

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

Plaintiffs Zurich Ins. Co., et. al., ("Plaintiffs") have brought an objection to discharge of debt of A. Emmett Barnes ("Debtor") under section 523(a)(4) of the Code. Plaintiffs allege that Debtor committed fraud in a fiduciary capacity. Debtor has announced the possibility of presenting the testimony of William G. Hayes, a purported expert on insurance industry matters. Plaintiffs contend that this witness should not be allowed to testify regarding two conclusions: 1) the practice of insurance agents of not maintaining separate accounts and not treating premiums as trust funds;¹ 2) Plaintiffs' alleged reliance upon Debtor's purported duty to maintain premiums as trust funds.² Plaintiffs contend that the first conclusion is matter of law to which an expert may not testify, and the second conclusion is "totally irrelevant" to the proceedings.

The Court must make several findings as to actions brought under section 523(a)(4). The Court must find both fraud and the existence of a fiduciary relationship. 11 U.S.C. § 523(a)(4). The existence of a fiduciary relationship is determined by

¹ This is based on the witness' statement in response to interrogatories:

[I]t is my conclusion that agencies in the State of Georgia generally do not treat premiums as trust funds and have not done so in the recent past. This fact is well known in the insurance industry.

² Based on the witness' assertion:

[I]t is my conclusion that Zurich did not do anything to assure itself that a premium trust was established in a separate bank account or that premiums were properly handled by the Barnes' Agencies.

reference to federal law. Blashke v. Standard (In re Standard), 123 B.R. 444, 451-56 (Bankr. N.D. Ga. 1991). Fraud is determined by reference to state law. In re Byard, 47 B.R. 700, 707 (Bankr. M.D. Tenn. 1985) (discussing the collateral estoppel effect of prior judgments, the court found "Fraud, conversion and misapplication of funds are issues well within the regular competence and experience of state courts").

Plaintiffs rely upon state statutes to impose a fiduciary duty upon Debtor.³ While the fiduciary capacity of a debtor is a question of federal law, state statutes may create a fiduciary relationship "by imposing trust-like duties, such as segregating accounts, on those who enter into certain kinds of contracts." Blashke at 453 (citing Angelle v. Reed (In re Angelle), 610 F.2d 1335, 1340 (5th Cir. 1980)). Finding a fiduciary relationship conferred by state law is a matter of interpreting that law and determining if "the trust arises prior to and without reference to the act creating the debt." Sloan Electric Co., Inc. v. Strode (In re Strode), No. 93-04041A slip op. at 11 (Bankr. S.D. Ga. Mar. 14, 1994).

Fraud, on the other hand, is a question of fact. King v. Towns, 102 Ga. App. 895 (1960). There are five elements to a finding of fraud under Georgia law:

- 1) that the defendant made the representations;
- 2) that at the time he knew they were false (or what the law regards the equivalent of knowledge);
- 3) that he made them with the intention and purpose of deceiving the plaintiff;
- 4) that the plaintiff relied upon such representations;

³ O.C.G.A. § 33-23-35(b).

5) that the plaintiff sustained the alleged loss and damage as the proximate result of their having been made.

McLendon v. Galloway, 216 Ga. 261, 263 (1960).

In the matter before the Court, Plaintiffs complain that the above referenced testimony of Mr. Hayes is inconsistent with Rule 702 of the Federal Rules of Evidence which 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).⁴

The testimony to be offered by Mr. Hayes would have to be considered in light of the findings the Court must make under section 523(a)(4). The Court must consider what the testimony would be offered to prove. Inasmuch as Plaintiffs rely upon state law to create a fiduciary duty on Debtor's part, this is a question of law. Section 702 does not provide for expert testimony regarding "legal standards." Marx & Co., Inc. v. Diner's Club, Inc., 550 F.2d 505, 510 (2nd Cir. 1977), cert. denied, 434 U.S. 861 (1977) ("interpretation of the contract is for the jury and the question of legal effect is for the judge"). The testimony of Mr. Hayes to the effect that the practice of the industry varies from the alleged duty imposed under state law is not relevant to the determination the Court

⁴ 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).

must make regarding Debtor's status as a fiduciary,⁵ and is inconsistent with Fed. R. Evid. 702 inasmuch as it is offered to resist classification of Debtor as a fiduciary.

However, Mr. Hayes' testimony regarding the practice of the industry may be relevant to the question of Plaintiffs' reliance upon the alleged fraud as well as Debtor's intent. Testimony regarding the practice of an industry is admissible "to enable the [finder of fact] to evaluate the conduct of the parties against the standards of ordinary practice in the industry." Id. at 509 (citing VII Wigmore on Evidence § 1949, at 66 (3d ed. 1940)). If Mr. Hayes testifies that the regular practice in the industry is not to maintain trust accounts, and further, that Plaintiffs knew of or endorsed such a practice, this might be relevant evidence as to the Plaintiffs' required reliance.

Additionally, an industry-wide practice of not maintaining trust accounts could bear upon the question of Debtor's fraudulent intent in allegedly failing to maintain such an account. Since experts may testify regarding facts in issue pursuant to Fed. R. Evid. 702, the Court's decision must turn on the question of relevance. Mr. Hayes' testimony may satisfy the requirement of relevance.⁶

In sum, Fed. R. Evid. 702 allows an expert witness to

⁵ Fed. R. Evid. 402.

⁶ "Relevant evidence" means evidence having any tendency to make the existence of any fact that is of consequence to the determination of the action more probable or less probable than it would be without the evidence.

Fed. R. Evid. 401 (West 1993).

testify regarding issues of fact such as fraud, and not conclusions of law such as Debtor's status as a fiduciary. Having determined that the expert may testify regarding factual issues pertaining to fraud, the Court must determine at trial that 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."⁷ The Court will not exclude the proffered testimony of Mr. Hayes at this time as the possibility exists that his testimony would both be admissible and relevant to issues before the Court. Plaintiffs may, however, renew their motion at trial if it appears that Mr. Hayes' testimony is offered for an improper purpose, or any other purpose not in accordance with this order.

SO ORDERED, this _____ day of December, 1994.

James D. Walker, Jr.
United States Bankruptcy Judge

⁷ See supra. at n.4.

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 3rd day of January, 1995.

Cheryl L. Spilman
Deputy Clerk
United States Bankruptcy Court