
IN THE UNITED STATES BANKRUPTCY COURT
FOR THE MIDDLE DISTRICT OF GEORGIA
MACON DIVISION

IN RE:)
)
AIDEN EMMETT BARNES, III,) CHAPTER 11 BANKRUPTCY
) CASE NO. 93-51514
DEBTOR)
)
ZURICH INSURANCE COMPANY,)
AMERICAN ZURICH INSURANCE)
COMPANY, ZURICH AMERICAN)
INSURANCE COMPANY OF ILLINOIS)
and AMERICAN GUARANTY AND)
LIABILITY INSURANCE COMPANY,)
)
PLAINTIFFS)
)
VS.) ADVERSARY PROCEEDING
) NO. 93-5072
A. EMMETT BARNES, III,)
)
DEFENDANT)

BEFORE

JAMES D. WALKER, JR.

UNITED STATES BANKRUPTCY JUDGE

COUNSEL:

For the Debtor/Defendant: CHARLES E. CAMPBELL
J. MICHAEL LEVENGOOD
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For the Plaintiffs: JAMES H. ROLLINS
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ORDER ON MOTION FOR RECONSIDERATION AND
MOTION IN LIMINE

The present dispute arises in the context of an adversary proceeding filed by Plaintiffs Zurich Ins. Co., et. al., ("Plaintiffs") to object to the discharge of debt of A. Emmett Barnes ("Debtor") under section 523(a)(4) of the Code. Plaintiffs seek reconsideration of this Court's order entered December 30, 1994, which granted in part and denied in part Plaintiffs' motion in limine to preclude testimony of William G. Hayes, a purported expert on insurance industry matters. In the motion in limine, Plaintiffs had sought the exclusion of testimony proffered by Debtor's expert regarding Debtor's intent, Debtor's status as a fiduciary, and Plaintiffs' reliance upon Debtor's alleged fraud. The Court granted the motion excluding testimony regarding Debtor's status as a fiduciary, finding that such an issue was a conclusion of law outside the scope of permissible testimony under Federal Rule of Evidence 702. However, the Court stated that it would allow testimony regarding Debtor's intent and Plaintiffs' reliance as those issues are issues of fact bearing on a finding of fraud.

In this motion for reconsideration, Plaintiffs contend anew

that this witness should not be allowed to testify regarding Plaintiffs' alleged reliance upon Debtor's purported duty to maintain premiums as trust funds, or industry practice as it relates to Debtor's intent in failing to hold funds in trust.

Debtor has also filed a motion in limine in this proceeding. Debtor's motion seeks an order denying Plaintiffs the opportunity to present testimony from Charles E. Huff, Chief Fraud Investigator and Deputy Receiver for the Office of the Insurance Commissioner of the State of Georgia.¹ Debtor contends that Mr. Huff's testimony violates Federal Rule of

¹ Based upon Mr. Huff's expert witness report stating:

I have reached a conclusion about whether Mr. Barnes's [sic] conduct complies with the requirements of Georgia law. It is my conclusion that Barnes acted in violation of the portion of the insurance code which governs fiduciary standards, in the monies collected by Barnes and his agencies were not used to pay insureds' premiums.

Report of Charles E. Huff at ¶ 4.

Mr. Huff goes on to state:

Under Georgia law an insurance agent is required to hold premiums received in a fiduciary capacity. These funds must be paid the insurer, or if the funds represent a premium refund, to the insured. The agent is not permitted to use the funds for any other purpose. If it is demonstrated that an agent has failed to meet the requirements set forth in O.C.G.A. § 33-23-35(b), that an agent has violated state law and that agent can be subject to sanctions through the Office of the Insurance Commissioner and can also be subject to criminal sanctions.

Report of Charles E. Huff at ¶ 5.

Evidence 702.

Turning first to Plaintiffs' motion for reconsideration, Plaintiffs contend that fraud is not an issue in this case, and that they wish to proceed under a theory of defalcation in a fiduciary capacity. Hence, Plaintiffs would have this Court exclude any testimony offered regarding intent or reliance as irrelevant to the pleadings. The Court takes judicial notice of the pleadings filed in this case and notes that Plaintiffs' complaint contains the following statement in Count II:

23. The Plaintiffs reallege the allegations set forth in Paragraphs 1 through 18 as if fully set forth herein.

24. The acts described above constitute fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny.

25. The Debtor's indebtedness to the Plaintiffs is nondischargeable under 11 U.S.C. § 523(a)(4).

Plaintiffs' Complaint To Determine Dischargeability Of Debt at 5.

Plaintiffs have not amended their complaint to drop the allegations of fraud, so fraud was an issue before the Court when the Court denied in part Plaintiffs' motion in limine. For that reason alone the Court would deny this motion for reconsideration. It is not for the Court to speculate as to which basis under section 523(a)(4) Plaintiffs proceed. If allegations are made to which testimony would be both relevant and admissible, the Court will consider the testimony in light

of the allegations. The allegations in this matter might support the conclusion that fraud is an issue and hence testimony regarding fraud might be both relevant and admissible.

However, the Court garners from this motion for reconsideration that Plaintiffs' have abandoned any claim of fraud in this adversary proceeding. In the interest of narrowing issues for trial, the Court will reconsider its order based solely on allegations of defalcation in a fiduciary capacity. In reconsidering the Court's previous order, the Court is placing reliance upon Plaintiffs' abandonment of the fraud claim, and will not permit issues of fraud on the part of Debtor to be further litigated in this action.² Accordingly, the Court must determine if any of the testimony offered by Debtor's witness would be relevant and admissible in an action for defalcation in a fiduciary capacity.

Defalcation in a fiduciary capacity has been grounds for denial of discharge in virtually every version of the bankruptcy laws passed by Congress over the years. However, an agreed upon definition of defalcation has apparently failed to gain consensus within United States Courts. This Court finds guidance in the case of Quaif v. Johnson, 4 F.3d 950 (11th Cir. 1993), where the Circuit found:

'Defalcation' refers to a failure to produce funds

² The doctrine of judicial estoppel seems particularly applicable.

entrusted to a fiduciary. [citation omitted]. However the precise meaning of 'defalcation' for purposes of § 523(a) (4) has never been entirely clear. [citation omitted]. An early, and perhaps the best, analysis of this question is that of Judge Learned Hand in Central Hanover Bank & Trust Co. v. Herbst, 93 F.2d 510 (2nd Cir. 1937). Judge Hand concluded that while a purely innocent mistake by the fiduciary may be dischargeable, a 'defalcation' for purposes of this statute does not have to rise to the level of 'fraud,' 'embezzlement,' or even 'misappropriation.' Id. at 512. Some cases have read the term even more broadly, stating that even a purely innocent party can be deemed to have committed a defalcation for purposes of § 523(a) (4). [citations omitted].

Id. at 955.

Taking its cue from the Circuit Court, this Court turns to Judge Learned Hand's decision in the Central Hanover Bank decision and the cases cited therein. In Central Hanover Bank, the court stated:

We do not hold that no possible deficiency in a fiduciary's accounts is dischargeable; in Re Bernard, 87 B.R. 705, 707, we said that 'the misappropriation must be due to a known breach of the duty, and not to mere negligence or mistake.' Although that word probably carries a larger implication of misconduct than 'defalcation,' 'defalcation' may demand some portion of misconduct; we will assume *arguendo* that it does.

Id. at 512.

In In re Bernard, 87 F.2d 705 (2nd Cir. 1937), the court stated "Section 17a(4) places liabilities 'created by his [the debtor's] fraud, embezzlement, misappropriation, or defalcation' in the same clause. Such a collection under the rule of 'ejusdem generis' indicates that the misappropriation must be

due to a known breach of the duty, and not to mere negligence or mistake." Id. at 707.

The fact that an ejusdem generis interpretation of section 523(a)(4) would result in a finding that some degree of "evil intent" is necessary to find nondischargeable defalcation has not escaped notice by federal courts. Discount Home Center, Inc. v. Turner (In re Turner), 134 B.R. 646, 658 (Bankr. N.D. Okla. 1991). The court in Turner went on to note that federal courts have not generally required a showing of intent, and have instead given the term 'defalcation' a broader interpretation than that applied to the terms 'fraud,' 'embezzlement,' and 'larceny' also contained in the statute. Id. at 658; see also Morales v. Codias (In re Codias), 78 B.R. 344 (Bankr. S.D. Fla. 1987) (finding that defalcation may be based upon negligence or ignorance); Seibels, Bruce & Co. v. England, 63 B.R. 76 (Bankr. N.D. Ga. 1986). However, the fact remains that case law cited with approval by the Eleventh Circuit seems to make intent relevant to some degree in a finding of defalcation. Central Hanover Bank at 512; Bernard at 707.

The Court declines to adopt any particular interpretation of the term "defalcation" at this time. The Court need only find that some authority exists which would make an inquiry into Debtor's intent relevant to these proceedings. The Court thus limits the scope of this order to find that evidence of intent

will not be excluded, pending further consideration of this issue. Should the Court later determine that intent is irrelevant the Court will disregard testimony of intent in rendering its decision.

For now, whether Debtor's actions constitute a "purely innocent mistake by the fiduciary", Quaif at 955, is a question of fact to which Mr. Hayes' testimony regarding industry practice may shed light. The weight given this testimony is a duty of this Court as the finder of fact. Hence the Court will not deprive Debtor of the opportunity to produce evidence of Debtor's intent, and will not alter its previous order on motion in limine in this regard. However, in no line of cases has Plaintiff's reliance been cited as an element of defalcation. The Court will modify its previous ruling such that Debtor's witness will be precluded from presenting evidence regarding Plaintiffs' reliance.

Debtor contends that the testimony offered by Mr. Huff is in the nature of a legal conclusion, and is therefore beyond the scope of Federal Rule of Evidence 702. Rule 702 provides:

If scientific, technical, or other specialized knowledge will assist the trier of fact to understand the evidence or to determine a fact in issue, a witness qualified as an expert by knowledge, skill, experience, training, or education, may testify thereto in the form of an opinion or otherwise.

Fed. R. Evid. 702 (West 1993).³

It is well settled that experts may not offer testimony in the form of an opinion or otherwise which would constitute a legal conclusion. Marx & Co., Inc. v. Diner's Club, Inc., 550 F.2d 505, 510 (2nd Cir. 1977), cert. denied, 434 U.S. 861 (1977). It is the Court's role to arrive at conclusions of law upon consideration of the facts of the case. Mr. Huff, therefore, may not properly testify regarding whether Debtor's conduct complies with Georgia law. Similarly, Mr. Huff may not properly testify as to whether Debtor was accorded the status of a fiduciary under the law. Such testimony is beyond the scope of Rule 702, and will not be considered by the Court. Mr. Huff's testimony will not be excluded in its entirety, but will be limited to testimony properly within the scope of Rule 702.

In sum, the Court has reconsidered its order of December 30, 1994, in light of Plaintiffs' abandonment of fraud claims. The apparent disagreement among federal courts regarding the definition of defalcation as used in 11 U.S.C. § 523(a)(4) may provide legal relevance to the issue of Debtor's intent. Therefore, Mr. Hayes may properly testify as to matters regarding Debtor's intent. However, there is no legal authority

³ Under Rule 702 the Court must find 1) the expert testimony "could assist the trier of fact in understanding the evidence or determining a fact in issue;" and 2) the witness "is properly qualified to give the testimony sought." Hon. Barry Russell, Bankruptcy Evidence Manual, § 702.1, p. 396 (West 1993).

supporting the notion that reliance is an issue possessing any legal relevance in an action for defalcation. Mr. Hayes may not give testimony as to matters of Plaintiffs' reliance. Plaintiffs' motion for reconsideration is granted in part and denied in part.

Federal Rule of Evidence 702 allows an expert witness to testify regarding issues of fact and not conclusions of law. The testimony of Plaintiffs' expert will be excluded to the extent that such testimony expresses an opinion constituting a conclusion of law. Mr. Huff's statements to the effect that Debtor occupied the role of a fiduciary and violated Georgia law are plainly conclusions of law which are properly excluded. Debtor's motion in limine is granted.

SO ORDERED, this 27th day of January, 1995.

James D. Walker, Jr.
United States Bankruptcy Judge

CERTIFICATE OF SERVICE

I, Cheryl L. Spilman, certify that a copy of the attached and foregoing was mailed to the following:

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This 27th day of January, 1995.

Cheryl L. Spilman
Deputy Clerk
United States Bankruptcy Court