UNITED STATES BANKRUPTCY COURT
DISTRICT OF MINNESOTA

In re:

JOHN EDWARD BLUMENTRITT, BKY 00-40723

Debtor.

MICHAEL E. BURTON, ON BEHALF OF HIMSELF AND NEW CITIES BUILDING AND DEVELOPMENT, INC., a Minnesota Corporation,

Plaintiff, ADV 00-4122

-v.-

JOHN E. BLUMENTRITT,

Defendant.

FINDINGS OF FACT, CONCLUSIONS OF LAW AND ORDER FOR JUDGMENT

At Minneapolis, Minnesota, February 6, 2001.

The above-entitled matter came on for trial before the undersigned on November 16 and 17, 2000; December 5 and 6, 2000; January 8, 10, 11, and 18, 2001. Plaintiff Michael Burton ("Burton") was represented by Phillip Gainsley; Defendant John E. Blumentritt ("Debtor") was represented by Richard I. Diamond. The court, having heard all of the evidence and the arguments of counsel, makes the following:

FINDINGS OF FACT

1. Burton has been in the home-building business all of his adult life, starting in the 1970s as a general laborer, then as a framing carpenter, and ultimately as a finishing carpenter. Until he became self-employed, all of his employers were engaged

in the contracting business. He worked in his father's contracting business in the early years and then moved to several companies within the Twin Cities area. In early 1995, he launched his own corporation, Michael Burton Homes, Inc. ("Michael Burton Homes").

2. Debtor is a designer of homes who has also been in the home-building business, serving local Twin Cities clients, for many years. Debtor's expertise includes finding land, designing homes, and marketing projects.

3. In 1996, Debtor and Burton combined their talents to build three dwellings designed by Debtor and construction-supervised by Burton. All three houses (referred to at times as the Palm, Buran, and O'Donnell homes) were successful, and all three owners were satisfied. These projects were done under the name of Michael Burton Homes. Burton and Debtor had an oral handshake agreement to split the profits on these homes. The projects were run well (with the normal construction glitches) and each made a tidy profit which Debtor and Burton split.

4. The two parties then decided to launch a home-building business together. They formed New Cities Building and Development, Inc. ("New Cities"), a Minnesota corporation. Each was a Director. Burton and Debtor were and remain owners of an equal number of shares of the New Cities' issued and outstanding capital stock. Burton was chief operating officer and chief

financial officer-treasurer; Debtor was chief executive officer-president and secretary. Burton was to handle construction responsibilities, while Debtor was charged with marketing and design. The parties agreed that their recompense for work would be to share the profits on each of their projects equally, though each at times took nominal equal draws against their final distribution as work progressed on some of their projects. They also entered into a share purchase agreement and adopted corporate bylaws. The bylaws governed the corporation's designation of its officers. New Cities' stated purpose was the development and construction of urban residential dwellings. Their marketing focus was expected to be the "infill" of urban lots: industry jargon for the tear down of old homes followed by construction of upscale, expensive new homes.

5. To build single family homes, one must be a licensed builder, licensed through the State of Minnesota Department of Commerce. Burton had such a license which had originally been obtained in 1995. This builders license was a requisite to obtaining a City of Minneapolis license to build within city limits. On November 19, 1996, Burton applied for and received a City of Minneapolis building contractor class A license in his name for New Cities, License No. 5740. In his application, he listed himself and Debtor as corporate members. Because of licensing regulations and state statute, Burton is responsible on

the warranties for New Cities projects for the ten year period after completion.

6. In 1996, New Cities began construction of a home in Minnetonka ("the Creek Ridge house"). This home was nearly completed by the summer of 1997, at which time a buyer was still yet to be found.

7. Sometime in January 1997, New Cities undertook to construct a home at 2806 Chowen Avenue South in Minneapolis ("the Chowen house"). Unlike their initial three projects, the Chowen house was to be built on "spec" with the hopes that they would find a buyer during or following construction. New Cities was also in the middle of building the Creek Ridge house. Because both houses were being built on "spec," New Cities had to obtain construction finance loans, which both Burton and Debtor guaranteed, in a sum exceeding $700,000. Both projects were upscale, expensive homes designed to be marketed to wealthy individuals.

8. New Cities was, like most small businesses, undercapitalized. Both Debtor and Burton expected to make a living off their business. But their doing so required a constant infusion of new deposits from new clients on new projects or prompt closings on finished homes. Because Debtor could not generate enough new sales, the Creek Ridge house had been built without a preobtained buyer and remained unsold, and

the Chowen house, also a "spec" project, was in the early stages of construction, New Cities was in financial trouble by the summer of 1997. With no money coming in from either previous or current projects, both Debtor and Burton wanted to get out of this business venture and into another. By late August 1997, things were so bad that they had consulted the corporate attorney regarding possible dissolution.

9. On September 5, 1995, Debtor told Burton that he [Debtor] needed to pursue other money-making opportunities. Debtor was being pressured at home by his spouse to bring in more money. Burton protested that New Cities needed Debtor's full time efforts. In response, Debtor acknowledged: "You gotta do what you gotta do." The fair import of their conversation was that Debtor told Burton that he [Burton] could begin looking for other work. In the last week of August, in fact, Burton had made a down payment on a piece of property that he was thinking of attempting to build in the name of Michael Burton Homes, applied for insurance, and re-applied for his state license for Michael Burton Homes.

10. Meanwhile, the Chowen house was listed in the Parade of Homes, a local real estate marketing event in the home-building industry. The Parade of Homes is a widely-anticipated annual event sponsored by the Builders Association of the Twin Cities ("Builders Association"), membership in which is required for a

builder to list a house on the parade route. Burton filled in for Debtor, who had dropped the ball, and arranged to have a brochure box placed at the front of the property and filled with brochures advertising the Chowen house for sale. In a September 5, 1997, telephone conversation with Debtor, Burton requested that he be allowed to place an advertisement for Michael Burton Homes in the brochure box on the Chowen house premises to attract new business for himself when the parties went their separate ways. Debtor told Burton that Burton could do what he needed to do, acknowledging that both parties needed to survive.

11. There followed a series of bitter actions by the parties, referred to at trial as the "brochure wars." Burton, believing he had permission to do so, put a flier regarding Michael Burton Homes in the brochure box along with the materials advertising the Chowen house as a New Cities project designed by Debtor. Debtor got very angry and took Burton's flier out of the brochure box. This occurred several times over a period of a few days during which Burton would put his advertising materials in the box, Debtor would take them out, and the whole thing would start over again. Debtor, in a fit of rage, also tore Michael Burton Homes' name off the signage on the Chowen house. The import of all this was that Burton took the steps he thought he had been permitted to take and Debtor grew angry (really angry, as evidenced in a series of letter exchanges between Debtor and

Burton from September through November of 1997), believing Burton had left him holding the bag and that Burton was undermining New Cities' efforts to market its unsold properties.

12. On September 8, 1997, Debtor sent a letter to Burton in which he locked Burton out of further work with New Cities. Thereafter, Debtor changed the locks, effectively barring Burton from the Chowen house site and from all further work for New Cities. Debtor also opened a new checking account into which he deposited funds coming in to New Cities (the official former account being in Burton's hands but essentially without funds). While he never took formal steps necessary to dissolve the corporation, and extinguish or buy out Burton's shares, or to remove him as an officer and director, Debtor did take over completing, eventually selling the Chowen house, and, because it never did sell, arranging for a foreclosure sale to take place on the Creek Ridge house. In addition, for about nine months thereafter, Debtor continued to operate as New Cities. He tried to build one home (the Hillsman project), directed another business opportunity to a different builder (the Jones home), and did some design work for another. During this nine month period, while he locked Burton out, Debtor paid himself and his spouse, Jeanne Blumentritt, $49,782.72 (approximately $2,000 of which was paid to his spouse); attorneys' fees and expenses of $23,349.02 to several law firms he used to represent himself personally in

his dispute with Burton; and office expenses of $6,627.61. Debtor knew that paying himself and his spouse a salary and paying his personal attorneys' fees was contrary to the respective rights of the parties as 50/50 shareholders to the profits on New Cities projects. Never before had the parties engaged in such practices. Rather they had taken only occasional or minimal equal draws until the homes New Cities built closed, understood to be an offset in settling up at the closing.

13. Debtor also began a letter campaign designed to bring the festering dispute between himself and Burton to the attention of others. First, on September 17, 1997, Debtor wrote to Burton and accused him of, *inter alia*, breaching his fiduciary duty to the corporation, theft, fraud, perjury, and wrongfully competing with New Cities. Debtor later sent a copy of the letter to an attorney at the Minnesota Department of Commerce and a representative at the Builders Association.

14. Next, on October 27, 2997, Debtor prepared and mailed a letter to all of New Cities' suppliers and subcontractors, stating:

a. Burton's relationship with New Cities was "severed";

b. Burton was directed by New Cities to cease all construction supervision of the Chowen house;

c. New Cities had experienced a financial hardship since Burton was "fraudulently taking funds from the New Cities' checking account and allocating these funds to his new company"; and

d. The suppliers and subcontractors should continue to look to Burton for payment for "commitments made prior to August 26, 1997."

This letter was received by the thirty-five or so intended recipients, many of whom testified at trial that they believed its contents to be true, raising concern about their doing business again with Burton in the future. Copies of this letter were also sent to the two banks that had financed the Chowen and Creek Ridge houses, as well as to an attorney with whom Debtor had consulted regarding the dispute with Burton.

The statements about fraud were not true. Burton had taken no money from New Cities and had done nothing against its interests. Debtor knew these statements were not true when he prepared and mailed the letter and he testified at trial that he intended to send the letters, intended the recipients to believe Burton was disreputable and not to be trusted, and intended to cause harm to Burton by their ceasing to continue to do business with him.

15. Also on October 27, 1997, Debtor prepared and mailed a letter to the Builders Association. In that letter, Debtor:

a. Confirmed an earlier telephone conversation with the association;

b. Stated that "a series of unethical findings, breach of corporate fiduciary responsibilities and subsequent fraudulent wrong doings" pertained to Burton; and

c. Urged the Builders Association not to reinstate the membership Burton sought for Michael Burton Homes.

Copies of this letter were sent to and received by the licensing division of the Minnesota Department of Commerce and the Residential Warranty Corporation with whom Burton had a membership. A copy was also sent to Debtor's counsel. As a direct consequence of this letter, the Builders Association suspended processing Burton's application for membership until he cleared up his difficulties with Debtor. In fact, Michael Burton Homes still has not been reinstated as a member of the Builders Association. The content of this letter was not true; Burton was not guilty of any "fraudulent wrongdoings"; and Debtor knew the content was untrue.

16. Debtor testified that he provided his counsel with all relevant facts about his dispute with Burton and that both of these letters were carefully reviewed and authorized by counsel. I did not believe him as I did not believe much of what he said.

17. Both of Debtor's letters caused Burton personal humiliation, mental anguish, and suffering. The letters were sent intentionally, were intended to cause harm, and were targeted at Burton. Debtor knew at the time that Burton could not do business as a contractor if he lost his state license. Debtor also knew that without his membership in the Builders Association, Burton would not be allowed to show a home in the

Parade of Homes and therefore would not be able to effectively market any homes he did build. Debtor testified at trial that by circulating these letters to outsiders, he intended to cause Burton commercial harm. They had Debtor's desired effect. They harmed Burton's reputation and lowered him in the estimation of the local home-building industry. Burton's application to become a member of the Builders Association for Michael Burton Homes was denied.

18. In one of several steps he took to mitigate his damages, in a letter dated November 13, 1997, Burton insisted that Debtor retract the statements contained in both letters. Debtor refused and to this day, has never retracted any portion of the letters. In the aftermath of Debtor's letter-writing campaign, Burton also talked to a representative at the Builders Association to explain his dispute with Debtor and to try to quell the false allegations set forth in the letters. In addition, Burton unsuccessfully sought employment with several larger home-building companies in and around the Twin Cities area. While he certainly did not exhaust all possible employment opportunities in the home-building industry, Burton made a good faith effort to find a job in which he could use his construction and contractor skills. Moreover, he had been humiliated publicly and personally by the letters Debtor sent and could not have been

expected to immediately bounce back and act as if nothing had happened.

19. Meanwhile, on November 13, 1997, Debtor was able to obtain a Purchase Agreement from a couple who agreed to buy the Chowen house. This was the first of many devious actions taken by Debtor. Debtor, without the buyers' knowledge, falsified portions of the purchase price paragraph in the Purchase Agreement to disguise the fact that the buyers were paying New Cities $87,800 against the purchase price of $439,000, plus paying for subsequent change orders. Only through third-party discovery in a state court action brought by Burton against Debtor did Burton learn that the buyers were to pay New Cities $87,800 upon acceptance of their mortgage application, and the balance upon the New Cities' draw requests. Debtor did this so he would receive and be able to pocket a profit on change orders.

20. In January 1998, Burton sued Debtor and New Cities, seeking dissolution of the corporation. This litigation dragged on for several years, most of such delay having been caused by Debtor who repeatedly changed counsel and was wholly uncooperative and devious during discovery, and still had not been tried when Debtor filed for bankruptcy relief on February 11, 2000.

21. Debtor, knowing Burton still claimed an interest in New Cities, then engaged in a long series of further attempts to secretly hide assets from Burton:

a. He falsified change orders on the Chowen house to make it look like the buyers had actually authorized him to take out "salary" for himself and for his spouse.

b. He took deposits and progress payments from two buyers on new projects (Hillsman and Jones) and transferred them to his own personal banking accounts.

c. He received a $20,000 check from the Chowen house buyers in January, 1998, which he had the buyers write out to him personally and deposited in his personal savings account.

d. Without Burton's knowledge or permission, on December 9, 1997, he filed a false renewal of license No. 5740, Burton's builders license with the City of Minneapolis, in the business name of New Cities, omitting Burton's name as a corporate member, but retaining Burton's license number. Since Burton was no longer associated with New Cities, Debtor fraudulently obtained a license to do business in Minneapolis using Burton's name.

e. While subcontractors were pressing for payment from, and, indeed, taking judgments against New Cities, he closed the new corporate account he had opened and began placing corporate sums in his personal account at Schwab & Co.

22. In further "dirty tricks" in February 1998, Debtor wrote letters to certain New Cities subcontractors and suppliers directing them to look to Burton for payment of corporate debts. These letters, when added to Debtor's earlier letter, exacerbated the harm to Burton's reputation with these suppliers and subcontractors, not to mention causing further financial difficulties for Burton. Basically, by paying himself, his

spouse, his attorneys, and his office expenses, Debtor was placing all unpaid subcontractors and suppliers on New Cities projects at risk of full payment. In short, he chose to take care of himself before taking care of his obligations to Burton and to the company's creditors.

23. On May 8, 1998, Debtor wrote to New Cities' attorney and said he was resigning as president of New Cities. He did so at a time when the Chowen house was still unfinished and the Hillsman home was under construction. He tendered no formal resignation, and there was no formal action noting his effective withdrawal from the corporation. Accordingly, throughout and to this day, Debtor remains a fifty-percent shareholder of New Cities, its president, CEO, and secretary; Burton remains a fifty-percent shareholder, COO, CFO, and treasurer.

24. The parties have stipulated and I find that between September 1997, when he locked Burton out, and May 5, 1998, when he resigned, Debtor used corporate funds as follows:

a. $47,782.72 paid to himself;

b. $2,000 paid to his spouse, Jeanne Blumentritt;

c. $23,349.02 paid to four law firms; and

d. $6,627.61 paid for office expenses.

Burton claims that all of these funds were converted from the corporation and that Debtor and his spouse were not entitled to take any of this money. Debtor urges that because he was running

the corporation he was entitled to a reasonable salary, his spouse did secretarial and business work for which she was entitled to be paid, the office expenses were reasonable and necessary office expenses, and that the lawyers performed work on behalf of New Cities for which the corporation should pay. I find, to the contrary, that the Debtor wrongfully withdrew $73,131.74 from the corporation and that New Cities is entitled to its return. In taking these sums, I further find that Debtor breached his fiduciary duty as an officer, director, and fifty-percent shareholder to the corporation and to Burton as his co-shareholder. While Debtor was entitled to reimbursement for office expenses, the withdrawal of any sum for "salary" for himself or his spouse was unauthorized, as was the payment for his personal attorneys' fees. Prior to the "lockout," neither shareholder had withdrawn funds (except on the most minimal draw basis), until a sale closed. They would not and should not have done so while mechanics lien claimants remained unpaid. Thus, not only did Debtor deviate from prior business practices, he also converted funds in violation of Minnesota Statutes § 514.02, since at the time there were outstanding mechanics lien claimants who remained unpaid. As for the attorneys' fees, I reject the Debtor's contention that the billings from attorneys were for corporate debt. To the contrary, they were almost exclusively for Debtor's personal business. Any recovery, of course, belongs

to New Cities to be used first for payment of the corporation's unpaid debts.

25. On July 7, 1998, the attorney for the buyers of the Chowen house negotiated with various of the property's subcontractors and suppliers an agreement by which many of them took substantially less than what New Cities owed them, or, in instances where they did not record lien statements, simply waived their right to payment entirely. As found previously, Debtor's act of paying himself while not paying these subcontractors and suppliers, all of whom had received the letter Debtor wrote on October 27, 1997, had foreordained their losses. At the closing on the Chowen house, Burton discharged a lis pendens to facilitate the sale.

26. Sometime in here, Debtor, who had contracted as New Cities with Hillsman, defaulted on performance of the Hillsman home-building contract, leaving the purchaser to pick up the pieces. That purchaser finished the home with a different contractor, but sued Burton, Debtor, and New Cities for breach of contract. Burton had had nothing to do with entering into the Hillsman contract in December of 1997 (long after he had been locked out) but, because his license was used without his knowledge, was a responsible party who will remain liable for warranty work on that project.

27. In early 1999, a supplier to New Cities on the Creek Ridge house sued New Cities and obtained a judgment for unpaid amounts. Unable to collect, the creditor notified the Minnesota Department of Commerce, which, in turn, notified Burton, that failure to satisfy the judgment, along with other judgments against New Cities, would result in revocation of the license of both New Cities and Michael Burton Homes. The state did revoke Burton's license in March 1999 when he was unable to satisfy the judgments. Burton spent from March 1999 to July 2000 trying to get his license reinstated.

28. Burton, as the licensed builder, remains liable on all Michael Burton Homes and New Cities built homes for warranty claims.

29. Prior to October 27, 1997, Burton had a good reputation and a reservoir of goodwill within the local building trades community. The combination of Debtor's letters and the sacrifices forced upon the suppliers and subcontractors caused them to believe that Burton's "fraudulent conduct," as alleged in Debtor's letters, was the reason they remained unpaid, when in fact, it was Debtor who paid himself and abandoned any responsibility to the suppliers and subcontractors, basically leaving Burton holding the bag.

30. Sometime following the "lockout," Nancy Bausman approached Burton with a request that he serve as her builder on

a construction project she was designing and building. She testified that she would have made Burton her 50/50 partner in this project (which is now actually ongoing) but when she approached the Minnesota Department of Commerce to see if he could be her builder, she was told that there were judgments against him which, until cleared and paid, would prevent his working as a licensed contractor. The record is unclear as to whether the judgments referred to were judgments <u>against</u> New Cities for work done on the Creek Ridge house or the Chowen house. She used another contractor who is completing the job. Burton claims to have lost $315,000 profit to himself personally on this job. For two reasons, I find that he is not entitled to any recovery for this part of his claim. First, I see no causal connection between the lost opportunity and the claimed defamation or conversions. It was not clear from the evidence presented what judgments were referred to. It appeared that some of these judgments existed from the work on the Creek Ridge house, but it is not known whether any related to the Chowen house. And, since New Cities was in trouble on the Creek Ridge house long before the falling out between Debtor and Burton, I am not at all confident that the cause of those judgments was not simple business failure that existed long before the "lockout." Debtor's conversion of corporate funds and/or defamatory letters would not be connected to such damages. Moreover, the evidence

that such significant profits could have been made on this project was speculation, at best. The entire claim rested on an assumption that Burton would have made a percentage profit equal to or better than the types of profits he made when building for Michael Burton Homes. This record is filled with evidence regarding the variables that can affect or plague new home construction work, including New Cities' own "spec" project, the Creek Ridge house, which failed miserably and went into foreclosure.

31. Debtor was not a credible witness at trial. He was contentious and evasive and was repeatedly impeached with documentary evidence and his extensive prior deposition testimony. I discredit most of his testimony. He simply could not seem to make a truthful statement. In fact, he admitted in this trial that he had lied at points in his deposition testimony, and he failed to be forthcoming with documentary discovery materials. His story changed a number of times during the three long years of state or federal court proceedings. And, on several critical issues, his trial testimony under oath was contradicted by a tape of the telephone conversation of September 5, 1997.

CONCLUSIONS OF LAW AND ORDER FOR JUDGMENT

I. Exceptions to Discharge

Burton raises two exception to discharge claims under § 523 of the Bankruptcy Code. Generally speaking, "[e]xceptions to discharge must be strictly construed against the creditor, in furtherance of the policy of providing the debtor with a fresh start in bankruptcy." E.W. Wylie Corp. v. Montgomery (In re Montgomery), 236 B.R. 914, 921 (Bankr. D.N.D. 1999) (citing Geiger v. Kawaauhau (In re Geiger), 113 F.3d 848, 863 (8th Cir. 1997), aff'd, 523 U.S. 57 (1998)). The burden of proof for each exception rests with the creditor and is a preponderance of the evidence standard. See id. (citing various Eighth Circuit cases).

More specifically, under § 523(a)(4), Burton claims that Debtor misappropriated corporate funds and breached his fiduciary duties while he controlled the corporation and, under § 523(a)(6), that Debtor's intentional circulation of defamatory letters injured Burton. At trial, Burton proceeded on both claims but, technically speaking, the § 523(a)(4) claim, and any accompanying recovery on that claim, belongs to the corporation, which is, along with Burton, a named plaintiff in this adversary proceeding, and the § 523(a)(6) claim belongs to Burton individually.

A. § 523(a)(4)

1. Derivative Action

As a threshold matter, as a fifty-percent shareholder, Burton brought the § 523(a)(4) claim for misappropriation and conversion of corporate funds as a derivative action on behalf of New Cities. A shareholder may pursue a derivative action on behalf of the corporation under certain circumstances. See Minn. R. Civ. P. 23.06 (2000). Specifically, a shareholder may maintain a derivative action if: (1) he was a shareholder at the time events relevant to the derivative action took place; (2) the complaint "allege[s] with particularity the efforts, if any, made by the plaintiff to obtain the desired action from the directors or comparable authority ... and the reasons for the plaintiff's failure to obtain the action or for not making the effort"; and (3) in enforcing the corporation's right, the plaintiff fairly and adequately represents the interests of similarly-situated shareholders. Minn. R. Civ. P. 23.06 (2000). See also Wessin v. Archives Corp., 592 N.W.2d 460, 464 (Minn. 1999) ("Where the injury is to the corporation, and only indirectly harms the shareholder, the claim must be pursued as a derivative claim." (citing Seitz v. Michel, 181 N.W. 102, 105 (Minn. 1921)); Wonzcl v. Mathies, 542 N.W.2d 634, 640 (Minn. Ct. App. 1996) ("A derivative action is required when the shareholder has suffered a harm that is indistinct from the harm suffered by other

shareholders or by the corporation itself." (citing Arent v. Distribution Sciences, Inc., 975 F.2d 1370, 1374 (8th Cir. 1992)). Though the § 523(a)(4) claim was admittedly inartfully plead as a derivative action in his complaint, Burton has satisfied the requisites for maintaining such an action. Despite the lockout, Burton was a shareholder when all of the events relevant to this claim took place and, as a fifty-percent shareholder, he is an adequate representative. Moreover, I find that demand on the Board of Directors in this case was unnecessary and would have been futile. See Winter v. Farmers Educ. & Coop. Union, 107 N.W.2d 226, 267 (Minn. 1961) (recognizing that the unique nature of loosely-organized cooperative made demand requirement "unrealistic" and that "such demand is not required where it is plain from the circumstances that it would be futile"). Because the corporation's Board, composed of two fifty-percent shareholders who were infighting, was deadlocked, New Cities clearly could not have asserted the § 523(a)(4) claim itself. Finally, bringing the § 523(a)(4) claim as a derivative action was appropriate because the injuries alleged-Debtor's conversion of corporate funds and breach of fiduciary duties-are injuries to New Cities as a corporation, not to Burton individually.

2. Claims

Section 523(a)(4) provides that a discharge does not discharge an individual debtor from any debt "for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny." 11 U.S.C. § 523(a)(4) (1994).

i. Defalcation While Acting in a Fiduciary Capacity

To prove defalcation while acting in a fiduciary capacity under § 523(a)(4), the plaintiff must show by a preponderance of the evidence that: (1) a fiduciary relationship existed between the creditor and the debtor defendant; and (2) the debtor committed fraud or defalcation in the course of that fiduciary relationship. See In re Montgomery, 236 B.R. at 922.

Regarding the first element, "the definition of 'fiduciary' ... is a question of federal law." Id. Specifically, the requisite fiduciary status may be established through an express trust or through a state statute imposing certain fiduciary duties. See Barclays American/Business Credit v. Long (In re Long), 774 F.2d 875, 878, 878 n.3 (8th Cir. 1985) (indicating that "fiduciary status" may not only be created through "express trusts" but also through state statute or other state law "creat[ing] fiduciary status in an officer which is cognizable in bankruptcy proceedings"). In terms of the latter, "a fiduciary relationship under section 523(a)(4) can be established ... where there is a clear fiduciary duty on the part of corporate officers

to a corporation with regard to the proper treatment of corporate assets over which the corporate officer has control." Hays v. Cummins (In re Cummins), 166 B.R. 338, 354 (Bankr. W.D. Ark. 1994) (citing In re Long, 774 F.2d 875 (8th Cir. 1985)). See also Black's Inc. v. Decker (In re Decker), 36 B.R. 452, 456 (D.N.D. 1983) ("It is well established that corporate officers occupy a fiduciary relationship to the corporation and its creditors" (citing, inter alia, Pepper v. Litton, 308 U.S. 295, 306-06 (1939); Westgor v. Grimm, 318 N.W.2d 56 (Minn. 1982); United Virginia Bank v. Fussell (In re Fussell), 15 B.R. 1016, 1021 (W.D. Va. 1981)).

Minnesota state statutory provisions impose fiduciary duties of acting in good faith and in the best interests of the corporation on corporate officers and directors. See, e.g., Minn. Stat. Ann. § 302A.361 (2000) ("An officer shall discharge the duties of an office in good faith, in a manner the officer reasonably believes to be in the best interests of the corporation, and with the care an ordinarily prudent person in a like position would exercise under similar circumstances."); Minn. Stat. Ann. § 520.01(3) (2000) ("'Fiduciary' includes a trustee under any trust, expressed, implied, resulting or constructive, executor, administrator, guardian, conservator, curator, receiver, trustee in bankruptcy, assignee for the benefit of creditors, partner, agent, officer of any corporation

public or private, public officer, or any other person acting in a fiduciary capacity for any person, trust, or estate.").

In addition, Minnesota case law clearly recognizes that corporate officers and directors, especially those who exercise some control over the corporate coffers, are fiduciaries. See generally Minnesota Valley Country Club v. Gill, 356 N.W.2d 356, 362 (Minn. Ct. App. 1984) ("Gill, as president and a director of Minnesota Valley, was a fiduciary of Minnesota Valley." (citing Minn. Stat. Ann. § 520.01(3) (1976)). In particular, in making decisions, corporate officers may not act in their own best interests but must bear in mind the interests of the corporation, its shareholders, and even its creditors. See, e.g., Association of Mill & Elevator Mut. Ins. Co. v. Barzen Internat'l, Inc., 553 N.W.2d 446, 451 (Minn. Ct. App. 1996) ("It is well established that, as fiduciaries to the corporation's creditors, the officers and directors of an insolvent corporation cannot approve a transfer or encumbrance of corporate assets, the effect of which is to enable the director or officer to recover a greater percentage of his debt than general creditors of the corporation with otherwise similarly secured interests." (citing Snyder Elec. Co. v. Fleming, 305 N.W.2d 863, 869 (Minn. 1981) (internal quotes and alterations omitted)); Backus v. Finkelstein, 23 F.2d 357, 360 (D. Minn. 1927) (stating that "'a director of a joint-stock corporation occupies one of those fiduciary relations where his

dealings with the subject-matter of his trust or agency, and with the beneficiary or party whose interest is confided to his care, is viewed with jealously by the courts'" (quoting Twin-Lick Oil Co. v. Marbury, 91 U.S. 587, 588 (1875)); Miller v. Miller, 222 N.W.2d 71, 78 (Minn. 1974) ("At the outset we acknowledge the well-recognized, common-law principle that one entrusted with the active management of a corporation, such as an officer or director, occupies a fiduciary relationship to the corporation and may not exploit his position as an 'insider' by appropriating to himself a business opportunity properly belonging to the corporation.").

In this case, Debtor, as chief executive officer-president and a director of New Cities, was a fiduciary required to act in good faith and in the best interests of the corporation. Recognized as a fiduciary under Minnesota law, Debtor therefore occupied the fiduciary capacity required under the first element of § 523(a)(4).

Regarding the second element, defalcation is defined as the "misappropriation of trust funds or money held in any fiduciary capacity; [the] failure to properly account for such funds." In re Montgomery, 236 B.R. at 923. Defalcation includes "the innocent default of a fiduciary who fails to account fully for money received." In re Montgomery, 236 B.R. at 923 (internal citations and quotes omitted) (alterations in original). See also

Tudor Oaks Ltd. P'ship v. Cochrane (In re Cochrane), 179 B.R. 628, 635 (Bankr. D. Minn. 1995)(stating that defalcation refers to a breach of fiduciary duty). Defalcation does not require an intentional wrong or bad faith and can include innocent or negligent misdeeds as well as ignorance. See Tudor Oaks Ltd. P'ship v. Cochrane (In re Cochrane), 124 F.3d 978, 984 (8th Cir. 1997). Moreover, a defalcation does not require that the debtor personally benefit from the act. See Hays v. Cummins (In re Cummins), 166 B.R. 338, 354 (Bankr. W.D. Ark. 1994). In short, defalcation is proven by the "simple failure to meet the duties imposed by nonbankruptcy law." Minnesota Trust Co. v. Yanke (In re Yanke), 225 B.R. 428, 437 (Bankr. D. Minn. 1998).

Debtor committed defalcation. He acted contrary to the best interests of the corporation. He knowingly put his own selfish interests ahead of all others: he did not pay subcontractors and suppliers even as he paid himself and his spouse comparatively generous salaries; diverted corporate funds to his personal Schwab account; and used corporate funds to pay off personal attorneys' fees bills. This mismanagement and misappropriation of corporate funds constituted a breach of the fiduciary duties he owed the corporation, its creditors, and his co-shareholder. See In re Decker, 36 B.R. at 458-59; In re Cummins, 166 B.R. at 355. Having found Debtor committed defalcation while acting in a

fiduciary capacity, any damages to New Cities resulting therefrom are non-dischargeable under § 523(a)(4).

ii. Embezzlement[1]

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[1]Contrary to the Debtor's argument that no cause of action other than defalcation while acting in a fiduciary capacity was properly before the court under § 523(a)(4), I reach the embezzlement portion of that provision for several reasons. First, even though the complaint only specifically plead defalcation while acting in a fiduciary capacity under § 523(a)(4), the facts alleged support both the defalcation and embezzlement claims. See Century '21' Shows v. Owens, 400 F.2d 603, 606, 607 (8th Cir. 1968) (suggesting that consideration of and jury instruction on a specific negligence cause of action were proper where facts plead and developed at trial supported such a cause of action, even though only general negligence was averred in complaint). More specifically, the facts for a defalcation claim are largely identical to those required for an embezzlement claim, with the exception of intent. As such, considering the embezzlement claim, in addition to the defalcation claim, had no effect on the pre-trial discovery or the evidence as presented at trial. Thus, the Debtor could not have been caught off guard or surprised when Burton's counsel raised the embezzlement issue first in his trial brief and subsequently in his opening statement and presentation of evidence at trial.

Moreover, while only referencing defalcation specifically, the complaint alleged § 523(a)(4) more generally, putting Debtor on notice of all potential claims under § 523(a)(4). See Miller v. American Heavy Lift Shipping, 231 F.3d 242, 247 (6th Cir. 2000) (making clear that "our modern rules of civil procedure are based on the concept of simplified notice pleading" (internal quotes and citations omitted)); see also Jodoin v. Samayoa (In re Samayoa), 209 B.R. 132, 136 (B.A.P. 9th Cir. 1997) ("'[T]he main purpose of the complaint is to provide notice of what the plaintiff's claim is and the grounds upon which the claims rest. ... [The] plaintiff must at least set forth enough details so as to provide the defendant and the court with a fair idea of the basis of the complaint and the legal grounds claimed for recovery.'" (quoting Acequia, Inc. v. Clinton (In re Acequia, Inc.), 34 F.3d 800, 814 (9th Cir. 1994) (quoting Self Directed Placement Corp. v. Control Data Corp., 908 F.2d 462, 466 (9th Cir. 1990)) (alterations in original)).

Finally, Federal Rule of Civil Procedure 15 suggests that pleadings can be readily amended to conform to the evidence as

To prove embezzlement under § 523(a)(4), it is not necessary to show that the debtor committed such offense while acting in a fiduciary capacity. See Collier on Bankruptcy ¶ 523.10[1][c] (15th rev. ed. 1999). Embezzlement is defined by reference to federal common law. See Kansas Bankers Sur. Co., v. Eggleston (In re Eggleston), 243 B.R. 365, 378 (Bankr. W.D. Mo. 2000). Thus, within the Eighth Circuit, embezzlement is defined as "the 'fraudulent appropriation of property of another by a person to

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presented at trial. See Miller, 231 F.3d at 248 ("This court has stated that the thrust of Rule 15 is to reinforce the principle that cases should be tried on their merits rather than the technicalities of pleading." (internal quotes and citations omitted)); see also In re Jodoin, 209 B.R. at 136 ("Generally, a party cannot succeed on a cause of action not stated in the complaint. ... However, FRCP 15(b) permits the parties to consent implicitly to amendments to the pleadings based on the actual trial. FRCP 15(b) is to be construed liberally."). In other words, if Burton had sought to amend his pleadings to more explicitly plead the § 523(a)(4) embezzlement claim, the court would most likely have allowed him to do so because, as mentioned above, Debtor would not have been prejudiced, the requisite facts having already been alleged under the defalcation claim. See Fed. R. Civ. P. 15(b) (stating that court should freely allow party to amend its pleadings unless such amendment would prejudice the other party).

In addition, Debtor could argue that the court need not reach the issue of embezzlement for another reason. Some case law implicitly suggests that embezzlement is subsumed within the broadly-defined concept of defalcation. See Black's Inc. v. Decker (In re Decker), 36 B.R. 452, 457 (D.N.D. 1983) ("The term 'defalcation' has been construed to be broader than embezzlement or misappropriation." (citing United Virginia Bank v. Fussell (In re Fussell), 15 B.R. 1016, 1022 (W.D. Va. 1981)). Thus, having considered the defalcation claim and decided that the Debtor committed defalcation while acting in a fiduciary capacity, the court does not necessarily need to discuss the issue of embezzlement. However, because the evidence produced at trial in this case supports an embezzlement claim, I will also consider that issue.

whom such property has been entrusted or into whose hands it has lawfully come.'" E.M. Wylie Corp. v. Montgomery (In re Montgomery), 236 B.R. 914, 923 (Bankr. D.N.D. 1999) (quoting Belfry v. Cardozo (In re Belfry), 862 F.2d 661, 662 (8th Cir. 1988)). Specifically, a creditor can prove embezzlement under section 523(a)(4) "'by showing that he entrusted his property to the debtor, the debtor appropriated the property for use other than that for which it was entrusted, and the circumstances indicate fraud.'" Id. (quoting Brady v. McAllister (In re Brady), 101 F.3d 1165, 1173 (6th Cir. 1996)).

As president of New Cities, Debtor was entrusted with and lawfully entitled to possession and control of corporate funds.[2] See In re Montgomery, 236 B.R. at 923 ("[Employee's] possession and control of [employer's] property-that is, its training program, materials, yard, and vehicles-was lawful and derived from his supervisory position over the same ... ."). However, he appropriated those corporate funds for purposes other than those

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[2]I need not discuss larceny under § 523(a)(4) because it does not apply to the facts here. Larceny is defined as the unlawful taking of another's property with fraudulent intent. See C&J Rentals, Inc. v. Purdy (In re Purdy), 231 B.R. 310, 312 (Bankr. E.D. Mo. 1999). Because Debtor, as a corporate officer, was lawfully entitled to possess and control New Cities monies, his possession and control was not initially unlawful as required to prove larceny. See In re Montgomery, 236 B.R. at 923 ("'Larceny differs from embezzlement in that larceny requires that the original taking of the property be unlawful, whereas with embezzlement the initial taking of the property is lawful but the subsequent possession becomes unlawful.'" (quoting 9B Am. Jur. 2d *Bankruptcy* § 3117 (1991)).

for which they were entrusted. After he locked Burton out, Debtor deposited corporate funds directly into his personal accounts and funneled corporate funds to personal expenses. For example, he took more than $23,000 out of the corporation's coffers to cover personal attorneys' fees. He also paid himself a salary of more than $47,000 during the eighth month period he controlled the corporation, even though that salary was unauthorized and contrary to the parties' prior business practices. Moreover, by using corporate funds to pay himself while mechanics lien claimants remained unpaid, Debtor violated Minnesota Statutes § 514.02. See Minn. Stat. Ann. § 514.02(1)(b) (2000).

Debtor claims he expended corporate funds during this time to keep the financially-troubled corporation afloat. Admittedly, where corporate funds "have been expended by the debtor in trying to keep the business operation going, courts have been loath to find the necessary intent" for embezzlement. In re Beasley, 62 B.R. 653, 655 (Bankr. W.D. Mo. 1986). See also First State Ins. Co. v. Bryant (In re Bryant), 147 B.R. 507, 512 (Bankr. W.D. Mo. 1992). A debtor who uses corporate funds openly for a corporate purpose does not commit embezzlement. See Getchell v. Lewensten (In re Lewensten), No. 4-88-823, 1989 WL 38623, at *7 (Bankr. D. Minn. Apr. 20, 1989) (showing of "open use of funds" for "corporate purpose" negates fraudulent intent). By contrast, a

debtor who is "secretiv[e]," "furtiv[e]," or "fail[s] to explain" likely possesses the requisite intent for embezzlement. In re Beasley, 62 B.R. at 655 (noting that "dispersal or use of those funds without explanation of reason or purpose" goes to the intent requirement). See also In re Montgomery, 236 B.R. at 923 (stating that "malevolent intent" is required for an embezzlement claim).

In this case, Debtor was crafty and devious. His payments for salaries and attorneys' fees were donned openly as being necessary corporate expenses but were, in actuality, personal expenses. Such camouflaged payments did not benefit the corporation; they benefitted Debtor alone and left the corporation with escalating subcontractor and supplier bills. Coupled with Debtor's habitual deposits of corporate funds directly into his personal Schwab account and his knowledge of this wrongdoing, these disguised personal payments evidence Debtor's deceptive and fraudulent intent. See In re Beasley, 62 B.R. at 655 ("If the debtor has appropriated funds for his own benefit, and has done so with fraudulent intent or by deceit, then it would appear the creditor need prove no more[.]" (citing United States v. Walker, 677 F.2d 1014 (4th Cir. 1982)); see also United Am. Ins. Co. v. Koelfgen (In re Koelfgen), 87 B.R. 993, 997 (Bankr. D. Minn. 1988). In short, I find that Debtor embezzled corporate funds. Accordingly, $49,782.72, which

represents salaries paid to Debtor and his spouse, and $23,349.02 paid in personal attorneys' fees, is excepted from discharge under the defalcation while acting in a fiduciary capacity prong of § 523(a)(4) or, alternatively, the embezzlement prong of that provision.

B. § 523(a)(6)

Relying on § 523(a)(6), Burton asserts that he is entitled to an exception from discharge judgment against the Debtor for the defamatory letters Debtor sent to various New Cities suppliers and subcontractors and the Builders Association, accusing Burton of, *inter alia*, breaching his fiduciary duties to the corporation and fraudulently taking money from corporate accounts. Section 523(a)(6) of the Bankruptcy Code specifically excepts from discharge "any debt ... for willful and malicious injury by the debtor to another entity or the property of another entity." 11 U.S.C. § 523(a)(6) (1994). Under this provision, "willful" and "malicious" are separate elements, each of which must be proven by the creditor by a preponderance of the evidence. See Fischer v. Scarborough, 171 F.3d 638, 641 (8th Cir. 1999); Allstate Ins. v. Dziuk (In re Dziuk), 218 B.R. 485, 488 (Bankr. D. Minn. 1998).

As the Supreme Court recently clarified, "willful" requires proving that the actor intended the injury and did not merely

intend the act that caused the injury. Kawaauhau v. Geiger, 523 U.S. 57, 61 (1998). This definition generally includes only those acts that fall within the category of intentional torts, as opposed to negligent or reckless torts. Id. at 61, 62. An intentional tort requires that the actor desire to cause the consequences of the act or believe that the consequences were substantially certain to result. Geiger v. Kawaauhau (In re Geiger), 113 F.3d 848, 852 (8th Cir. 1997) (citing Restatement (Second) of Torts § 8A (1965)), aff'd, 523 U.S. 57 (1998)).

By contrast, a "malicious" act under section 523(a)(6) is one that is "targeted at the creditor ... at least in the sense that the conduct is certain or almost certain to cause ... harm." Barclay American/Business Credit v. Long (In re Long), 774 F.2d 875, 881 (8th Cir. 1985). See also Johnson v. Miera (In re Miera), 926 F.2d 741, 743-44 (8th Cir. 1991). Circumstantial evidence can be used to ascertain whether malice existed. See In re Miera, 926 F.2d at 744.

Accordingly, to prevail under section 523(a)(6), Burton must show by a preponderance of the evidence that: (1) he suffered an injury as a result of an intentional tort ("willful"); and (2) Debtor's actions were targeted at him ("malicious"). See Dziuk, 218 B.R. at 488.

1. Willful

In this case, under the willful element, Burton alleges that the letters Debtor sent defamed him, injuring his reputation in the home-building community generally and his business relationship with subcontractors and suppliers specifically. Defamation is an intentional tort. See Oslin v. State, 543 N.W.2d 408, 417 (Minn. Ct. App. 1996). Common law defamation includes the following three elements: (1) the statement must be communicated to someone other than the plaintiff; (2) the statement must be false; and (3) the statement must tend to harm the plaintiff's reputation and to lower him in the estimation of the community. Stuempges v. Parke, Davis & Co., 297 N.W.2d 252, 255 (Minn. 1980) (citations omitted). More specifically, in this case, Burton asserts that the letters Debtor sent were defamatory *per se* because they were directed at him in his profession as a home builder. See Stuempges, 297 N.W.2d at 255 (stating that "[s]landers affecting the plaintiff in his business, trade, profession, office or calling are slanders per se and thus actionable without any proof of actual damages" (citing Anderson v. Kammeier, 262 N.W.2d 366, 372 (Minn. 1977)). As discussed *infra*, the *per se* defamatory nature of the letters Debtor sent figures heavily into the plaintiff's proof of and the court's award of damages. See id.

At trial, Burton proved the requisite elements of the intentional tort of defamation. As for the first element, it is undisputed that Debtor sent a letter to approximately thirty-five New Cities suppliers and subcontractors accusing Burton of "fraudulently taking" money from the corporation and a similar letter to the Builders Association, an attorney at the Minnesota Department of Commerce, and the Residential Warranty Corporation, stating that Burton had behaved unethically and breached his fiduciary duties to the corporation.

Under the second element, these statements were false. Despite the Debtor's contentions to the contrary, at no time did Burton wrongfully take money from the corporation. All draws Burton took as an officer were authorized and properly accounted for. All payments Burton made to subcontractors and suppliers as CFO and treasurer were well-documented and appropriate. Moreover, Burton always acted with the best interests of the corporation in mind. His conduct as both a director and construction supervisor and in his business dealings generally never even bordered on questionable, let alone unethical or fraudulent. Debtor offered no evidence at trial to indicate otherwise. In fact, Debtor knew all along that the accusations contained in these letters were untrue and unsubstantiated, indeed unsustainable.

Regarding the third element, even though he was technically not required to do so to proceed on a defamation *per se* claim, Burton showed that the circulation of these letters damaged his professional reputation. As a direct result of these letters, the Builders Association did not renew Burton's membership, depriving Burton of the ability to market in the Parade of Homes any homes he built; Residential Warranty Corporation cancelled his membership; and, at trial, many subcontractors testified that they believed the allegations contained in the letter to be true and, as a result, harbored serious concerns about doing business with Burton again in the future.

In his trial papers, Debtor raised two defenses to Burton's allegation that Debtor committed the intentional tort of defamation. First, Debtor claims that the statements made in the letters were true. Truth is always a complete defense to defamation. See Stuempges, 297 N.W.2d at 255. However, as discussed above, the statements Debtor made about Burton were false. Moreover, at the time he made the statements, Debtor knew they were false. Thus, I reject Debtor's first defense.

Second, Debtor invokes the conditional competitors privilege. He maintains that prior to the circulation of the letters, Burton had resurrected Michael Burton Homes to compete directly with New Cities, thereby justifying the circulation of

the letters. Restatement (Second) of Torts § 768 provides, in relevant part:

> (1) One who intentionally causes a third person not to enter into a prospective contractual relation with another who is his competitor or not to continue an existing contract terminable at will does not interfere improperly with the other's relation if
> (a) the relation concerns a matter involved in the competition between the actor and the other and
> (b) the actor does not employ wrongful means and
> (c) his action does not create or continue an unlawful restraint of trade and
> (d) his purposes is at least in part to advance his interest in competing with the other.

Restatement (Second) of Torts § 768 (1979). See generally United Wild Rice, Inc. v. Nelson, 313 N.W.2d 628, 633 (Minn. 1982) (discussing and applying elements of competitors privilege). This privilege recognizes that competition "justif[ies] interference with business relations so long as the four stated conditions are met." Verta Corp. v. Cooper Ind., Inc., No. C2-89-1811, 1990 WL 84665, at *3 (Minn. Ct. App. 1990) (designated as unpublished) (citing Conoco, Inc. v. Inman Oil Co., 774 F.2d 895, 907 (8th Cir. 1985)). The burden of proving the requisite elements of the competitors privilege rests with the defendant, Debtor in this case. See Bennett v. Storz Broad. Co., 134 N.W.2d 892, 901 (Minn. 1965). If Debtor satisfies this burden, the burden then shifts to the plaintiff, Burton in this case, to show that Debtor acted with actual malice sufficient to defeat application of the conditional privilege. See Rudebeck v. Paulson, 612 N.W.2d 450, 453 (Minn. Ct. App. 2000) ("Once it has

been shown that a conditional privilege applies, the plaintiff must prove actual malice to recover." (citing Stuempges, 297 N.W.2d at 257)). Actual malice, often referred to as common law malice, is "'actual ill will, or intent to causelessly and wantonly injure the plaintiff.'" Hunt v. University of Minnesota, 465 N.W.2d 88, 92 (Minn. Ct. App. 1991) (quoting Karnes v. Milo Beauty & Barber Supply Co., 441 N.W.2d 565, 568 (Minn. Ct. App. 1989)). Malice "may be shown by extrinsic evidence of personal ill will, or by intrinsic evidence such as the exaggerated language of the statement or the extent of the statement's publication." Hunt, 465 N.W.2d at 92.

Applying the competitors privilege to this case, Debtor did not satisfactorily prove the requisite elements. Admittedly, at the time Debtor circulated the letters, Michael Burton Homes and New Cities may have been competitors. Both entities were engaged in the home-building industry, and Burton and the Debtor knew and dealt with many of the same subcontractors and suppliers. Debtor did not, however, send these letters in the spirit of friendly competition. Rather, they were fraught with misrepresentations and professional attacks on Burton individually and professionally and, therefore, improper. See Verta Corp., 1990 WL 84665, at *3 ("One man may lawfully seek the business of a competitor and may tell the 'trade' not to buy of his competitor,

so long as he indulges in no threat, coercion, misrepresentation, fraud, or other harassing methods.").

Even if Debtor had met his burden of proving the four elements of competitors privilege, Burton likewise demonstrated that Debtor acted with actual malice in writing and sending the letters which contained untruths and were widely-circulated within the discrete Twin Cities home-building community. While Debtor testified repeatedly that he acted in good faith and sincerely believed that Burton had misappropriated corporate funds, I discredit Debtor's testimony and underscore that he produced no evidence at trial to sustain such a belief. Therefore, I also reject Debtor's second defense.

Having rejected the Debtor's defenses, I find that Burton proved the intentional tort of defamation. Debtor, by his own admission, sent the letters intending to injure Burton. In short, the Debtor acted "willfully" within the meaning of the term under § 523(a)(6).

2. Malicious

Burton also sustained his burden of proof on the second element of § 523(a)(6). Debtor acted maliciously. Debtor, by his own admission, wrote and circulated these letters to cause Burton commercial harm. He knew that the kinds of accusations contained in the letters, if brought to the attention of the proper people in the home-building community, would likely result

in Burton losing his license and Builders Association membership and not being able to procure subcontractors for future jobs. Indeed, Debtor's letter-writing campaign had the desired effect.

In response to this second element, Debtor raises the advice of counsel defense. He asserts that his attorney reviewed the letter later circulated to the New Cities subcontractors and suppliers and a similar letter mailed to the Builders Association and Minnesota Department of Commerce. The attorney apparently suggested a few changes, though the nature and extent of those changes was not clear based on Debtor's testimony at trial, but did not advise Debtor not to send the letters. Since he relied on his attorney's advice, Debtor maintains that he did not act, and could not have acted, with the malicious intent required under § 523(a)(6).

Advice of counsel is a valid defense which absolves the debtor of the intent required for certain actions. See generally First Beverly Bank v. Adeeb (In re Adeeb), 787 F.2d 1339, 1343 (9th Cir. 1986) ("[A] debtor who acts in reliance on the advice of his attorney lacks the intent required to deny him a discharge of his debts."); McDonough v. Erdman (In re Erdman), 96 B.R. 978, 985-86 (Bankr. D.N.D. 1988) ("Reliance on attorney advice absolves one of intent only where that reliance was reasonable and where the advice given was informed advice."); Harkins v. Patterson (In re Patterson), 70 B.R. 124, 128 n.9 (Bankr. W.D.

Mo. 1986) ("When intention is an issue, advice of counsel is a factor to be considered, unless the party should know that failure to schedule the asset is forbidden by the law."). Generally speaking, a debtor may only invoke the advice of counsel defense if: (1) he has made a full disclosure to his attorney; and (2) the accompanying reliance on the counsel's advice is in good faith, i.e., reasonable. See In re Erdman, 96 B.R. at 986.

Applying the advice of counsel defense to this case, Debtor testified that he fully disclosed all of the relevant facts about his rift with Burton to a young associate whom he then had review both letters. I disbelieve Debtor's testimony. He did not make full disclosure to his attorney, nor did he have his attorney review either letter. Even if he did, Debtor's resulting reliance was unreasonable for several reasons. First, Debtor acted with an improper purpose. Debtor knew that the accusations contained in the letters were false and, as an experienced businessperson in the home-building industry, that circulating such letters was wholly inappropriate and would likely severely damage Burton's professional reputation. See United Orient Bank v. Green, 215 B.R. 916, 928-30 (D. S.D.N.Y. 1997) ("While [counsel] never advised Green that his actions either were or were not proper, ... Green neither asked nor cared whether they were appropriate. ... He knew that there was a substantial risk

that his actions were wrongful, as indeed would have been obvious to any reasonably intelligent person. He cannot now hide behind [counsel's] failure to tell him in words of one syllable that he could not lawfully proceed."); see also Tillman v. Wheaton-Haven Recreation Ass'n, Inc., 517 F.2d 1141, 1145 (4th Cir. 1975) ("The cases do not suggest that due diligence in seeking to ascertain the law would be a defense to a suit brought by a third person for an intentional tort."). Second, both before and after he claimed to have had his counsel review the letters, Debtor intended to circulate them. In other words, any review of the letters by counsel did not alter, and would not have altered, Debtor's intent to commit a malicious act, i.e. to harm Burton. Therefore, I reject Debtor's advice of counsel defense.

In conclusion, in circulating the letters, I find that Debtor committed the intentional tort of defamation with the intent to harm Burton and that any resulting damages Burton sustained are non-dischargeable under § 523(a)(6).

3. Defamation *Per Se* and Damages

Regarding damages on his § 523(a)(6) claim, Burton argues that the statements Debtor made in the letters were defamatory *per se* because they related to Burton's conduct as a businessperson and his profession as a home-builder. Certain statements regarding a person's business or occupation are defamatory *per* se under Minnesota law. See Anderson v. Kammeier,

262 N.W.2d 366, 372 (Minn. 1978). To prove a defamation *per se* case, the plaintiff must show that defendant's statements were "peculiarly harmful" to the plaintiff in his business: "the remarks must relate to the person in his professional capacity and not merely as an individual without regard to his profession." Anderson, 262 N.W.2d at 372. Once the plaintiff makes such a threshold showing, damages to his reputation as a result of the *per se* defamatory statements can be awarded without actual qualitative or quantitative proof. See Becker v. Alloy Hardfacing & Engineering Co., 401 N.W.2d 655, 661 (Minn. 1987) (reiterating that showing of harm to reputation is not required to recover damages in defamation *per se* action); see also Bauer v. State, No. C2-95-1090, 1996 WL 601647, at *7 (Minn. Ct. App. Oct. 22, 1996) (designated as unpublished)("In defamation actions general damages are imposed for the purpose of compensating the plaintiff for the harm that the publication has caused to his reputation." (citing Restatement (Second) of Torts § 621, cmt. a (1977)). In other words, where a defendant makes "false statements about a person's business, trade, or professional conduct, ... general damages are presumed." Becker, 401 N.W.2d at 660. If a plaintiff sustains his burden of proving defendant's statements were defamatory *per se*, the court may then fix an appropriate damage award so long as it fits within the parameters of general damages and is not excessive. Cf. Becker,

401 N.W.2d at 661 ("We also hold that the $30,000 compensatory damage award against appellants was not excessive. Becker was upset and embarrassed by the events surrounding the stolen car report, felt that his personal and business reputation had been damaged, and as a result put pressure on himself to work harder and longer hours at Anderson."). In addition, punitive damages are recoverable in defamation *per se* cases without proof of actual damages. See Anderson, 262 N.W.2d at 372; Becker, 401 N.W.2d at 661; Loftsgaarden v. Reiling, 126 N.W.2d 154, 154-55 (Minn. 1964), cert. denied, 379 U.S. 845 (1964). However, damages for "special harm," which includes mental distress and accompanying economic loss, must "be supported by proof of actual damages." Bauer, 1996 WL 601647, at *7 (defining special harm as "emotional distress that is proved to have been caused by the defamatory publication").

Burton proved the statements Debtor made in the letters were defamatory *per se*. In accusing Burton of fraudulently appropriating corporate funds and not acting in the best interests of the corporation, Debtor directly attacked Burton's conduct as a businessperson. More particularly, Debtor's charges that Burton had used monies belonging to New Cities to fund the resurrection of Michael Burton Homes and that the Builders Association should consider denying Burton's membership

application for that entity were peculiarly harmful to Burton as a home-builder.

Having proven that Debtor's statements related directly to Burton in his profession, Burton is presumptively entitled to recover general damages. As a direct result of Debtor's letters, Burton's reputation in the home-building industry was tarnished. Burton lost his Builders Association membership. He also lost the good working relationships he had forged with subcontractors and suppliers over the course of many projects in an industry that requires such relationships for a general contractor, like Burton, to be successful. He was not able to find a job in the home-building industry and, instead, eventually landed a job at Home Depot, making substantially less and working nights and weekends.

The effects of Debtor's letter-writing campaign were felt in Burton's personal life as well. His relationship with his wife was rocky, and he quarreled often with his teenage son. He lost his confidence, was unable to sleep, and acted distant and withdrawn. He had been humiliated and clearly felt additional pressure to make ends meet and provide for his family.

To counter Burton's damage claim, Debtor maintains that Burton did not take any steps to mitigate his damages. Rather, Debtor claims Burton just sat back and let the allegedly damaging statements in the letters run their course. Under general

principles of tort law, "a person injured by the wrongful act or omission of another has a duty to mitigate damages by exercising reasonable precaution in the care and treatment of such injury." Couture v. Novotny, 211 N.W.2d 172, 174 (Minn. 1973) (personal injury action). In other words, the injured party must use "reasonable diligence" and "good efforts" to mitigate its damages. Deutz-Allis Credit Corp. v. Jensen, 458 N.W.2d 163, 166 (Minn. Ct. App. 1990). See also Lanesboro Produce & Hatchery Co. v. Forthun, 16 N.W.2d 326, 328 (Minn. 1944) (discussing steps non-breaching party to a contract must take to mitigate its damages).

In this case, Burton attempted to mitigate his damages in several ways. First, shortly after Debtor published the defamatory letters, in a letter dated November 13, 1997, Burton asked Debtor to retract the statements made. Cf. Minn. Stat. Ann. § 548.06 (2000) (requiring plaintiff to demand a retraction as a prerequisite to recovery of damages for the publication of a libel in a newspaper). Indeed, Burton has continually sought retraction of the statements during the course of the litigation between these two parties.

In addition, though he did not respond in writing as requested, Burton did have a phone conversation with a representative at the Builders Association in which he tried to explain the fallout between himself and Debtor and Debtor's

subsequent false allegations. Early on, Burton also commenced a lawsuit against Debtor in state court. Though the lawsuit did not contain a defamation claim, Burton indicated that any recovery obtained would be used to pay suppliers and subcontractors, effectively attempting to repair his business relationship with these tradespeople.

Finally, Burton testified that he unsuccessfully sought employment from other home-building companies in the greater Twin Cities area. While Debtor correctly pointed out that Burton did not necessarily vigorously pursue employment opportunities in the home-building industry, Burton was not required to do anything and everything Debtor thought Burton should have done to mitigate his damages. Moreover, given that Burton had been substantially humiliated and lacked confidence, his failure to continue to seek out re-employment in the home-building industry was not surprising and, in fact, understandable. Burton was only required to use good efforts and take reasonable steps to mitigate his damages. He did so; therefore, I reject Debtor's mitigation argument.

II. Attorneys' Fees

Burton seeks recovery of the attorneys' fees incurred in this adversary proceeding. "[A]bsent a specific statutory or contractual provision to the contrary, such fees are not

recoverable." Burt v. Maurer (In re Maurer), 256 B.R. 495, 501 (B.A.P. 8th Cir. 2000) (citing Williams v. Kemp (In re Kemp), 242 B.R. 178, 183 (B.A.P. 8th Cir. 1999), aff'd, 232 F.3d 652 (8th Cir. 2000)). Burton has offered no contractual or statutory basis for recovery of attorneys' fees and is, therefore, not entitled to an award of such fees.

ACCORDINGLY, IT IS HEREBY ORDERED THAT:

1. Plaintiff, Michael Burton, seeking derivatively for and on behalf of New Cities Building & Development Inc., a Minnesota corporation, shall have and receive of the Defendant $73,131.74.

2. Plaintiff, Michael Burton, individually, shall have and receive of the Defendant the sum of $300,000 for damages for defamation.

3. Plaintiff shall have no recovery for attorneys' fees.

4. The judgments referenced in Paragraphs 1 and 2 are excepted from discharge in this bankruptcy case under §§ 523(a)(4) (as to Paragraph 1) and 523(a)(6) (as to Paragraph 2).

LET JUDGMENT BE ENTERED ACCORDINGLY.

Nancy C. Dreher
United States Bankruptcy Judge

STATE OF MINNESOTA

ss.

COUNTY OF HENNEPIN

I, Karen Krouch, hereby certify: I am a Deputy Clerk of the United States Bankruptcy Court for the District of Minnesota; on February 6, 2001, I placed copies of the attached

ORDER

in envelopes addressed to each of the following persons, corporations, and firms at their last known addresses, and had them metered through the court's mailing equipment:

NCD, AM, +2 local distribution

Phillip Gainsley, Esq.
701 Fourth Ave. S., Suite 527
Minneapolis, MN 55415-1810

Richard I. Diamond, Esq.
601 Carlson Parkway, Suite 1050
Minnetonka, MN 55305

I sealed and placed the envelopes in the United States Mail at Minneapolis, Minnesota.

Karen Krouch