

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE SOUTHERN DISTRICT OF GEORGIA
SAVANNAH DIVISION

IN RE:)
)
MARVIN SAMUEL STRODE,) CHAPTER 7 BANKRUPTCY
) CASE NO. 92-42515
)
)
) DEBTOR)
)
)
SLOAN ELECTRIC CO., INC.,)
)
)
) PLAINTIFF) ADVERSARY PROCEEDING
) NO. 93-04041A
VS.)
)
)
MARVIN SAMUEL STRODE,)
)
)
) DEFENDANT)

BEFORE

JAMES D. WALKER, JR.
UNITED STATES BANKRUPTCY JUDGE

COUNSEL:

For Debtor/Defendant: C. JAMES MCCALLAR
MARK BULOVIC
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For Plaintiff: THOMAS M. HUNTER
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The Chapter 7 Trustee: JAMES L. DRAKE, JR.
Post Office Box 9149
Savannah, Georgia 31412

MEMORANDUM OPINION

Sloan Electric Co., Inc. ("Sloan Electric") filed this adversary proceeding seeking a determination that Marvin Samuel Strode ("Debtor") is indebted to Sloan Electric, and further, that such debt is nondischargeable. Sloan Electric also seeks exemplary damages.

FINDINGS OF FACT

Debtor was a forty (40%) percent shareholder and principal officer in DeWitt-Strode Insurance Services, Inc. ("DeWitt-Strode"). The owner and president of Sloan Electric is James Irvin Sloan. His wife, Martha C. Sloan is the secretary/treasurer.

According to Mr. and Mrs. Sloan, Mr. Clyde K. Hull, Jr. ("Mr. Hull") is the "father" of their retirement plan. Mr. Hull was authorized to invest the money which was paid to fund the corporation's obligation under its ERISA qualified pension and profit sharing plan. Mr. and Mrs. Sloan testified that Mr. Hull had complete discretion regarding the investment of the funds.

On September 15, 1990, Sloan Electric delivered a check to Mr. Hull in the amount of Twenty-five Thousand Four Hundred Sixty-six Dollars (\$25,466.00) payable to "DeWitt-Strode." The check bore the notation "1989 Pension Plan Contribution." Mr.

Hull in turn delivered the check to DeWitt-Strode where it was deposited into the general operating account. The funds were subsequently disbursed by DeWitt-Strode in the ordinary course of its business as an insurance agency.

Mr. and Mrs. Sloan evidenced minimal investment expertise. They relied exclusively on Mr. Hull to manage and direct their investments. Mr. and Mrs. Sloan had no expectations regarding the use of the funds which were made payable to DeWitt-Strode. They were simply following Mr. Hull's directions in the belief that Mr. Hull would see that they received the benefit of the investment in the pension and profit sharing plan.

DeWitt-Strode was not engaged in the business of investing retirement funds. They did not have a trust account. DeWitt-Strode's ordinary course of business was to receive funds from customers into the firm's general operating account and to thereafter remit premiums to insurance companies from those funds. The commission portion of the customer payments would be retained by DeWitt-Strode.

Sloan Electric made several profit sharing plan investments other than the one at issue in this case. In each instance, Sloan Electric complied with the directions given by Mr. Hull. Although Mr. and Mrs. Sloan never inquired of Mr. Hull as to the plan's investments, they did receive periodic reports from entities such as Prudential-Bache and Jefferson Pilot Insurance Company regarding the performance of invested funds.

Mr. and Mrs. Sloan first noticed a problem when Sloan Electric was unable to reconcile its 1991 profit sharing plan accounts with its deposits. The plan administrator said she had difficulty contacting Mr. Hull to obtain information regarding the funds in question. It became apparent about two years following the September 15, 1990, check that Sloan Electric had no documentation as to the disposition of those funds, other than the canceled check reflecting the deposit into the DeWitt-Strode account.

Debtor testified that Mr. Hull authorized DeWitt-Strode to use the funds as a short term loan and that the loan was to be considered as an investment by the Sloan Electric profit sharing plan. Mr. Hull testified to the contrary. He said that Debtor was instructed to deposit the funds in a segregated trust account in the name of DeWitt-Strode. Mr. Hull testified further that DeWitt-Strode was never authorized to commingle the funds or use the funds in the ordinary course of its business.

The evidence demonstrates that Mr. Hull was not an agent of DeWitt-Strode at any time prior to or subsequent to the transaction of which Sloan Electric complains. Mr. Hull's relationship with DeWitt-Strode was characterized as an "independent producer". He was not directly employed by DeWitt-Strode. There was no evidence that DeWitt-Strode took any steps to represent to the general public that Mr. Hull was an agent of DeWitt-Strode. Further, there is no indication that Mr. Hull

represented to any person or entity including Sloan Electric that he had such capacity.

Mr. Hull's representations cannot be attributed to Debtor or DeWitt-Strode. Any such representations made to Sloan Electric were made by Mr. Hull in his individual capacity. Although the facts of this case are in dispute as to the instructions given by Mr. Hull to Debtor, this Court finds Mr. Hull's testimony to be implausible. The testimony of Debtor to the affect that Mr. Hull authorized him to utilize the funds as a short term loan in the ordinary course of the business of DeWitt-Strode appears to be more credible.

This conclusion is important as to the first evidentiary matter in controversy. Mr. Hull testified as to specific instructions he said he gave to Debtor regarding the way the Sloan Electric pension funds were to be deposited and segregated. There were no notes evidencing the treatment of the Sloan Electric funds as a loan. There was no testimony as to any agreement for the date it was to be repaid or the interest rate to be applied. Sloan Electric argues that these facts point to the conclusion that the funds were not placed with DeWitt-Strode as a loan but were instead intended to be set aside in a segregated trust account.

Debtor testified that Mr. Hull and another individual were being invited to participate in a venture to acquire an interest in DeWitt-Strode. Debtor said that Mr. Hull's participation was

at least partly for the purpose of funding short term operating losses at DeWitt-Strode, which losses ranged at times from Twenty Thousand (\$20,000.00) Dollars to Forty Thousand (\$40,000.00) Dollars per month.

Mr. Hull had made certain loans to DeWitt-Strode as follows:

<u>DATE:</u>	<u>AMOUNT:</u>
10/26/89	\$ 13,349.54
01/05/90	\$ 10,000.00
12/06/90	\$ 10,311.00
12/17/90	\$ 6,500.00

All of these transactions evidence an interest on the part of Mr. Hull in financial participation in DeWitt-Strode. As to these loans, there were no notes or agreements regarding the payment of interest. If Mr. Hull authorized the Sloan Electric funds to be used as a loan, the failure to require a note or to agree on an interest rate would have been consistent with the way Mr. Hull loaned his own funds to DeWitt-Strode. The evidence of the lack of a note or an agreement as to the payment of interest does not point to the conclusion, as urged by Sloan Electric, that Debtor had been instructed to deposit the Sloan Electric funds into a segregated trust account.

Debtor also testified that he asked Mr. Hull about

repayment of the Sloan Electric loan, and was told by Mr. Hull that he had already repaid the loan to Sloan Electric. Debtor claims Mr. Hull then stated that DeWitt-Strode owed him the money used to repay Sloan Electric. Mr. Hull countered stating that Debtor never offered to repay the funds and, further, that Debtor refused to repay the funds despite his repeated requests.

As referred to above, Mr. Hull was involved in a transaction intended to acquire for himself an interest in the DeWitt-Strode business. Mr. Hull testified that he engaged in negotiations to acquire an interest in DeWitt-Strode through a combination of corporate entities which would acquire DeWitt-Strode as a subsidiary corporation. An agreement to that effect was signed by Mr. Hull on December 21, 1990. Mr. Hull testified that he revoked the agreement on the same day it was signed. He testified further that he was out of the deal on January 1, 1991. Both assertions proved to be untruthful.

A letter from Mr. Hull dated February 25, 1991, to the attorney handling the documentation of the DeWitt-Strode acquisition transaction indicated that as of that date Mr. Hull did not consider the agreement to be void. It was not until February 28, 1991, that the agreement was voided by way of a letter issued by Mr. Hull's attorney.

Mr. Hull said he signed an agreement with another company on January 1, 1991 which had the effect of voiding the agreement with DeWitt-Strode. His testimony was discredited by reliable

documentary evidence in the form of a telecopy transmission cover sheet showing that the agreement Mr. Hull said he signed on January 1, 1991 was still in draft form as of July 30, 1991.

The funds were never repaid to Mr. Hull or Sloan Electric by DeWitt-Strode. In December 1992, Sloan Electric filed suit in Chatham County Superior Court, Civil Action File No. X92-4006-B against Debtor and six others. The suit as to Debtor was stayed by the filing of this Chapter 7 case on December 14, 1992.

CONCLUSIONS OF LAW

There is no dispute in this case that Debtor's insurance agency DeWitt-Strode obtained funds belonging to Sloan Electric, and expended those funds without the knowledge or permission of Sloan Electric. The Court concludes that any obligations owing by Debtor to Sloan Electric stemming from the transactions described above are dischargeable in this bankruptcy case.

Sloan Electric claims that Debtor's conduct renders the subject debt nondischargeable pursuant to 11 U.S.C. §§ 523(a)(2)(A), 523(a)(4) and 523(a)(6).¹ As in all proceedings

¹11 U.S.C. §§ 523(a)(2)(A), 523(a)(4) and 523(a)(6) provide:

(a) A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt...

(2) for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by...

under section 523, the plaintiff has the burden of proving nondischargeability by a preponderance of the evidence. Grogan v. Garner, 498 U.S. 279 (1991). The Court's analysis is fact intensive and, given the disputed testimony, depends largely upon the credibility of the witnesses and evidence presented.

11 U.S.C. § 523(a)(2)(A)

Debtor knew that the funds paid to DeWitt-Strode were an asset of the Sloan Electric Pension and Profit Sharing Plan. This knowledge on the part of Debtor is an essential element of Sloan Electric's contention that Debtor's discharge should be denied. However, in order for Sloan Electric to establish Debtor's financial obligations as nondischargeable under section 523(a)(2)(A), it must prove that Debtor obtained the funds through false pretenses, a false representation, or actual fraud. The Court finds that Sloan Electric has failed to carry its burden of proof under this section.

The language of section 523(a)(2)(A) applies only to funds obtained through false pretenses, a false representation, or actual fraud. The Court's analysis will therefore focus on the

(A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition;...

(4) for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny;...

(6) for willful and malicious injury by the debtor to another entity or to the property of another entity;...

manner in which DeWitt-Strode came into possession of Sloan Electric's funds. The facts show that Debtor neither solicited the funds from Sloan Electric, nor made any form of representation to Sloan Electric regarding the proposed use of said funds. Mr. Hull had sole discretion as to how to invest company funds and exercised that discretion in this case.

Sloan Electric contends that Debtor is liable for implied fraud under applicable state law. It is not necessary to decide that question, since the Bankruptcy Code is clear that under 11 U.S.C. § 523(a) (2) (A) only a finding of actual fraud will render a debt nondischargeable. Having found that Debtor, in obtaining Sloan Electric's funds, made no false representations, regarding the proposed use of Sloan Electric's funds, the Court finds that neither Debtor nor DeWitt-Strode came into possession of the subject funds through false pretenses, a false representation, or actual fraud. Sloan Electric may not rely upon section 523(a) (2) (A).

11 U.S.C. § 523(a) (4)

Sloan Electric claims that Debtor committed fraud or defalcation while acting in a fiduciary capacity contrary to the provisions of 11 U.S.C. § 523(a) (4). In order to establish any liability on Debtor's part as nondischargeable under section 523(a) (4), Sloan Electric must first demonstrate that Debtor held a fiduciary capacity within the meaning of the Bankruptcy Code. The Court finds that Sloan Electric has failed to carry

its burden of proof under this section.

The meaning of the term "fiduciary" as it is used within the Bankruptcy Code is determined by federal law. Blashke v. Standard, 123 B.R. 444 (Bankr. N.D. Ga. 1991). The Supreme Court has consistently interpreted the term "fiduciary" as used in the various bankruptcy acts in a narrow fashion. Id. In the case of Chapman v. Forsyth, 43 U.S. 202 (1844), the Court stated:

The cases enumerated, "the defalcation of a public officer", "executor", "administrator", "guardian", or "trustee", are not cases of implied but special trusts, and the "other fiduciary capacity" mentioned must mean the same class of trusts. The act speaks of technical trusts, and not those which the law implies from contract. A factor is not, therefore, within the act.

The Supreme Court has been consistent in this narrow interpretation of the term fiduciary. Hennequin v. Clews, 111 U.S. 676 (1883) (person receiving securities as collateral for a loan and not returning them after the loan was repaid does not become fiduciary within the meaning of § 33 of the Bankruptcy Act of 1867); Noble v. Hammond, 129 U.S. 65 (1889) (agreement between parties may give rise to a kind of trust, but not within the meaning of the Bankruptcy Act); Upshur v. Briscoe, 138 U.S. 365 (1891) (placing trust or confidence in a debtor, in the popular sense of the terms, is not enough to create a fiduciary relationship within the meaning of the bankruptcy act, although actions may have been of a "fiduciary character").

Additionally, the trust created must exist prior to the act creating the debt and without reference to that act. Angelle v. Reed (In re Angelle), 610 F.2d 1335 (5th Cir. 1980) (constructive trust is not sufficient to create a fiduciary relationship under the provisions of the bankruptcy act). In the case at bar, neither Debtor nor DeWitt-Strode were party to an express trust of the type contemplated by the Bankruptcy Code.

However, at least one court has speculated that state statutes can make parties fiduciaries "by imposing trust-like duties, such as segregating accounts, on those who enter into certain kinds of contracts." Id. at 1340. Therefore, if state law imposes a trust-like duty on a person it may create a trust within the meaning of the Code if the trust arises prior to and without reference to the act creating the debt.

Sloan Electric argues that the receipt of the pension monies by DeWitt-Strode created an implied trust under Georgia law by virtue of O.C.G.A. § 53-12-90. That section provides: "An implied trust is either a resulting trust or a constructive trust." Neither resulting trusts nor constructive trusts exist prior to the act creating the debt and without reference to that act.² Therefore, Debtor is not a fiduciary within the meaning of the Bankruptcy Code, and Sloan Electric may not rely upon 11 U.S.C. § 523(a)(4).

11 U.S.C. § 523(a)(6)

²See O.C.G.A. §§ 53-12-91 and 53-12-93.

Debts incurred through "willful and malicious injury by the debtor to another entity or to the property of another entity" are nondischargeable in bankruptcy. 11 U.S.C. § 523(a)(6). Sloan Electric correctly points out that conversion may be willful and malicious injury within the meaning of section 523(a)(6). However, Sloan Electric incorrectly relies upon the case of Tinker v. Colwell, 193 U.S. 473 (1902) as the proper standard with which to judge Debtor's behavior. In the Bankruptcy Reform Act of 1978, Congress rejected the holding of Tinker to the extent that reckless disregard is no longer sufficient to establish willful injury within the meaning of the Code. H. Rept. No. 95-595 to accompany H.R. 8200, 95th Cong., 1st Sess. (1977) pp. 363-365.

The term "willful" as used in section 523(a)(6) means intentional. Chrysler Credit Corp. v. Rebhan, 842 F.2d 1257 (11th Cir. 1988). The term "malicious" means with an intent to injure. In re Posta, 866 F.2d 364 (10th Cir. 1989). Intent to injure may be implied by a debtor's conduct. In re Vaughn, 779 F.2d 1003 (4th Cir. 1985). Read together, these cases hold that Debtor must have intended to injure Sloan Electric by using their funds.

The facts support a finding that Debtor's acts were willful in the sense that he knew that he was using Sloan Electric's funds. However, having found that Debtor in no way solicited Sloan Electric's funds, retained said funds when Debtor knew he

should have returned them or disposed of said funds out of the ordinary course of business, this Court cannot find that Debtor's acts were malicious. The Court cannot imply an intent to injure Sloan Electric based on these facts. Therefore, section 523(a)(6) will not render any of Debtor's possible obligations nondischargeable.

Summary

Sloan Electric has failed to carry its burden regarding proof of the non-dischargeability of any liability of Debtor arising out of the transactions in this case. Debtor did not obtain the funds in question through false pretenses, a false representation or actual fraud. Further, Debtor did not occupy fiduciary capacity as to Sloan Electric within the meaning of the Bankruptcy Code or commit a willful and malicious injury to Sloan Electric.

This Memorandum Opinion expresses no conclusion as to the liability of the Debtor, if any, under state law. This Court's decision regarding dischargeability, however, does not negate the possibility that Debtor and others might be liable to the Plaintiff under the standard of law applied in the state courts. Whatever liability might be established there as to Debtor will be discharged in this case.

The state court action has been stayed as to Debtor. It would be futile for the Plaintiff to pursue that state court action further if the sole purpose was to establish a liability

on the part of Debtor for the recovery of money from Debtor. On the other hand, if the establishment of that liability would serve some other useful purpose, such as establishing a claim for the purpose of receiving pro rata distribution of assets from the Trustee in this case, this order should not be construed as a barrier to the further prosecution of that state court action.

In the interest of expediting a resolution of the matters which are currently pending in the state court action among several parties, including Debtor, this court abstains pursuant to 28 U.S.C. §1334(c) from further considering the matter of Debtor's liability under state law and, further, finds cause for relief from the stay pursuant to 11 U.S.C. § 362(d)(1) for the purpose of authorizing the parties to proceed with the state court action.

In concluding that discretionary abstention is appropriate and relieving the automatic stay, it is acknowledged that Debtor might be subjected to further inconvenience and expense in defending himself in that action. It is further acknowledged that Debtor might have no incentive to participate in the state court action. The state court will have to determine the effect, if any, of such conduct by Debtor. The Chapter 7 Trustee in this case may have to decide if he should intervene in the case to resist the claim. To the extent that a liability of one or more of the Defendants is interrelated, the state

court can sort out the rights and liabilities of the parties without the necessity of interpreting the significance of the findings of this Court as to the non-dischargeability of this debt. The state court action can now proceed to conclusion in the same manner as it would have had this Chapter 7 case never been filed with the exception that any liability established against Debtor in this case, at the conclusion of that action, will be discharged by this Chapter 7 proceeding.

DATED this 14th day of March, 1994.

JAMES D. WALKER, JR., Judge
United States Bankruptcy Court

CERTIFICATE OF SERVICE

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

Mr. C. James McCallar
Post Office Box 9026
Savannah, Georgia 31412

Mr. Mark Bulovic
Post Office Box 9026
Savannah, Georgia 31412

Mr. Thomas M. Hunter
7370 Hodgson Memorial Drive
Suite A-9
Savannah, Georgia 31406

Mr. James L. Drake, Jr.
Post Office Box 9149
Savannah, Georgia 31412

This 15th day of March, 1994.

Cheryl L. Spilman
Deputy Clerk
United States Bankruptcy Court

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE SOUTHERN DISTRICT OF GEORGIA
SAVANNAH DIVISION

IN RE:)
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SLOAN ELECTRIC CO., INC.,))
PLAINTIFF)) ADVERSARY PROCEEDING
)) NO. 93-04041A
VS.))
))
MARVIN SAMUEL STRODE,))
DEFENDANT))

ORDER

In accordance with the Memorandum Opinion entered this date, it is hereby

ORDERED that any liability of the Defendant/Debtor, Marvin Samuel Strode, to the Plaintiff, Sloan Electric Co., Inc., is hereby determined to be dischargeable; and it is hereby further

ORDERED that the Plaintiff and all other parties to the action pending in the Chatham County Superior Court, Civil Action File No. X92-4006-B, are relieved from the provisions of 11 U.S.C. § 362, to the extent necessary, to permit them to prosecute their claims for liability against all parties, including Debtor. Enforcement of any judgment obtained against Debtor by the Plaintiff is stayed as a consequence of the finding of dischargeability stated above in this order.

SO ORDERED this 14th day of March, 1994.

JAMES D. WALKER, JR., Judge
United States Bankruptcy Court

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This 15th day of March, 1994.

Cheryl L. Spilman
Deputy Clerk
United States Bankruptcy Court