first instance as guarantor.[4]

The next question is how long that accrual went forward. On the record made before this Court, the answer has to be "for the duration"--that is, over the entire accrual of the debt that was reduced to judgment. As just noted, it is irrelevant to the Defendant's liability as guarantor whether the Defendant-Heise stock transfer was ever consummated. But to the extent that such a transfer is relevant to any alternate theory of the Defendant's liability, the record well-establishes that Heise never became a formal shareholder of Old Dominion, and never succeeded to any equitably-recognizable interest in the stock either. There was no evidence that the sale was ever consummated. In particular, there was no clear evidence that Heise had ever paid the Defendant the purchase price from her own assets, and none at all that the Defendant had ever formally

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[3]The court in *Shakopee Sports Center* did hold that, when a guaranty "does not specifically include a date of expiration or a termination provision," termination of the guaranty's effectiveness "after a reasonable time may be implied." 431 N.W.2d at 541. Here, a holding to that effect is not warranted. To all external appearances, the Defendant was still an active owner-principal in Old Dominion's operations. All of the expropriations of client funds that gave rise to the state-court judgment took place within two years of the execution of the SPA, the date on which the Defendant now would have himself absolved of responsibility. Under these circumstances, and with the Defendant's ongoing involvement, it cannot be said that a "reasonable time" passed so as to deem the Defendant's guaranty to have lapsed. *Loving & Assocs., Inc. v. Carothers*, 619 N.W.2d 782 (Minn. App. 2000) does not help the Defendant either. The *Loving & Assocs.* court held that the holding in *Shakopee Sports Center* had to be limited to "cases in which the principal [debtor as to which the guaranty is given] retains its identity after undergoing a change in composition or structure," 619 N.W.2d at 787; that the continuing liability of a non-terminating guarantor in the wake of his principal's merger with another corporate entity presented an issue of fact; and that it could nonetheless be held on appropriate facts that the merger effected a termination of the guaranty despite the guarantor's failure to terminate on his own motion. *Loving & Assocs.* is distinguishable on the very fundament of its rationale. As this record showed, Old Dominion retained its original structure and ownership throughout. Thus, the facts here do not merit deeming a guarantor freed of his undertaking due to an imposition of substantially different risk attendant to a corporate merger involving his principal.

[4]This is so whether the Defendant actually transferred his equity interest in Old Dominion to Heise or not. Until released by the beneficiary or terminated by the guarantor pursuant to contract, a corporate principal's personal guaranty of the corporation's obligation remains enforceable despite the termination or alteration of that person's formal legal affiliation with the corporation. *Borg Warner Acc. Corp. v. Shakopee Sports Center, Inc.*, 431 N.W.2d at 541.

transferred his shares of stock to her, on Old Dominion's corporate books or otherwise. The Defendant's testimony on the relevant facts was vague and evasive; it really was no more than an insistence that, as far as he knew, he had "abided by the terms of" the SPA.

The Defendant acknowledged that his personal income tax returns for years 2001 - 2003 contained no recitations regarding a sale of stock in a business corporation. He admitted that he had remained as an officer of Old Dominion (vice president) after the date of the SPA. On the matter of consideration for the stock sale, he was able to attest only to Heise having paid him "a chunk here, a chunk there" via checks that she would issue to him from the escrow account she maintained under the name of Integrity Title Services, whenever he had a need for money and asked her for some.[5]

After a brief "leave of absence" that followed the execution of the SPA, the Defendant continued to actively work in Old Dominion's operations, managing its "production department," having contact with clients, "maintaining business," and attending some real estate closings. To all external appearances, and in particular as the Defendant and Heise held out Old Dominion to the Plaintiff, the Defendant remained a principal and the sole owner of Old Dominion. Accordingly, and not unreasonably, Robert Ibler, ("Ibler") a vice president of the Plaintiff and manager of its Upper Midwest Area, concluded that the stock ownership sale that the Defendant had told him about in September, 2001 had not gone forward. For the next two years, Ibler believed that the Defendant remained as Old Dominion's owner, and that Old Dominion had taken Heise on as a new employee who would be able to remedy the defects in Old Dominion's performance that Ibler had drawn to the Defendant's attention shortly after August 31, 2001.

In contacts with Ibler over that two-year period, the Defendant never purported to

[5]It was not clear from testimony whether the half-dozen checks written to the Defendant on Old Dominion and Profile checking accounts, totaling $52,700.00, received into evidence as Plaintiff's Exhibit 27, were intended to be applied to this purpose as well.

confirm that he had sold his stock in Old Dominion, and Heise never referred to herself as the owner of Old Dominion. (At most, Heise notified Ibler that she was "changing the name of" Old Dominion to Profile. Ibler understood this as signifying only a change of business name for an ongoing single concern.) As a result, Ibler never demanded that Old Dominion or any successor entity or person enter a new IAC with an attendant personal guaranty. The Plaintiff's standards of operation unconditionally required such a measure under such circumstances, to ensure maximum accountability for any agent that would bind the Plaintiff to insure real estate title.

Thus, from September, 2001 until the Plaintiff terminated the agency under the Old Dominion IAC effective December 12, 2003, the Defendant was the sole shareholder and a vice president of Old Dominion, and he remained actively involved in the "production department" of its operations. There was no change in the structure of risk he assumed when he executed the guaranty, so he remained liable under it during the full accrual of the shortfall indemnified by the Plaintiff.

2. Is the Defendant's Debt to the Plaintiff Excepted from Discharge in Bankruptcy?

The Plaintiff seeks to have the Defendant's debt to it excepted from the discharge granted in the underlying bankruptcy case, under three different statutory theories.

A. 11 U.S.C. § 523(a)(2)(A): False Pretenses, False Representation, or Actual Fraud.

11 U.S.C. § 523(a)(2)(A) creates an exception from discharge for debts that were incurred through the debtor's use of "false pretenses, a false representation, or actual fraud." In this circuit, the creditor making complaint under § 523(a)(2)(A) must prove five elements:

1. The debtor made a false representation of fact;
2. The debtor knew the representation to be false at the time the debtor made it;
3. The debtor made the representation with the intent and purpose of deceiving the creditor;

4. The creditor justifiably relied on the debtor's representation; and

5. The creditor sustained the alleged injury as the proximate result of the making of the representation.

These elements are binding precedent in this circuit under three different decisions. Two were issued by the Eighth Circuit Court of Appeals in 1987, *In re Van Horne*, 823 F.2d 1285, 1287 and *In re Ophaug*, 827 F.2d 340, 343. The third, going to the nature of the creditor's reliance, is *Field v. Mans*, 516 U.S. 59, 74-75 (1995). This alignment of elements has been recognized and applied by the lower courts in the Eighth Circuit many times. *E.g.*, *In re Church*, 328 B.R. 544 (B.A.P. 8th Cir. 2005); *In re Austin*, 317 B.R. 525 (B.A.P. 8th Cir. 2004); *In re Grause*, 245 B.R. 95 (B.A.P. 8th Cir. 2000); *In re Guske*, 243 B.R. 359 (B.A.P. 8th Cir. 2000); and *In re Stearns*, 241 B.R. 611 (Bankr. D. Minn. 1999).

The Plaintiff's main theory under § 523(a)(2)(A) goes back to the inception of the parties' relationship. At the time of its formation in 1997, Old Dominion had become the agent of Old Republic National Title Insurance Company, another issuer of title insurance. Over the ensuing one and one-half years, Old Dominion accumulated a shortfall of over $50,000.00 in premiums collected from its own clients but payable to Old Republic for policies committed by Old Dominion. Ultimately, per the Defendant, Old Republic "came back on" Old Dominion, demanded payment of the shortfall, and terminated Old Dominion's agency. Apparently Old Dominion (or, perhaps, the Defendant personally) made good to Old Republic on these monies eventually.

After Old Dominion's termination by Old Republic, it seems, the Defendant approached the Plaintiff to request agency status from it. He dealt with Ibler on this matter. There is no evidence that Ibler ever asked the Defendant whether he or Old Dominion had ever had an agency relationship terminated by another title insurance company.[6] However, in any event the Defendant never disclosed Old Dominion's difficulties with the Old Republic shortfall to the Plaintiff,

[6] Ibler did not testify to having made such an inquiry.

by any means.[7] Through its employees, the Plaintiff would have put great importance on knowing about an agent's "funding issue" like the Old Republic matter; such history bore directly on a prospective agent's suitability to handle funds for which the Plaintiff as insurer might ultimately be called to account. In reliance on the pretense that was supported by the Defendant's non-disclosure, as well as the Defendant's personal guaranty, the Plaintiff granted Old Dominion agency status and Old Dominion then began to issue title insurance policies. The ensuing liabilities to Old Dominion/Profile clients on some of those policies were the claims to which the Plaintiff became subrogated; the Plaintiff's judgment in the Hennepin County District Court was premised on those claims.

To be sure, the Defendant did not make an affirmative statement of fact to the Plaintiff about the Old Republic matter, such as declaring that he had never had any funding difficulties with a title insurer or denying that he had had such with Old Republic in particular. Nonetheless, silence on a point of fact material to a prospective creditor's evaluation can satisfy the requirement of § 523(a)(2)(A), that the debtor had done *something* to induce the creditor's action, at least if the debtor is aware of the materiality of the subject matter. *In re Lauer*, 371 F.3d 406, 413 (8th Cir. 2004) (debtor commits "garden variety common law fraud" when it induces creditor to part with money or property by knowing concealment of past facts material to subject of their transaction).[8]

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[7]Ibler testified unequivocally to that effect. The Defendant stated that he did not recall whether he had disclosed to Ibler the reasons for the Old Republic termination. Of the two, Ibler's testimony is by far the more credible--not the least because such a point would have been a "red flag" for the Plaintiff in addressing any application for agent status on title insurance. Had the flag gone up, Old Dominion's application might well have gone no further.

[8]As a matter of logic, it does so by giving rise to the "false pretense" that the statute explicitly recognizes as triggering the exception to discharge. *In re Anderson*, 181 B.R. 943, 950-951 (Bankr. D. Minn. 1995) (debtor's "engaging in silence when there is a duty to speak," creating "false and misleading set of circumstances, or false and misleading understanding of a transaction," can constitute "false pretense" cognizable under § 523(a)(2)(A)).

When he made the application to the Plaintiff in 1999, the Defendant had been employed in the real estate closing and title insurance business for nearly thirty years, "pretty much [his] whole adult life." He considered himself "pretty much" an expert in the issuance of the product and the management of clients' affairs and an agency's business in connection with that. As such, he was amply aware that his very recent history with Old Republic would be material to the Plaintiff.[9] On such notice, he had an obligation to disclose; and from his failure to make the disclosure, given the patent materiality of the subject matter to be disclosed, his intent to induce the Plaintiff to rely on the resultant pretense is readily inferred.[10] The Plaintiff, through Ibler (and possibly other persons), relied in fact on the pretense. Under the circumstances, its reliance was justifiable.[11] The ensuing change of position--newly authorizing Old Dominion to commit the Plaintiff as insurer to future clients--led directly to the losses that the Plaintiff eventually suffered, as adjudicated to the Hennepin County District Court, for which the Defendant is liable personally as guarantor.

Where a debtor's personal liability on account of a debt arose under a guaranty of a third party's "direct" liability to the creditor, the debtor's debt can be found nondischargeable in the guarantor-debtor's bankruptcy case only if the debtor had a role in the creation of the debt that itself was characterized by acts and intent that would satisfy the elements of one of the nondischargeability provisions of § 523(a). *In re Ellison*, 296 F.3d 266, 271-272 (4th Cir. 2002); *In*

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[9] The record is not crystal-clear on the point, but it appears that the Defendant approached the Plaintiff with the intention to have it succeed Old Republic as the sole insurance issuer for Old Dominion--the relationship with an insurer being an utter necessity for Old Dominion to carry on its business.

[10] And, it is the mere intent to induce a creditor to change position, coupled with a knowledge of falsity, that makes out the intent to deceive that is the third element of the Eighth Circuit's test under § 523(a)(2)(A). *In re Gibson*, 149 B.R. 562, 572 (Bankr. D. Minn. 1993).

[11] The Defendant did not raise an issue of the propriety of the Plaintiff's reliance, under the justifiability standard of *Field v. Mans*, so he really cannot complain of any fact-finding on the issue. Under all of the circumstances, the facial character of the Defendant's pretense (a clean record in dealing with client monies) was not such as to prompt Ibler to further investigate on the point; so Ibler not unjustifiably relied on it. *See Field v. Mans*, 516 U.S. at 74-77.

re Mickens, 312 B.R. 666, 681 (Bankr. N.D. Cal. 2004); *In re Tinkler*, 311 B.R. 869, 875 (Bankr. D. Colo. 2004). Under the analysis just recited, that is the case here. *Cf. In re Miller*, 276 F.3d 424, 428-429 (8th Cir. 2002) (for purposes of dischargeability, declining to impute fraud of securities salesperson to debtor, the president and CEO of securities brokerage with which salesperson was affiliated, where debtor did not make representations regarding investments to plaintiffs, even though securities law made debtor, as supervisor, jointly and severally liable with salesperson). The whole of Old Dominion's debt to the Plaintiff is traceable in causation back to the Defendant's act of false pretense. As a result, the Defendant's liability to the Plaintiff as guarantor on the whole of that debt is excepted from discharge in bankruptcy under § 523(a)(2)(A).[12]

B. 11 U.S.C. § 523(a)(4): Defalcation by Fiduciary, Larceny.

Under 11 U.S.C. § 523(a)(4), a debt is excepted from discharge if it arose from "fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny."

For the application of the first option of § 523(a)(4), the existence of a fiduciary relationship is determined by federal law. *In re Cochrane*, 124 F.3d 978, 984 (8th Cir. 1997). The fiduciary relationship must have involved an "express trust," *In re Long*, 774 F.2d 875, 878 (8th Cir. 1985), or a "technical trust," *In re Cochrane*, 124 F.3d at 984, under which the debtor was the trustee or other designated fiduciary, *id*., and which was created "before and without reference to

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[12]This outcome means that the Plaintiff prevails on its § 523(a)(2)(A) count on this identified sequence of events. However, the Plaintiff's proffered alternative under the same statute fails. This one was based on the fact that Ibler had put the Defendant on notice in late August, 2001 that the Plaintiff would terminate Old Dominion's agent status as a result of Ibler's discovery that the policies that Old Dominion had committed to clients on the Plaintiff's count "were not being reported and not paid for." In response, the Defendant told Ibler that he was "in the process of selling the business," that the prospective purchaser was "someone with good business skills" who "would handle the escrow funds properly," and that the Plaintiff "should give her a chance." Apparently the subject of these representations was Heise. The first statement was not necessarily untrue, at the time, and the Plaintiff did not prove that it was false. To the extent that the second and third could even be considered as going to solid and specific facts, the Plaintiff did not prove their contemporaneous falsity, not to mention the Defendant's knowledge of that. (The incidence of Heise's later embezzlements and expropriations is no evidence of any earlier lack of experience, skill, or even honesty on her part.) These two statements more fall between puffing and promise. The fourth statement is only an exhortation. None of these meet the threshold element of § 523(a)(2)(A).

the wrongdoing that caused the debt." *In re Cochrane*, 124 F.3d at 984 (internal quotes and citation omitted). *See also In re Dloogoff*, 600 F.2d 166, 168 (8th Cir. 1979) (decided under Bankruptcy Act of 1898); *In re Yanke*, 225 B.R. 428, 434 (Bankr. D. Minn. 1998), *aff'd*, 230 B.R. 374 (B.A.P. 8th Cir. 1999); *In re Crea*, 31 B.R. 239, 244 and n. 5 (Bankr. D. Minn. 1983). An express trust is created by a direct, positive, and objectively-manifested act under contract, or under an instrument such as a deed or will. *In re Koelfgen*, 87 B.R. 993, 996 (Bankr. D. Minn. 1988). A technical trust is one imposed by statute. *In re Bologna*, 206 B.R. 628, 632 (Bankr. D. Mass. 1997). Constructive trusts--those imposed only by a court, and after the fact--are not cognizable under § 523(a)(4). *In re Long*, 774 F.2d at 878-879; *In re Crea*, 31 B.R. at 244. Neither are relationships that amount to no more than ones of debtor and creditor, created under contract. *Werner v. Hofmann*, 5 F.3d 1170, 1172 (8th Cir. 1993); *In re Shahrokhi*, 266 B.R. 702, 707-708 (B.A.P. 8th Cir. 2001); *In re Koelfgen*, 87 B.R. at 997.

Here, the Plaintiff relies on the IAC and Minnesota statute as the source of a trust relationship to satisfy the threshold requirement of § 523(a)(4). First, it cites paragraph 4.I of the IAC, which provides in pertinent part:

> In those instances where Agent closes real estate transactions and receives and disburses funds of others, Agent shall:
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> a. maintain said funds safely in accounts fully insured by an agency of the Federal Government and in accordance with applicable state laws;
>
> b. maintain separate from Agent's personal or operating accounts all funds received by Agent from any source in connection with transaction(s) in which Principal's title insurance is involved;
>
> c. disburse such funds only for the purposes for which they were entrusted . . .

Then, it points to Minn. Stat. § 82.17, the definitional provision for Chapter 82 which governs "Real

Estate Brokers and Salespersons." Minn. Stat. § 82.17, Subd. 7, the only part that the Plaintiff cites, defines "[t]rust funds" in pertinent part as

> . . . funds received by a . . . closing agent in a fiduciary capacity as part of a real estate or business opportunity transaction, pending the consummation or termination of a transaction, and includes all down payments, earnest money deposits, rents for clients, tax and insurance escrow payments, damage deposits, and any funds received on behalf of any person.

In turn, Subd. 10 of the same statute defines "[c]losing agent" and "real estate closing agent" in pertinent part as

> . . . any person whether or not acting as an agent for a title company, . . . who for another . . . directly or indirectly provides closing services incident to the sale, trade, lease, or loan of residential real estate, including drawing or assisting in drawing papers incident to the sale, trade, lease, or loan, or advertises or claims to be engaged in these activities.

Finally, Chapter 82 appears to have only one substantive provision that relates specifically to the matter at bar, i.e., that goes to the duties of a real estate closing agent in relation to trust funds. In pertinent part, Minn. Stat. § 82.24, Subd. 4 reads:

> **Commingling funds**. A . . . closing agent shall deposit only trust funds in a trust account and shall not commingle personal funds or other funds in a trust account . . .

To the extent that these sources in public and private law can be read as establishing a trust relationship cognizable under § 523(a)(4), they would do so only if the party that is in bankruptcy, i.e., the debtor-petitioner, had the legal status of "real estate closing agent" as defined there. The protections of the trust relationship would run to the beneficiary of the disbursement of the "trust funds," i.e., the client on the closing. A party that became legally subrogated to such a beneficiary would succeed to the beneficiary's right to complain of defalcation in the administration of the trust funds. However, its complaint would only run against the person or entity that actually had had the duty to the party to whose rights the plaintiff had become subrogated.

Here, the only participant that bore that duty, and that could be tagged with fiduciary status under the cited provisions, is Old Dominion. Old Dominion was a corporation with a separate legal personality, distinct from the Debtor's. The Plaintiff produced no evidence that the Debtor ever contractually undertook, in his individual capacity, a status as closing agent in connection with any of the closings handled through Old Dominion. The agency relationship for the issuance of title insurance in connection with those closings ran contractually between the Plaintiff and Old Dominion, again as a corporate entity. Though the Defendant signed the IAC, he did so in the express status of Old Dominion's president. Old Dominion is the only person or entity named as "Agent" in the opening paragraph of the IAC.

Clearly, it was the Plaintiff's full contemplation that Old Dominion, the corporation, was the only one to be vested with agency status under the IAC. Hence, it was the only participant that would be legally deemed to handle trust funds during the closings for which the Plaintiff was issuing title insurance. Neither the IAC nor the guaranty have any provision vesting the Defendant, in his individual right, with a trustee's or fiduciary's duty over funds that Old Dominion would receive in connection with any closing for which the Plaintiff would stand as insurer of title.

This leaves us, then, with a situation where the Defendant is individually liable on account of a debt that could be fairly attributed to Old Dominion's defalcation of its fiduciary duties. But the Defendant's liability is only contractual, as guarantor. As such, his liability arose and ripened only after Old Dominion failed to make good to the Plaintiff on any debt to which Old Dominion became subrogated. *Midland Nat'l Bank of Minneapolis v. Sec. Elevator Co*., 161 Minn. 30, 33, 200 N.W. 851, 853 (1924).

This matter is directly analogous to the one that the Eighth Circuit analyzed under

§ 523(a)(4) in *Hunter v. Philpott*, 373 F.3d 873 (8th Cir. 2004). There, the individual debtor's obligation to certain union pension and benefit funds arose under the Employee Retirement Income Security Act of 1974 ("ERISA") in consequence of the failure of his business corporation to make contractually-required contributions to those plans. But, as an individual, even though he was a corporate principal, the debtor in *Hunter v. Philpott* "was . . . not legally obligated to hold any particular property for the benefit of the Funds." 373 F.3d at 876. His personal liability to the funds arose by operation of statute alone, under a "responsible person" provision of ERISA. He did not ever "expressly assume[ ] the status of trustee of any trust arising from" the corporation's collective bargaining agreement with the unions. 373 F.3d at 876. His obligation on account of the company's failure arose *after* the creation of any trust relationship in favor of the funds that was cognizable under ERISA. 373 F. 3d at 877. With "[t]he only possible trust relationship [between the debtor and the funds having] sprung *from* the . . . act that created the financial liability," i.e., the failure to make payment into the funds, any trustee status to be imputed to the debtor there would be under a constructive trust, adjudicated only after the fact. 373 F.3d at 877 (emphasis added). Under longstanding Supreme Court authority, this could not trigger nondischargeability under § 523(a)(4). 373 F.3d at 877 (citing *Davis v. Aetna Acceptance Co.*, 293 U.S. 328, 333 (1934)).

Under this Eighth Circuit precedent, with close to all-fours status, the Plaintiff's theory under the first alternative of § 523(a)(4) fails. The Defendant's debt to the Plaintiff is not excepted from discharge as one for "fraud or defalcation while acting in a fiduciary capacity."[13]

However, a component of the full debt is excepted from discharge through an

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[13]The only legal authority the Plaintiff cited for this theory was *In re Manzo*, 106 B.R. 69 (Bankr. E.D. Pa. 1989). The *Manzo* court imputed fiduciary status to the individual principal of an issuing agency, as to client funds received in connection with title-insured real estate transactions. In Pennsylvania, a statute expressly imposed "fiduciary capacity for all funds received or collected," on any licensed insurance agent or broker, and the debtor there had such a license. This aspect of the legal backdrop--lacking here, at least insofar as the argument and record reflect--is enough to distinguish *Manzo*. But beyond that, this court is bound by the Eighth Circuit's analysis, which is much more refined than the *Manzo* court's, and in any event is virtually on-point precedent.

alternate theory under § 523(a)(4), "larceny." This is because the conduit of liability on that component is personal to the Defendant rather than through the guaranty.

During the time that Heise and the Defendant worked together to run Old Dominion, Heise channeled at least some of the transactions of Old Dominion clients through checking accounts that she maintained under the name of Integrity Title Services.[14] At least one of these accounts was used as a trust account for the receipt of client funds in real estate closings and for disbursement in payment of mortgage-secured debt, taxes, and closing costs.

Heise assumed primary responsibility for the management of money going through Old Dominion's operations. While they were jointly operating the business, the Defendant went to Heise from time to time and asked her for money additional to his salary from Old Dominion. The Defendant's testimony on the nature of the resulting disbursements was vague, i.e., as to whether they were to be considered personal loans to him, some form of channeled payment on the SPA, or some other form of "draw" on the business's revenues. In any event, when asked, Heise "never refused [the Defendant] a check" per his own admission. Over their joint participation in the business, the total of the funds he received in this way was $99,497.60. All of these checks were drawn on client escrow accounts maintained under the names of Old Dominion or Integrity Title Services.[15] The Defendant knew that at the time he received them.

For the purposes of § 523(a)(4), larceny is defined as a fraudulent misappropriation

[14]There is a grotesque irony in Heise's choice of assumed business name. In the Hennepin County District Court lawsuit, Judge Rosenbaum found that Heise converted hundreds of thousands of dollars of client funds to the benefit of herself, her associates, and members of her immediate family, through the use of the Integrity Title Services accounts. Among the uses to which the funds were put were the purchase of a Hummer and other vehicles for given individuals and the payment of housing costs and other personal expenses.

[15]This figure is the total of the checks received into evidence as Plaintiff's Exhibits 27, 28, and 29. In argument and brief the Plaintiff's counsel referred to a figure several thousand dollars larger. It is not clear where the discrepancy lies; but, as will be seen, it is only academic in light of the outcome on the § 523(a)(2)(A) count.

of property, in which "the felonious intent must have existed at the time of the taking," *In re Routson*, 160 B.R. 595, 610 (Bankr. D. Minn. 1993), making the act of taking itself illegal, "criminal fraud[,] . . . theft," *In re King*, 68 B.R. 569, 573 (Bankr. D. Minn. 1986).

The Defendant's knowing receipt of the money of Old Dominion clients, directly off escrow accounts, readily fits this definition. The Defendant never did contest the wrongfulness of his appropriation of these funds; and, given his career-long engagement in the industry, he could not well have done so. This component to his aggregate debt to the Plaintiff[16] is separately excepted from discharge under the third alternative of § 523(a)(4).

C. 11 U.S.C. § 523(a)(6): Willful and Malicious Injury.

The Plaintiff also pleaded 11 U.S.C. § 523(a)(6). This statute excepts from discharge any debt "for willful and malicious injury by the debtor to another entity or to the property of another entity." This can include a willful and malicious conversion of the property or property interest of a creditor. *In re Long*, 774 F.2d at 879-882 (8th Cir. 1985).

The Plaintiff's original briefing on this theory was quite broad-brushed, but counsel clearly was driving at the notion of conversion. The wording used in closing argument--"basically theft," "he simply stole the money"--was more redolent of "larceny" as contemplated by § 523(a)(4). However, the Defendant's actions in taking and negotiating the checks from Heise also fit the bill for a conversion--that is, an interference with property rights, to the use of the Defendant, *In re Long,* 774 F.2d at 879--and the conversion here was accompanied by both of the requisite states of mind, willfulness and malice. The Defendant knew both that he was invading the legal interests of those with proper claims to the funds, and that his receipt and use of the funds would deprive the proper owners of the value of them. His intent to bring about both of those consequences--legal and

[16]The amount of the wrongful disbursements made directly to the Defendant was subsumed in the total debt of Old Dominion to the Plaintiff that was reduced to judgment in the Hennepin County District Court.

financial--is readily inferred from the circumstances. *See*, as to nature of “willfulness” and “malice,” *In re Stage*, 321 B.R. 486, 492-493 (B.A.P. 8th Cir. 2005); *In re Dziuk*, 218 B.R. 485, 487 and nn. 3-4 (Bankr. D. Minn. 1998) (to merit nondischargeability under § 523(a)(6), “the debtor must have intended both the injury and the harm,” as those concepts are defined in the Restatement (Second) of Torts).

The Plaintiff’s counsel did not frame any other basis for nondischargeability under § 523(a)(6), and this one essentially duplicates the analysis under § 523(a)(4). Nonetheless, there is a separate legal basis for excepting the debt attributable to the Defendant’s receipt of monies derived from Old Dominion trust funds under § 523(a)(6).

ORDER FOR JUDGMENT

On the discussion just memorialized,

IT IS HEREBY ORDERED, ADJUDGED, AND DECREED:

1. The Plaintiff shall recover from the Defendant the sum of $2,286,422.21, together with such interest and costs as it may hereafter tax.

2. The debt evidenced by Term 1 was excepted from the discharge granted to the Defendant in BKY 04-32102, by operation of 11 U.S.C. § 523(a)(2)(A).

3. Of the debt evidenced by Term 1, the sum of $99,497.60 was also excepted from discharge in BKY 04-32102, by operation of 11 U.S.C. §§ 523(a)(4) and 523(a)(6).

LET JUDGMENT BE ENTERED ACCORDINGLY.

BY THE COURT:

/E/ Gregory F. Kishel

GREGORY F. KISHEL
CHIEF UNITED STATES BANKRUPTCY JUDGE