

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF NEW YORK

FILED
IN CLERKS OFFICE
U.S. DISTRICT COURT ED. N.Y.

★ AUG 19 1998 ★

In Re:	X	P.M. _____	DISTRICT COURT
JAMES McGURREN	:	:	97-CV-2365 (ARR)
Debtor	:	:	<u>NOT FOR PUBLICATION</u>
LOUIS SENDER	X	P.M. _____	<u>OPINION AND ORDER</u>
Plaintiff,	:	:	Bankruptcy Court
-against-	:	:	Case No. 896-83050-478
JAMES McGURREN,	:	:	Adv. Pro. No.
Defendant.	:	:	896-8412-478
ROSS, United States District Judge:	X	P.M. _____	

ROSS, United States District Judge:

Appellant James McGurren commenced this action in the district court, pursuant to 28 U.S.C. § 158(a), seeking review of the decision of the Bankruptcy Court (Hon. Dorothy Eisenberg) denying appellant's motion for summary judgment and granting appellee's cross-motion for summary judgment. For reasons described below, the grant of summary judgment to appellee is reversed and the case remanded to the Bankruptcy Court for further proceedings.

ISSUES TO BE DECIDED ON APPEAL

Pursuant to Bankruptcy Rule 8010(a)(1)(C), appellant was required to list those issues to

be decided on this appeal in his brief. Appellant has failed to do so. Appellant has also specifically disclaimed the appeal of one issue decided by the Bankruptcy Court, whether res judicata would bar the Appellee/Plaintiff's claim. Appellant's Reply Brief at 4. Because of this, the issues to be decided on appeal are limited to those specifically challenged in Appellant's Brief. The appeal of all other issues is deemed waived.

Appellant claims (1) that the Bankruptcy Court committed reversible error when it granted judgment for damages without holding an inquest; and (2) that the Bankruptcy Court erred in finding as a matter of law that Appellant's debt was non-dischargeable because Appellant stood in a fiduciary relationship to the Appellee.

Appellee refutes Appellant's claims, and further (1) argues that Appellant's appeal is untimely and (2) asks that this court considers sanctions on its own motion.

FACTUAL BACKGROUND

Appellee Louis Sender ("Sender") is a licensed certified public accountant in the state of New York. Prior to July, 1989, Sender was in an accounting partnership with Martin Moses ("Moses"). By an agreement dated July 28, 1989, (the "Agreement") Sender and Moses dissolved this partnership. Under the Agreement, Sender was entitled to receive 28% of the amounts collected for services rendered to a list of specified clients subsequent to the dissolution of the partnership. These amounts were to be payable to Sender on a monthly basis, for a three year period following the effective date of the Agreement. During the fourth and fifth years after the effective date of the Agreement, Sender was to receive monthly payments of 25/28ths

of the amounts payable to Sender during the third year after the effective date of the Agreement.

The clients from whose billings Sender would be receiving these payments were those that Sender had serviced during the life of the partnership. After the Agreement had been executed, but before its effective date, Appellant James McGurren (“McGurren”) became a partner with Moses in a new accounting partnership. On the effective date of Agreement, October 1, 1989, McGurren, Sender and Moses initialed the last several pages of the Agreement, which consisted of the list of clients from whose billings Sender would receive the specified monthly payments. The accounting partnership between McGurren and Moses continued from October, 1989, to around June, 1991, with payments regularly made to Sender from the billings of those clients whom he had previously serviced.

The partnership between Moses and McGurren dissolved around June, 1991, and from that time forward, McGurren ceased making payments to Sender, although he did continue to service at least some of the clients listed in the Agreement. McGurren has made none of the payments specified by the Agreement since June, 1991.

PRIOR JUDICIAL PROCEEDINGS

Sender brought an action in Nassau County Supreme Court against McGurren for the amounts owed to him under the Agreement, entitled Louis Sender v. Moses & McGurren, Martin Moses & James McGurren. On October 18, 1995, the Supreme Court (Hon. George A. Murphy, J.S.C.) granted Sender summary judgment as to the amount owed him under the Agreement for the payments due from June, 1991, to September, 1994. In finding for Sender, the court did not

state a certain amount that Sender was owed, but only that he was owed the amounts due under the Agreement during the months that McGurren failed to pay him. In deciding the case, the Nassau County Supreme Court found that McGurren had complied with the Agreement for one and a half years, that he had voluntarily signed the Agreement, that he had manifested his acceptance of the Agreement and that he had received consideration for it in the form of his continued access to the specified clients.

On May 10, 1996, McGurren filed a voluntary Chapter 7 bankruptcy petition in the Bankruptcy Court of the Eastern District of New York. On August 21, 1996, Sender initiated this proceeding, by filing a complaint in the Bankruptcy Court seeking to except the debt owed to him from bankruptcy discharge in accordance with § 523(a)(4) of the Bankruptcy Code on the grounds that the debt was incurred by fraud or defalcation at a time when McGurren was in a fiduciary relationship with Sender. On March 28, 1997, the Bankruptcy Court (Hon. Dorothy Eisenberg), denied McGurren's motion for summary judgment, granted Sender's cross-motion for summary judgment, and determined that the debt owed Sender by McGurren was not dischargeable in bankruptcy.

The Bankruptcy Court made this determination by finding that the Agreement created an express trust between Sender and McGurren. (Transcript of March 6, 1997 Hearing at 13 (No. 97-CV-2365)). The Bankruptcy Court found that the Agreement contained the four elements required by New York law for an agreement to create a trust: (1) a designated trustee who is not the same person as the beneficiary; (2) a designated beneficiary; (3) a clearly identifiable trust property; and (4) actual delivery of the trust property to the trustee. *Id.* at 12. In the opinion of the Bankruptcy Court, McGurren was the trustee, Sender the beneficiary and the client list the

trust property of the trust created by the Agreement. Sender was found to have delivered the trust property when he handed the client list over to McGurren. Id. Having found that the trust, and hence McGurren's fiduciary duty to Sender, arose before the debt was formed, the Bankruptcy Court concluded that the debt was non-dischargeable under § 523(a)(4). Id. at 12-13. The Bankruptcy Court granted Sender a judgment of \$70, 635. McGurren perfected his appeal to this court on June 19, 1997.

DISCUSSION

I. Standard of Review

When reviewing the decisions of a Bankruptcy Court, the district court applies a de novo standard of review as to questions of law and a "clearly erroneous" standard as to questions of fact. Bankr.R. 8013. See e.g. In re Nemko, 202 B.R. 673, 677 (E.D.N.Y. 1996). When sitting as an appellate court, the first task of this court in reviewing a grant of summary judgment is to determine whether the court below properly held that there were no genuine issues of material fact for trial. See Motor Vehicle Mfrs. Ass'n v. New York State Dep't of Env'tl. Conservation, 79 F.3d 1298, 1304 (2d Cir.1996). Examining the evidence in the light most favorable to the nonmoving party, this court is then to "apply a de novo standard of review to ensure that the substantive law was correctly applied." Id.; accord Adjustrite Systems, Inc. v. GAB Services, Inc. 145 F.3d 543, 547 (2d Cir.1998).

II. The Facts in the Record Are Insufficient to Support the Finding of the Bankruptcy Court That As a Matter of Law There Was a Fiduciary Relationship Between McGurren and Sender

In order for a debt to be found nondischargeable under 11 U.S.C. § 523(a)(4), the debt must be “for fraud or defalcation while acting in a fiduciary capacity. . . .” To determine that a debt is non-dischargeable under this provision, this court must find (1) that the debtor was acting in a fiduciary capacity, and (2) that the debt is for defalcation or fraud while acting in this capacity. In re Caulfield, 192 B.R. 808, 818 (Bankr. E.D.N.Y.1996) (citations omitted). The Bankruptcy Court found, from the terms of the Agreement, that as a matter of law McGurren owed such a fiduciary duty to Sender and that McGurren's debt to Sender was thus non-dischargeable. The Bankruptcy Court so held on the basis that the sums owed to Sender were deemed to be part of a trust, of which McGurren was the trustee and Sender the beneficiary. For reasons described below, following this court’s de novo review of the Bankruptcy Court’s decision, that holding is reversed, and this case remanded for further fact-finding.

A. The Bankruptcy Code Disfavors Non-Dischargeability

Under 11 U.S.C. § 523, certain types of debt are excepted from discharge, largely to prevent dishonest debtors from evading their creditors. However, “[a] guiding principle in analyzing these exceptions is that they be narrowly and strictly construed, so as to assure that the basic bankruptcy policy of giving honest debtors a fresh start is not frustrated.” In re Levitan, 46 B.R. 380, 383 (Bankr. E.D.N.Y. 1985) (citation omitted). In particular, the term ‘fiduciary’ is to be given a narrow meaning consonant with the principles of the Bankruptcy Code. In re Guy, 101 B.R. 961, 983 (Bankr.N.D.Ind.1988).

Further, the burden of proof as to non-dischargeability falls upon the party who opposes dischargeability. In re Kressner, 164 B.R. 235, 238 (Bankr. S.D.N.Y. 1994) (citation omitted).

The standard of proof is by preponderance of the evidence. In re Caulfield at 818 (citation omitted).

B. The Non-Dischargeability of a Debt is a Question of Federal Law

The term ‘fiduciary’ in § 523(a)(4) is defined by federal law. Id. However the term is affected by state law in that state law may determine when a person has entered into a trust or a trust-like obligation. Matter of Angelle, 610 F.2d 1335, 1341 (5th Cir.1980). But in interpreting the predecessor statute to § 523(a)(4), the Supreme Court limited the term ‘fiduciary’ to include only those persons who were fiduciaries under a ‘technical’ trust: “[T]he statute speaks of technical trusts, and not those which the law implies from the contract.” Chapman v. Forsyth, 43 U.S. (2 How.) 202, 208, 11 L.Ed. 236 (1844). Technical trusts either may be created by an agreement between the parties or may be imposed by statute. In re Levitan, 46 B.R. 380, 384 (Bankr. E.D.N.Y. 1985). An individual may thus be considered a fiduciary for the purposes of § 523(a)(4) either because she is a trustee due to an express trust agreement recognized by state law (‘express trust’) or because she has entered into a transaction in which the state imposes trustee-like obligations (‘statutory trust’). See, e.g., In re The Brunswick Hospital Center, Inc., 156 B.R. 896 (E.D.N.Y.1993) (hospital operator was a trustee by express trust agreement); In re Silba, 170 B.R. 195 (Bankr. E.D.N.Y.1994) (general contractor made a fiduciary under New York Lien Law as to sums retained for payment to suppliers and subcontractors).

Furthermore, in order for a trust to create a fiduciary duty recognized within the meaning of 11 U.S.C. § 523(a)(4), the trust must be in existence prior to the act that created the debt. Davis v. Aetna Acceptance Co., 293 U.S. 328, 333, 55 S.Ct. 151, 154 (1934). A ‘constructive

trust' that arises solely out of the debtor's wrongdoing is thus insufficient to create the fiduciary relationship required for a finding of non-dischargeability under § 523(a)(4). In re Paley, 8 B.R. 466, 469 (Bankr. E.D.N.Y. 1981).

C. The Record Contains Insufficient Evidence to Support a Finding As a Matter of Law that the Agreement Created a Trust

Sender has not raised the issue of whether McGurren is a fiduciary due to a statutory trust. Nor, because of applicable federal law, can Sender claim that McGurren was a fiduciary because of a constructive trust arising out of Sender's breach of contract. So his claim now stands or falls on whether the record supports the conclusion of the Bankruptcy Court that as a matter of law the Agreement created a trust under New York law.

A trust may arise in New York either orally or by written statement, and no particular form of words is necessary. Agudas Chasidei Chabad of U.S. v. Gourary, 833 F.2d 431, 434 (2d Cir.1987) (citation omitted). A trust may also arise by implication so long as the "implied trust arises as a necessary inference from unequivocal evidence." Id. (citation omitted). For a trust to be valid in New York it must contain four elements: "(1) a designated trustee . . . ; (2) a designated beneficiary; (3) clearly identifiable trust property; (4) the actual delivery of the trust property to the settlor with the intent of vesting legal title in the trustee." In re The Brunswick Hospital Center, Inc., 156 B.R. 896, 900 (E.D.N.Y. 1993) (citation omitted). In order to find a trust arrangement for the purposes of § 523(a)(4), the normal incidents to a trust relationship must be present: segregation of trust funds, accountability of the trustee and the formal expression of a trust relationship between the parties. In re Storms, 28 B.R. 761, 764 (Bankr.

E.D.N.C. 1983).

“A trust involves a duty of the fiduciary to deal with *particular* property for the benefit of another. . . . The debtor-creditor relationship on the other hand, involves only the obligation to pay money; it endows the creditor with merely a personal claim against the debtor.” In re Nova Real Estate Investment Trust, 23 B.R. 62, 66-67 (E.D.Va. 1982), quoted in In re Gans, 75 B.R. 474, 490 (Bankr.S.D.N.Y. 1987) (emphasis added). Courts have relied upon the actual character of the relationship described by agreements when determining whether or not a trust has been created, and not on the use of particular words: “The fact that a commercial agreement contains the word ‘trust’, however, does not make the agreement a trust agreement, nor does it create a fiduciary relationship.” In re Paley, 8 B.R. 466, 469 (Bankr.E.D.N.Y. 1981).

The crucial question in this case is thus whether the Agreement expressed the obligations ordinarily incidental to the formation of a trust sufficiently to allow the Bankruptcy Court to find it to have created one. If the Agreement did not, there was no evidentiary basis for the Bankruptcy Court to conclude that it created anything other than an ordinary commercial contract, and not a trust. Courts have found that “an ordinary commercial agreement, although it may contain certain elements of trust and confidence, is not sufficient standing alone to establish an express or technical trust.” In re Guy, 101 B.R. 961, 984 (Bankr. N.D.Ind. 1988). For a contractual agreement to create a non-dischargeable debt, the agreement must contain “language that unmistakably creates an obligation to hold proceeds separate and to remit ‘specific money’.” In re Banister, 737 F.2d 225, 227 (2d Cir. 1984), quoting Independence Discount Corp. v. Bressner, 47 A.D.2d 756, 757, 365 N.Y.S.2d 44, 46 (2d Dep't. 1975). Cf. In re Niven, 32 B.R. 354, 357 (Bankr. W.D.Ok. 1983) (“Further, and we believe, more importantly, there exists a

clearly defined trust res. It is the absence of such a trust res which has led the courts to hold that a trust sufficient for the 'fiduciary capacity' requirement of § 523(a)(4) was not present.”).

In In re Paley, an agreement between an association of airlines and a travel agent specified that the agent was to hold 'in trust' funds received from customers for airplane tickets. 8 B.R. 466, 468 (Bankr.E.D.N.Y. 1981). However, even though the contract used the term 'trust' and identified a specific source of income (the airplane tickets) as belonging to the airline, no trust was found by the court because “taken in its entirety the Agreement appears to be no more than an ordinary commercial contract.” Id. at 469. A significant part of that court’s decision rested on the fact that “the Agreement does not require the defendants to segregate the funds prior to paying the plaintiff. Moreover, the plaintiff neither alleged nor submitted any evidence that the defendants were under a duty to segregate funds received from the sale of plaintiff’s tickets.” Id. The court found this type of agreement only to create a principal-agent relationship between the parties, not a relationship of beneficiary-trustee. Id.

Other cases have reached similar results when examining agreements that more closely resemble ordinary commercial agreements than trusts. In In re Gallaudet, a floor plan financing agreement in which the debtor agreed to 'hold in trust' proceeds from car sales was held not to constitute a trust because “the agreement did not provide nor did Ford Credit require Gallaudet Motors, Inc., to segregate the proceeds received from the sale of the floor-planned vehicles and to deposit them in a special account for the benefit of Ford Credit.” 46 B.R. 918, 925 (Bankr. D.Vt. 1985). Accord In the Matter of Storms, 28 B.R. 761 (Bankr.E.D.N.C. 1983); In re Tester, 62 B.R. 486 (Bankr.W.D.Va. 1986). The agreement in In re Gallaudet was a security agreement incidental to a creditor-debtor relationship, not a trust, and as such did not create a fiduciary

relationship. 46 B.R. at 925.

In contrast to these cases, courts have regularly found trusts and fiduciary relationships to exist when the agreements were expressed in the form typical of a trust agreement. In In re Niven, the court found the relevant agreement to create a trust in part because that agreement required the trustee to hold the “‘trust funds’ separate and apart from all other funds” and so barred the trustee from commingling trust funds with other funds. 32 B.R. 354, 357 (Bankr. W.D.Okla. 1983). Moreover, the agreement in that case identified itself as ‘This Trust Agreement’ and named the debtor as a trustee. Id. Similarly, in In re The Brunswick Hospital Center, Inc., the court found there to be a trust, because the trust agreement clearly identified itself as such, and specifically identified the trustee, the beneficiaries and the property that would constitute the trust. 156 B.R. 896, 900 (E.D.N.Y. 1993).

Bearing in mind both that the mere use of the word ‘trust’ in an agreement does not create a trust, In re Paley, 8 B.R. 466, 469 (Bankr.E.D.N.Y. 1981), and that no particular use of words is necessary to the formation of a trust, Agudas Chasidei Chabad of U.S. v. Gourary, 833 F.2d 431, 434 (2d Cir. 1987) (citation omitted), this court will now examine the Agreement to determine if it creates a trust. On its face, the Agreement seems only to effect the sale of a partnership interest by Sender, with a corresponding covenant not to compete, in return for a schedule of payments to be made over the five years after the effective date of the Agreement. No specific use of the words ‘trust’, ‘trustee’, or ‘beneficiary’ is made in the Agreement. While not controlling, the absence of such terms does weigh against an intent to create a trust on the part of Sender, Moses and McGurren.

More importantly, however, the Agreement contains no statement pertaining to

segregation of the funds to be paid to Sender during the five years following the effective date of the Agreement. For example, ¶ 5 of the Agreement states that “SENDER shall receive from THE PARTNERSHIP: (a) TWENTY-EIGHT (28%) PERCENT of the amounts collected on account of services rendered by THE PARTNERSHIP from the clients listed in Schedule ‘B’ attached hereto for each of the three (3) years following the EFFECTIVE DATE. Such payment shall be made monthly on or before the 15th day of each month subsequent to collection.” No further statement governs the manner of payment. Similarly, in ¶ 5(b), governing payments to be made in the fourth and fifth years following the effective date of the Agreement, the only statement as to the manner of payment is: “Such payments shall be payable on or before the fifteenth (15th) day of each month.” The plain meaning of the Agreement permits the payments of the sums due Sender to both accumulate in and be made out of the ordinary accounts of the partnership, or indeed, out of any account available to Moses or McGurren.

Segregation of funds is a normal incident of a trust relationship and its absence from the Agreement creates a strong inference that the parties did not intend to create a trust. “In general, when the circumstances are such that the recipient of the funds is entitled to use them as his own and can commingle them with his own moneys, a debtor-creditor relationship results, not a trust.” In re Penn-Dixie Steel Corp., 6 B.R. 817, 823-24 (Bankr.S.D.N.Y. 1980) (citation omitted). Here, the record before the Bankruptcy Court contained no evidence supporting a finding, as a matter of law, as to the intent of the parties to create a trust. Because the existence of a trust is essential to support the further finding of a fiduciary relationship between McGurren and Sender, the Bankruptcy Court’s determination that the debt owed by McGurren was non-dischargeable under § 523(a)(4) must be reversed.

III. Other Issues

A. Sanctions

Bankruptcy Rule 9011(c)(1)(B) permits this court to impose appropriate sanctions on its own initiative for certain misconduct, including the use of frivolous legal arguments or the allegation of factual contentions without evidentiary support. This court finds that no action by McGurren's attorneys in raising this appeal is worthy of sanctions, and so declines to impose them.

B. Timeliness of the appeal

Bankruptcy Rule 8009(a)(1) requires an appellant to file his brief within fifteen days of the entry of the appeal onto the docket. As appellee points out, appellant filed his brief on June 19, 1997, while his appeal was entered onto the docket on April 4, 1997. Appellee's Brief at 7. Appellee seeks to have this appeal dismissed for untimeliness.

Bankruptcy Rule 8009 does not contain a provision parallel to that contained in F.R.App.P. 31 which provides “(c) *Consequence of Failure to File Briefs*. If an appellant fails to file a brief within the time provided by this rule or within the time as extended, an appellee may move for dismissal of the appeal.” Instead, an appellee may seek relief only from Bankruptcy Rule 8001(a): “An appellant’s failure to take any step other than the timely filing of a notice of appeal does not affect the validity of the appeal, but is grounds only for such action as the district court or bankruptcy appellate panel deems appropriate, which may include dismissal of the appeal.”

This court finds no bad faith or negligence on the part of McGurren in filing his brief on

appeal and so declines to dismiss the appeal as untimely.

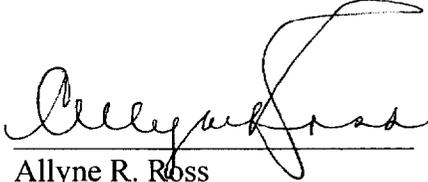
C. The judgment for a specific sum ordered by the bankruptcy court

Because this court reverses the Bankruptcy Court's finding that McGurren's debt to Sender was non-dischargeable, it is unnecessary to decide whether the Bankruptcy Court acted appropriately in granting Sender a money judgment on the debt without an inquest.

CONCLUSION

This court finds that the factual record before the Bankruptcy Court did not provide a sufficient basis for the Bankruptcy Court to find, as a matter of law, that McGurren owed a fiduciary duty to Sender, and so reverses the Bankruptcy Court's holding that McGurren's debt to Sender was non-dischargeable. Because other evidence of and/or grounds for non-dischargeability may be discovered upon further factual examination, this case is remanded to the Bankruptcy Court for further proceedings consistent with this opinion.

So ORDERED.


Allyne R. Ross
United States District Judge

Dated: August 18, 1998
Brooklyn, New York

SERVICE LIST:

John Harris, Esq.
Davidoff & Malito LLP
605 Third Avenue
34th Floor
New York, New York 10158

C. Stephen Hackeling, Esq.
Macco, Hackeling & Stern
164 Main Street
Huntington, NY 11743

cc: Bankruptcy Judge Eisenberg