No. 11-____

IN THE

Supreme Court of the United States

RANDY CURTIS BULLOCK,
Petitioner,

v.

BANKCHAMPAIGN, N.A.,
Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Eleventh Circuit

PETITION FOR A WRIT OF CERTIORARI

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June 14, 2012

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QUESTIONS PRESENTED

What degree of misconduct by a trustee constitutes "defalcation" under § 523(a)(4) of the Bankruptcy Code that disqualifies the errant trustee's resulting debt from a bankruptcy discharge – and does it include actions that result in no loss of trust property?

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PETITION FOR A WRIT OF CERTIORARI

Randy Curtis Bullock respectfully petitions for a writ of certiorari to review a judgment of the United States Court of Appeals for the Eleventh Circuit.

OPINIONS BELOW

The opinion of the court of appeals is reported at 670 F.3d 1160 (11th Cir. 2012). Pet. App. 1a-14a. The respective memorandum opinions of the district and bankruptcy courts for the Northern District of Alabama are unreported. Pet. App. 16a-28a, 29a-44a.

JURISDICTION

The judgment of the court of appeals was entered on February 14, 2012. The court denied rehearing on March 16, 2012. Pet. App. 15a. This Court has jurisdiction under 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS INVOLVED

Section 523 of the United States Bankruptcy Code provides: "(a) A discharge under section 726, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt . . . (4) for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny . . . ."

STATEMENT OF THE CASE

1. This case began as a dispute among family members over administration of the father's life

insurance trust and ultimately resulted in the Chapter 7 bankruptcy of one of the children, petitioner Randy Curtis Bullock, who had been appointed by his father as trustee. Petitioner's father, Curt Bullock, created the trust, the Curt Bullock Trust No. 2, in 1978. The trust's sole asset was his father's life insurance policy, which featured a $1 million death benefit and accumulated cash value. Petitioner and his siblings were named as beneficiaries. Until his father approached him about a loan from the trust, petitioner did not know that he was the trustee. In fact, neither he nor his four siblings were aware that the trust existed. Pet. App. 45a.

2. The dispute involved three loans taken against the cash value of the life insurance policy. All three loans were repaid in full, with six percent interest. Pet. App. 17a. The first loan, for $117,545.96, was made in 1981 at the request of petitioner's father, the settlor of the trust. The loan went to petitioner's mother, Imogene Bullock, so that she could repay a debt that she owed to the family garage-construction business. Pet. App. 2a. The second loan, for $80,257.04, was made in 1984 to petitioner and his mother. The loan proceeds were used to purchase certificates of deposit, which later were cashed and used, along with other funds, to purchase a garage fabrication mill in Springfield, Ohio, for approximately $200,000.00. Pet. App. 2a. The third loan, for $66,223.96, was made in 1990 to petitioner and his mother, and used in the purchase of an office building and other Springfield real estate. Pet. App. 2a. All of the loans, totaling $264,026.96, were evidenced by notes to the trust, and were secured by first mortgages on property appraised for approximately $447,000.00. Payments were made on the loans for 15 years.

Petitioner resigned as the trustee for the trust in 1998 at the request of some of the beneficiaries. Respondent, BankChampaign, N.A., was designated successor trustee. Within a few months after resigning, petitioner paid the remaining balance of the loans, with interest. The total of the payments made on the loans by petitioner and his mother was $455,440.76.

3. In 1999, two of the five beneficiaries of the trust, petitioner's two brothers, filed an action in the Circuit Court of Vermilion County, Illinois, asserting claims that petitioner breached his fiduciary duty as trustee of the Curt Bullock Trust. Petitioner's brothers claimed that any profits earned by petitioner and his mother as a result of the loans should be turned over to the trust. The action also named other businesses in which petitioner had an interest as defendants and sought a constructive trust on all profits, proceeds, and assets obtained by petitioner and the other defendants. Pet. App. 47a.

4. The Illinois court found that petitioner did "not appear to have had a malicious motive in borrowing funds from the trust." Pet. App. 45a. The court made no other finding concerning petitioner's intent, motive, or state of mind. The court made no finding that petitioner committed a knowing or deliberate breach of fiduciary duty. But the court granted summary judgment in favor of petitioner's brothers because the fully-repaid loans were deemed self-dealing transactions and thus breaches of fiduciary duty under Illinois law. Pet. App. 57a. The court found that the trust did not earn any profit on the loans, which were repaid at the same interest rate charged by the insurance company. The court awarded damages to the trust of $250,000, which the

court estimated to be the benefit obtained by petitioner from the breaches of duty, though characterizing the "actual monetary benefit" as "difficult to ascertain." Pet. App. 46a. The court added an award of $35,000 in attorneys' fees to the trust, $25,000 of which respondent was directed to pay to the two brothers who commenced the action. Pet. App. 47a-49a.

5. The Illinois court also impressed a constructive trust on the assets of petitioner and of two affiliated entities in the amount of the judgment against petitioner. Pet. App. 47a-48a. The constructive trust expressly included the Springfield mill property and petitioner's beneficial interest in the Curt Bullock Trust. The effect of this order was to put petitioner's assets, which he might have used toward payment of the judgment, in respondent's control. In the years since entry of the Illinois judgment in 2002, respondent has rejected petitioner's demands that the property subject to the constructive trust be liquidated to pay the judgment.

6. On October 21, 2009, petitioner filed for bankruptcy under Chapter 7 of the Bankruptcy Code seeking a discharge of his debts. Respondent, as successor trustee of the Curt Bullock Trust, filed an adversary proceeding on January 11, 2010 to obtain a ruling excepting petitioner's obligations under the Illinois judgment from discharge under 11 U.S.C. § 523(a)(4). Petitioner answered and, though not a lawyer, defended himself *pro se* in the adversary proceeding. Respondent filed a motion for summary judgment contending that petitioner should be collaterally estopped from contesting issues that were decided by the Illinois court and that the Illinois court's judgment established § 523(a)(4) "defalcation"

as a matter of law. On May 27, 2010, the bankruptcy court granted this motion. Pet. App. 29a-44a. Petitioner appealed to the district court, but it affirmed in an unpublished order. Pet. App. 16a-28a.

7. On further appeal, the United States Court of Appeals for the Eleventh Circuit acknowledged a split among the circuits as to the definition of "defalcation." The court aligned itself with the Fifth, Sixth, and Seventh Circuits to hold that "defalcation requires a known breach of a fiduciary duty, such that the conduct can be characterized as objectively reckless." Pet. App. 10a-11a. The Eleventh Circuit determined that "self-dealing" was objectively reckless, and concluded that petitioner's actions amounted to defalcation sufficient to except petitioner's debt from discharge, even though the Illinois court had not found that petitioner committed a knowing breach of fiduciary duty. Pet. App. 11a.

REASONS FOR GRANTING THE WRIT

A. The Circuits Are Divided on the Meaning of "Defalcation," with the Result of Inconsistent Application of an Important Provision of Personal Bankruptcy Law.

This case affords the Court a compelling opportunity to resolve a deep and longstanding conflict among the federal circuits concerning the meaning and application of the phrase "defalcation while acting in a fiduciary capacity" found in § 523(a)(4) of the Bankruptcy Code. One court has aptly characterized the current situation, detailed below, as "persistent confusion." *Denton ex rel. Denton v. Hyman* (*In re Hyman*), 502 F.3d 61, 68 (2d Cir. 2007). The Court has not construed this provision since its inclusion in the Bankruptcy Act of 1978. Pub. L. No. 95-598, 92

Stat. 2549. The Court last interpreted a predecessor provision in *Davis v. Aetna Acceptance Co.*, 293 U.S. 328 (1934), but did not then address the quantum-of-culpability issue now presented.

The division among the circuits is best considered in the context of the statutory structure. The Court has posited that the exceptions of particular debts from bankruptcy discharge "should be confined to those plainly expressed." *Kawaauhau v. Geiger*, 523 U.S. 57, 62 (1998) (quoting *Gleason v. Thaw*, 236 U.S. 558, 562 (1915)). This rule of narrow construction reinforces the Bankruptcy Code's "fresh start" policy, long a foundation of bankruptcy law: "One of the primary purposes of the Bankruptcy Act is to 'relieve the honest debtor from the weight of oppressive indebtedness, and permit him to start afresh free from the obligations and responsibilities consequent upon business misfortunes.'" *Local Loan Co. v. Hunt*, 292 U.S. 234, 244 (1934) (quoting *Williams v. United States Fidelity & Guaranty Co.*, 236 U.S. 549, 554-55 (1915)).

The discharge exception provision, § 523(a), is basically divisible into two groups of exceptions. *See Grogan v. Garner*, 498 U.S. 279, 287-88 (1991). The first group consists of types of debts that are *per se* non-dischargeable for various policy reasons: certain taxes, domestic support obligations, educational loans, restitution orders and the like. The second group of non-dischargeable debts are the product of wrongdoing, including debts resulting from willful and malicious injury, § 523(a)(6); fraud or certain false representations, § 523(a)(2); and death or injury caused by driving while intoxicated, § 523(a)(9). In this second group is § 523(a)(4)'s exception "for fraud

or defalcation while acting in a fiduciary capacity, embezzlement, or larceny . . . ."

Courts seem to agree that not every breach of fiduciary duty amounts to a discharge-ineligible "defalcation." But the consensus ends there. The federal circuits fall into three camps regarding the mental state required for a misappropriation or a failure to account to constitute "defalcation" under section 523(a)(4) of the Bankruptcy Code: (1) scienter or extreme recklessness, adhered to by the First and Second Circuits; (2) known breach of a fiduciary duty, such that the conduct can be characterized as "objectively reckless," applied by the Eleventh Circuit in this case and by the Fifth, Sixth, and Seventh Circuits; and (3) mere negligence or innocent mistake resulting in misappropriation, applied by the Ninth, Fourth, and Eighth Circuits.[1]

1. *Scienter or Extreme Recklessness*

The First and Second Circuits require "a mental state embracing intent to deceive, manipulate, or defraud" paralleling the scienter requirement in the well-developed law of securities fraud. *Rutanen ex rel. Quevillon v. Baylis* (*In re Baylis*), 313 F.3d 9, 20 (1st Cir. 2002) (quoting *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 n.12 (1976)). The standard can be met with a showing of "extreme recklessness" constituting "an extreme departure from the standards of ordinary care," greater than the "mere conscious taking of risk associated with the usual torts standard of recklessness." *Baylis*, 313 F.3d at 20 (quoting *Greebel v. FTP Software, Inc.*, 194 F.3d 185, 198 (1st

[1] The D.C. Circuit has not considered the definition of defalcation. The Third and Tenth Circuits have not addressed defalcation in published opinions. *Bullock*, 670 F.3d at 1166.

Cir. 1999)). In *Hyman*, 502 F.3d at 68, the Second Circuit explicitly aligned itself with the First Circuit and adopted this scienter or extreme recklessness standard: "We believe that these concepts—well understood and commonly applied in the securities law context—strike the proper balance under section 523(a)(4). This standard ensures that the term 'defalcation' complements but does not dilute the other terms of the provision . . . all of which require a showing of actual wrongful intent." *Id*.

Baylis involved a lawyer acting as co-trustee who was accused of various acts of defalcation. In its analysis, the First Circuit pointed out that the defalcation exception is located in the same sentence with exceptions for fraud, embezzlement, and larceny, all of which require specific intent. *Baylis*, 313 F.3d at 20 (excepting from discharge any debts "for fraud and defalcation while acting as a fiduciary, and embezzlement and larceny generally"). The court reasoned that an act that constitutes a defalcation "must be a serious one indeed, and some fault must be involved." *Id*. at 19. "[A] creditor must be able to show that a debtor's actions were so egregious that they come close to the level that would be required to prove fraud, embezzlement, or larceny." *Id*. at 20. The court concluded that requiring "a mental state embracing intent to deceive, manipulate, or defraud," borrowed from securities law, properly calibrated the meaning of defalcation with the level of culpability of fraud, embezzlement, and larceny also listed in subsection (a)(4), while avoiding redundancy with fiduciary "fraud" by also encompassing "extreme recklessness," a "lesser form of intent." *Id*. (quoting *Ernst & Ernst*, 425 U.S. at 193 n.12, and *Rizek v. SEC*, 215 F.3d 157, 162 (1st Cir. 2000)). The court reversed the lower court's exception from discharge of

all of Baylis's debts to the trust, but affirmed the exception from discharge to the extent he used trust funds to pay personal expenses.

2. *Knowing Breach or "Objectively Reckless"*

The Eleventh Circuit in this case joined the circuits that have adopted a recklessness standard that is less rigorous than the First and Second Circuits' standard. *Bullock v. BankChampaign, N.A.* (*In re Bullock*), 670 F.3d 1160 (11th Cir. 2012). Pet. App. 1a-14a. These circuits require varying degrees of willfulness, knowledge, and objective recklessness, but all require something more than "mere negligence." *See, e.g., FNFS, Ltd. v. Harwood* (*In re Harwood*), 637 F.3d 615 (5th Cir. 2011); *Patel v. Shamrock Floorcovering Servs., Inc.* (*In re Patel*), 565 F.3d 963 (6th Cir. 2009); *Meyer v. Rigdon*, 36 F.3d 1375 (7th Cir. 1994).

The Fifth Circuit requires "a willful neglect of duty" which is "essentially a recklessness standard." *Schwager v. Fallas* (*In re Schwage*r), 121 F.3d 177, 184-85 (5th Cir. 1997) (quoting *Moreno v. Ashworth* (*In re Moreno*), 892 F.2d 417, 421 (5th Cir. 1990)). Willfulness is measured objectively based on "what a reasonable person in the debtor's position knew or reasonably should have known." *Harwood*, 637 F.3d at 624 (quoting *Office of Thrift Supervision v. Felt* (*In re Felt*), 255 F.3d 220, 226 (5th Cir. 2001)). The Sixth and Seventh Circuits have recited a standard for defalcation that requires "something more than negligence or mistake, but less than fraud." *Follett Higher Educ. Grp. v. Berman* (*In re Berman*), 629 F.3d 761, 765 n.3 (7th Cir. 2011) (citing *Meyer*, 36 F.3d at 1385); *see Patel*, 565 F.3d at 970 (labeling the standard as "objectively reckless" and rejecting "defalcation per se").

3. *Negligent or Innocent Mistake*

The most expansive reading of defalcation withholds discharge for even purely innocent mistakes and has been adopted by the Fourth, Eighth, and Ninth Circuits. *Republic of Rwanda v. Uwimana* (*In re Uwimana*), 274 F.3d 806, 811 (4th Cir. 2001) (citing *Pahlavi v. Ansari* (*In re Ansari*), 113 F.3d 17, 20 (4th Cir. 1997)); *Tudor Oaks Ltd. P'ship v. Cochrane* (*In re Cochrane*), 124 F.3d 978, 984 (8th Cir. 1997); *Sherman v. SEC* (*In re Sherman*), 658 F.3d 1009, 1017 (9th Cir. 2011); *Blyler v. Hemmeter* (*In re Hemmeter*), 242 F.3d 1186, 1190-91 (9th Cir. 2001). In these circuits, "negligence or even an innocent mistake which results in misappropriation or failure to account is sufficient." *Uwimana*, 274 F.3d at 811; *see Sherman*, 658 F.3d at 1017 ("[E]ven innocent acts of failure to fully account for money received in trust will be held as non-dischargeable defalcations; no intent to defraud is required.") (quoting *Hemmeter*, 242 F.3d at 1190-91).

4. *The Requirement of a Loss or "Failure to Account"*

The circuits also appear to conflict on the degree to which they require a creditor seeking to except an alleged defalcation debt from discharge to show that it has sustained a loss. The Eleventh Circuit here did not require that respondent prove a loss of principal; the court regarded the Illinois court's judgment for disgorgement of the purported benefit as alone sufficient. Other circuits appear to require that a loss of the entrusted property be demonstrated. *Commonwealth Land Title Co. v. Blaszak* (*In re Blaszak*), 397 F.3d 386, 390 (6th Cir. 2005) ("resulting loss" is required element); *R.E. Am., Inc. v. Garver* (*In re Garver*), 116 F.3d 176, 178 (6th Cir. 1997) (same); *see*

Lewis v. Scott (*In re Lewis*), 97 F.3d 1182, 1186 (9th Cir. 1996) (requiring "fail[ure] to account fully for money received").

B. The First and Second Circuit Approach is Most Consistent with the Statutory Text, Structure, and Purpose.

Petitioner submits that the First Circuit's view, expressed in *Baylis* and adopted by the Second Circuit as well, is the most faithful to the statutory text, structure, and purpose. That view comports with "the commonsense canon of *noscitur a sociis*—which counsels that a word is given more precise content by the neighboring words with which it is associated." *Freeman v. Quicken Loans, Inc.*, ___ U.S. ___, No. 10-1042, 2012 WL 1868063, at *6 (May 24, 2012) (quoting *United States v. Williams*, 553 U.S. 285, 294 (2008)). The Eleventh Circuit's definition of defalcation is simply too lax to be ranked among the likes of "fraud . . . , embezzlement, or larceny" found in the same clause, all of which require findings of wrongful intent. Fraud in a fiduciary relationship as contemplated by § 523(a)(4) requires fraudulent intent. *See McClellan v. Cantrell*, 217 F.3d 890, 893-94 (7th Cir. 2000); *see also Neal v. Clark*, 95 U.S. 704, 709 (1877) (stating that fraud involves "moral turpitude or intentional wrong," and that "[s]uch a construction . . . is consonant with equity, and consistent with the object and intention of Congress in enacting a general law by which the honest citizen may be relieved from the burden of hopeless insolvency."). Both of the other crimes listed in § 523(a)(4), embezzlement and larceny, require criminal intent. *See Ormsby v. First Am. Title Co.* (*In re Ormsby*), 591 F.3d 1199, 1205 (9th Cir. 2010); *Sherman v. Potapov* (*In re Sherman*), 603 F.3d 11, 13 (1st Cir. 2010). Larceny is a taking of

personal property "with intent to convert it or deprive the owner" of it, *Ormsby*, 591 F.3d at 1205, while embezzlement constitutes the "fraudulent conversion of the property of another by one who is already in lawful possession of it," *Sherman*, 603 F.3d at 13 (citations omitted). To construe "defalcation" more expansively, so as to allow an exception from discharge based on a lower threshold of wrongful intent, would be anomalous.

In evaluating whether an exception from bankruptcy discharge that is predicated on a debtor's serious misconduct should be imposed, the court should assess both the injury caused by the debtor's actions and the debtor's mental state. Mere negligence or even recklessness should not be enough to warrant an exception from discharge under § 523(a)(4) any more than it is under § 523(a)(6). *See Kawaauhau*, 523 U.S. at 63-64 (holding that medical malpractice not "willful and malicious" conduct). An honest trustee who, for instance, invests imprudently and produces a loss of *res* that results in his being held civilly liable should not be denied a bankruptcy discharge. Requiring a showing of a knowing wrongdoing or "extreme recklessness," plus a failure to account for the entrusted property, would ensure a fresh start is denied only for the most serious of misconduct that results in a loss to another.

In petitioner's case, there was no failure to account for the entrusted property, nor any loss of the trust principal. The investments chosen by petitioner, to a large degree for the benefit of his mother—the spouse of the trust settlor—were secured loans that were repaid on a regular schedule with interest, but not with any profit to the trust. The first loan, to his mother, was actually requested by his father. The

other two loans were made jointly to himself and his mother. The complaining parties were two of his siblings, children of the same parents. This was a squabble about family trust administration that escalated perversely and culminated in financial tragedy for petitioner. The judgment against petitioner was the state court's estimate of the benefit he received, not a reckoning for any loss.

As to his intent, there is no indication, much less any finding, that petitioner *knew* that the three loans made from his father's *inter vivos* life insurance trust were improper. The *only* judicial finding concerning petitioner's mental state was that his motive was apparently "not malicious." The burden to produce evidence of the requisite mental state was at all times on respondent, *see Palmacci v. Umpierrez*, 121 F.3d 781, 787 (1st Cir. 1997), but respondent sought summary judgment relying on the findings in the underlying state court action, a common tactic in exception-to-discharge litigation for a creditor holding a pre-bankruptcy judgment. But the state court's finding of no apparent ill intent, coupled with the fact of no resulting loss, falls far short of establishing the sort of grave misconduct that should deprive a financially-ruined individual from the statutory last refuge of discharge in bankruptcy. This case provides a vehicle for the Court to expound on the proper application of the statute to common and recurring fact patterns in the fiduciary context.

CONCLUSION

National bankruptcy laws should be uniformly applied in all states but, where exceptions to discharge are sought by creditors who assert defalcation debts, the outcomes now fluctuate from court to court. Petitioner respectfully submits that the Court should issue a writ of certiorari to remedy the prevailing confusion among the circuits, while undoing the injustice done to him.

Respectfully submitted,

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June 14, 2012

APPENDIX

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APPENDIX A

UNITED STATES COURT OF APPEALS,
ELEVENTH CIRCUIT

No. 11-11686

IN RE RANDY CURTIS BULLOCK,
Debtor.

RANDY CURTIS BULLOCK,
Appellant,

v.

BANKCHAMPAIGN, N.A.,
Appellee.

Feb. 14, 2012

Before BARKETT and PRYOR, Circuit Judges, and BUCKLEW,[*] District Judge.

BUCKLEW, District Judge:

Appellant Randy Curtis Bullock, Debtor-Defendant in the underlying bankruptcy adversary proceeding, appeals the district court's decision affirming the bankruptcy court's determination that the Illinois judgment debt owed to Appellee BankChampaign, N.A. is not dischargeable, pursuant to 11 U.S.C. § 523(a)(4). After careful review and with the benefit of oral argument, we affirm.

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[*] Honorable Susan C. Bucklew, United States District Judge for the Middle District of Florida, sitting by designation.

I. Background

In 1978, Appellant Bullock became the trustee of his father's trust. The trust's sole asset was a life insurance policy on his father's life, and Bullock and Bullock's four siblings were the beneficiaries. The terms of the trust provided that Bullock, as trustee, could borrow from the trust in only two situations: (1) to pay the life insurance premiums, and (2) to satisfy a beneficiary's request for withdrawal.

Despite the trust's limitations on borrowing, Bullock borrowed from the trust by making three loans that were secured by the cash value of the life insurance policy. First, in 1981, upon his father's request, Bullock borrowed $117,545.96 for his mother so she could repay a debt that she owed to Bullock's father's business. Second, in 1984, Bullock borrowed $80,257.04 for his mother and himself to purchase certificates of deposit, which were later cashed in and used toward the purchase of a garage fabrication mill in Ohio. Third, in 1990, Bullock borrowed $66,223.96 for his mother and himself to purchase real estate. These loans were all fully repaid.

Thereafter, Bullock's two brothers learned of the existence of the trust, and they filed suit against Bullock in Illinois state court. In the lawsuit, Bullock's brothers claimed that Bullock had breached his fiduciary duty as trustee by engaging in self-dealing via the three loans. The brothers moved for summary judgment on that claim, and in 2002, the Illinois court granted their motion. Specifically, the Illinois court stated that it could not "be disputed the loans made by [Bullock] while acting as trustee are considered self-dealing transactions. All of the loans were made to entities [Bullock] had a financial interest in or to a relative." [R:Tab K].

In its order awarding damages for the self-dealing, the Illinois court stated that Bullock did "not appear to have had a malicious motive in borrowing funds from the trust." [R:Tab M, Ex. 7]. However, the Illinois court concluded that "neither the facts and circumstances surrounding the loans nor the motives of [Bullock] can excuse him from liability." [R:Tab M, Ex. 7]. As a result, the Illinois court determined that damages should be awarded based on the benefit that Bullock received due to the self-dealing. The Illinois court stated that such would be hard to quantify, but based on its equitable powers, it determined that $250,000 represented the amount of the benefit that Bullock had received from the self-dealing. In addition, the Illinois court ordered that Bullock pay $35,000 in attorneys' fees. The Illinois court also put the property obtained with the self-dealt funds (a mill located in Ohio) under a constructive trust to secure it as collateral for the $285,000 judgment amount. The Illinois court placed another constructive trust on Bullock's beneficial interest in his father's trust as an additional source of collateral for the judgment.

The constructive trusts were awarded to Appellee BankChampaign ("Bank"), which had replaced Bullock as the trustee of his father's trust. Bullock contends that the Bank, as trustee, has blocked his attempts to sell or lease the mill property located in Ohio, which has prevented him from satisfying the Illinois judgment.[1]

Thereafter, in 2009, Bullock filed for bankruptcy under Chapter 7 in hopes that he could discharge the

[1] Because the Illinois court awarded the Bank a constructive trust over the Ohio mill, Bullock is unable to sell or lease the mill without the approval and cooperation of the Bank.

Illinois judgment debt. The Bank initiated an adversary proceeding to determine the dischargeability of the judgment debt pursuant to 11 U.S.C. § 523(a)(4). Section 523(a)(4) provides that debts arising from "fraud or defalcation while acting in a fiduciary capacity, embezzlement or larceny" are not dischargeable in bankruptcy. The Bank moved for summary judgment, arguing that the Illinois judgment debt was not dischargeable, and the bankruptcy court granted the Bank's motion.

Specifically, the bankruptcy court concluded that Bullock was collaterally estopped from attacking the Illinois judgment. The Illinois court had determined that Bullock had breached his fiduciary duty by self-dealing via the three loans. The bankruptcy court accepted the Illinois court's determination that Bullock had breached his fiduciary duty by engaging in self-dealing and concluded that such conduct amounted to fraud and defalcation. As a result, the bankruptcy court found that the Illinois judgment was a debt arising from fraud or defalcation while Bullock was acting in a fiduciary capacity, and as such, the judgment debt was not dischargeable, pursuant to § 523(a)(4).

Bullock appealed the bankruptcy court's judgment to the district court. The district court affirmed the bankruptcy court's decision, but it sympathized with Bullock's predicament—he had a judgment debt that he could satisfy only by selling the underlying collateral, but the Bank persisted in preventing the sale. The district court stated that it questioned the propriety of the Bank's actions and noted that holding collateral hostage in perpetuity is impermissible. However, the district court recognized that the propriety of the Bank's actions was not a basis for

finding that the judgment debt should be discharged. As a result, the district court concluded that while it was "convinced [the Bank] is abusing its position of trust by failing to liquidate the [property], this issue is not properly before this court, but rather should [be] brought by Bullock in an action in Illinois to consider the malfeasance of the trustee." [R:Tab G].

Thereafter, Bullock filed the instant appeal. In this appeal, Bullock argues that the bankruptcy court erred in two ways: (1) by concluding that the Illinois judgment was non-dischargeable, pursuant to § 523(a)(4); and (2) by failing to consider his affirmative defense that the Bank has acted wrongfully by impeding his attempts to sell or lease the collateralized property.

II. Standard of Review

"Because the district court in reviewing the decision of a bankruptcy court functions as an appellate court, we are the second appellate court to consider this case. Thus, this Court's review with regard to determinations of law, whether made by the bankruptcy court or by the district court, is de novo. The district court makes no independent factual findings; accordingly, we review solely the bankruptcy court's factual determinations under the 'clearly erroneous' standard." *In re Colortex Indus., Inc.*, 19 F.3d 1371, 1374 (11th Cir. 1994) (citations omitted).

III. Section 523(a)(4)

In determining whether the Illinois judgment debt should be discharged, this Court is mindful of the purpose of the Bankruptcy Code:

> A central purpose of the Bankruptcy Code is to provide an opportunity for certain insolvent

> debtors to discharge their debts and enjoy a fresh start. However, Congress has decided to exclude from the general policy of discharge certain categories of debts. One of these categories includes debts incurred by fraud or defalcation while acting in a fiduciary capacity. Such a debt is non-dischargeable [under 11 U.S.C. § 523(a)(4)]. Congress evidently concluded that the creditors' interest in recovering full payment of such debts ... outweighed the debtors' interest in a complete fresh start.

Eavenson v. Ramey, 243 B.R. 160, 164 (N.D. Ga. 1999) (alterations, citations, and internal quotation marks omitted). Furthermore, this Court must keep in mind that exceptions to discharge, such as § 523(a)(4), must be construed narrowly, and the burden is on the creditor to show that the exception to discharge applies. *See In re Mitchell*, 633 F.3d 1319, 1327 (11th Cir. 2011) (citations omitted).

In the underlying adversary proceeding, the Bank asked the bankruptcy court to find the Illinois judgment debt to be non-dischargeable under § 523(a)(4). The bankruptcy court concluded that the debt was not dischargeable because the Bank had established that the debt arose from fraud or defalcation while Bullock was acting in a fiduciary capacity. The parties do not dispute that the judgment debt arose from conduct that occurred while Bullock was acting in a fiduciary capacity (*i.e.*, while he was the trustee of his father's trust). Furthermore, at oral argument, Bullock appeared to concede that he was collaterally estopped from attacking the Illinois judgment to the extent that the Illinois court concluded that he breached his fiduciary duty as the trustee of his father's trust by engaging in self-dealing via the

three loans. Thus, the issue before this Court is whether the bankruptcy court correctly characterized Bullock's conduct as fraud and/or defalcation under § 523(a)(4). Upon consideration, we find that Bullock's conduct constituted defalcation under § 523(a)(4).[2]

This Court has stated that a "'[d]efalcation' refers to a failure to produce funds entrusted to a fiduciary" and that "the precise meaning of 'defalcation' for purposes of § 523(a)(4) has never been entirely clear." *Quaif v. Johnson*, 4 F.3d 950, 955 (11th Cir. 1993) (citations omitted). However, this Court has referred to the Second Circuit's decision in *Central Hanover Bank & Trust Co. v. Herbst*, 93 F.2d 510 (2d Cir. 1937), as containing "perhaps the best" analysis of the meaning of "defalcation" under § 523(a)(4).[3] *Quaif*, 4 F.3d at 955; *see also In re Fernandez-Rocha*, 451 F.3d 813, 817 (11th Cir. 2006).

In *Central Hanover*, an issue before the court was whether Herbst, who had been appointed as a receiver for real property in a foreclosure action, had committed a defalcation when he withdrew money that the court had awarded him as payment for his services as receiver before the time to appeal the order awarding him the money had expired. *See Central Hanover*, 93 F.2d at 511. The *Central Hanover* court analyzed the bankruptcy statute that provided that debts arising from fraud, embezzlement, misappropriation, or defalcation while acting as an officer or in a fiduciary capacity were not

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[2] Because we find that Bullock's conduct constituted defalcation under § 523(a)(4), we need not reach the issue of whether his conduct also constituted fraud under § 523(a)(4).

[3] The court in *Central Hanover* analyzed the meaning of defalcation under the predecessor statute to § 523(a)(4).

dischargeable. *See id.* In analyzing the meaning of defalcation, the *Central Hanover* court stated the following:

> Whatever was the original meaning of defalcation, it must here have covered other defaults than deliberate malversations, else it added nothing to the words, 'fraud or embezzlement.'
>
> . . .
>
> In the case at bar [Herbst] had not been entirely innocent . . . . A judge had awarded him the money, and prima facie he was entitled to it; but he knew, or if he did not know, he was charged with notice (having held himself out as competent to be an officer of the court), that the order would not protect him if it were reversed; and that it might be reversed until the time to appeal had expired. He made no effort to learn from the plaintiff whether it meant to appeal, and he did not wait until it could no longer do so; he took his chances. We do not hold that no possible deficiency in a fiduciary's accounts is dischargeable; . . . [we have said] that the misappropriation must be due to a known breach of the duty, and not to mere negligence or mistake. Although [misappropriation] probably carries a larger implication of misconduct than defalcation, defalcation may demand some portion of misconduct; we will assume arguendo that it does.
>
> All we decide is that when a fiduciary takes money upon a conditional authority which may be revoked and knows at the time that it may, he is guilty of a defalcation though it may not be a

> fraud, or an embezzlement, or perhaps not even a misappropriation.

Id. at 511, 512 (citation and internal quotation marks).

In *Quaif*, this Court interpreted *Central Hanover* as standing for the proposition that a defalcation under § 523(a)(4) does not have to rise to the level of fraud, embezzlement, or misappropriation.[4] *See Quaif*, 4 F.3d at 955. Additionally, this Court in *Quaif* noted that some courts interpret defalcation "more broadly, stating that even a purely innocent party can be deemed to have committed a defalcation for purposes of § 523(a)(4)." *Id.* (citations omitted).

This Court recognizes that there is a split among the circuits regarding the meaning of defalcation under § 523(a)(4). The Fourth, Eighth, and Ninth Circuits have concluded that even an innocent act by a fiduciary can be a defalcation. *See In re Uwimana*, 274 F.3d 806, 811 (4th Cir. 2001) (stating that "even an innocent mistake which results in misappropriation or failure to account" can be a defalcation); *In re Cochrane*, 124 F.3d 978, 984 (8th Cir. 1997) (concluding that defalcation does not require intentional wrongdoing; stating that it includes a fiduciary's innocent failure to fully account for money received); *In re Sherman*, 658 F.3d 1009, 1017 (9th Cir. 2011) (noting that intent to defraud is not required; stating

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[4] In *Quaif*, an issue before the Court was whether an agent who failed to remit insurance premiums, and instead commingled the money with his company's funds and used the funds to pay his company's operating expenses, committed a defalcation. *See Quaif*, 4 F.3d at 952. The *Quaif* Court held that the agent's conduct was a defalcation within the meaning of § 523(a)(4). *See id.* at 955.

that defalcation includes a fiduciary's innocent failure to fully account for money received). The Fifth, Sixth, and Seventh Circuits require a showing of recklessness by the fiduciary. *See In re Harwood*, 637 F.3d 615, 624 (5th Cir. 2011) (stating that defalcation is a willful neglect of a duty, which does not require actual intent; it is essentially a recklessness standard); *In re Patel*, 565 F.3d 963, 970 (6th Cir. 2009) (stating that a defalcation requires a showing of more than negligence; instead, the fiduciary "must have been objectively reckless in failing to properly account for or allocate funds"); *In re Berman*, 629 F.3d 761, 766 n. 3 (7th Cir. 2011) (stating that "defalcation requires something more than negligence or mistake, but less than fraud"). The First and Second Circuits require a showing of extreme recklessness.[5] *See In re Baylis*, 313 F.3d 9, 20 (1st Cir. 2002) (stating that "defalcation requires something close to a showing of extreme recklessness"); *In re Hyman*, 502 F.3d 61, 68 (2d Cir. 2007) (stating that defalcation "requires a showing of conscious misbehavior or extreme recklessness"). The Third Circuit has not addressed the issue, and the Tenth Circuit has made the brief statement in an unpublished opinion that defalcation requires some portion of misconduct. *See In re Millikan*, 188 Fed.Appx. 699, 702 (10th Cir. 2006).

Given our Circuit's explicit alignment with the *Central Hanover* case, this Court finds that defalcation under § 523(a)(4) requires more than mere negligence. Instead, this Court concludes that defalcation requires a known breach of a fiduciary duty,

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[5] In 2007, the Second Circuit re-evaluated the position that it took in the *Central Hanover* case and determined that it would align itself with the First Circuit when defining defalcation under § 523(a)(4).

such that the conduct can be characterized as objectively reckless. As such, this Circuit aligns itself with the Fifth, Sixth, and Seventh Circuits, which hold that defalcation under § 523(a)(4) requires a showing of recklessness by the fiduciary.

Applying the recklessness standard for defalcation to the facts of the instant case, this Court concludes that the bankruptcy court was correct in determining that Bullock committed a defalcation by making the three loans while he was the trustee of his father's trust. Because Bullock was the trustee of the trust, he certainly should have known that he was engaging in self-dealing, given that he knowingly benefitted from the loans. Thus, his conduct can be characterized as objectively reckless, and as such, it rises to the level of a defalcation under § 523(a)(4). Accordingly, the bankruptcy court's order must be affirmed on the issue of whether the Illinois judgment debt was non-dischargeable under § 523(a)(4) as a debt arising from a defalcation while Bullock was acting in a fiduciary capacity.

IV. Affirmative Defense

Bullock also argues that the bankruptcy court erred in failing to consider his affirmative defense that the Bank has acted wrongfully by impeding his attempts to sell or lease the collateralized property. Bullock cites *Heller v. Lee*, 130 Ill.App.3d 701, 85 Ill.Dec. 896, 474 N.E.2d 856 (1985), in support of his argument that the Bank's conduct has been wrongful.

In *Heller*, the plaintiffs obtained a judgment of more than $44,000 against the defendants. *See id.* at 857. The defendants had put up a bond consisting of a $15,000 certificate of deposit and a deed to real property appraised at $50,000. *See id.* After the judg-

ment was affirmed on appeal, the plaintiffs moved to release the bond, and the plaintiffs applied the $15,000 certificate of deposit to the outstanding judgment. *See id.* Thereafter, the defendants moved under an Illinois statute for a release from the judgment due to the plaintiffs acquiring the deed to the real property via the release of the bond. *See id.* While the court found that the defendants did not satisfy the requirement for release from judgment under the Illinois statute, the court found that the defendants were entitled to equitable relief and stated the following:

> The plaintiffs contend that they took the property as security for eventual cash payment of the judgment. We agree. But, as matters now stand, the plaintiffs can sit on the property indefinitely and institute supplemental proceedings to recover the rest of the judgment. Thus the plaintiffs have the use and enjoyment of a valuable piece of property while the defendants, who put the property up as bond expecting it to satisfy the judgment, are not only deprived of the property, but may also be compelled to dig even deeper in order to pay the judgment. Such a result is inequitable. The plaintiffs have received a windfall at the defendants' expense. If, as the plaintiffs contend, the transfer of the real estate was intended to secure the judgment, then by taking the deed, the plaintiffs acquired only a lien. Rather than proceed against the defendants to recover the judgment, the equitable solution is for the plaintiffs to foreclose on their lien by selling the property.
>
> We are guided in this result by the maxim that equity regards as done that which ought to be

> done. The parties intended the property to secure the judgment. Therefore, the property should be used to satisfy the judgment.
>
> . . . The cause is remanded and the trial court is directed to sell the property, apply the proceeds to the judgment, and remit the excess, if any, to the defendants.

Id. at 858.

Thus, based on *Heller*, Bullock argues that the Bank's actions regarding the collateral in this case have been wrongful and inequitable. Bullock takes this argument a step further and contends that because the bankruptcy court is a court of equity, and because the Bank has come to the bankruptcy court with unclean hands due to its wrongful conduct, the bankruptcy court should deny the Bank its requested relief of non-dischargeability. *See Matter of Garfinkle*, 672 F.2d 1340, 1347 n.7 (11th Cir. 1982) ("The doctrine [of unclean hands] is applicable in a court of equity to deny a plaintiff the relief he seeks even though his claim might otherwise be meritorious. The principles of equity govern the exercise of a bankruptcy court's jurisdiction.").

Bullock, however, has not cited any cases in which a court found a debt met the requirements of non-dischargeability under § 523(a) but ultimately concluded that the debt was dischargeable due to the creditor's unclean hands. Therefore, this Court concludes that the district court correctly determined that the propriety of the Bank's actions is not a basis for finding that the Illinois judgment debt should be discharged. Instead, this Court agrees with the district court's statement that while it was "convinced [the Bank] is abusing its position of trust by

failing to liquidate the [property], this issue is not properly before this court, but rather should [be] brought by Bullock in an action in Illinois to consider the malfeasance of the trustee." [R:Tab G].

This Court notes that if it accepted Bullock's argument and concluded that the judgment debt was dischargeable, Bullock would ultimately pay nothing more on the debt, as the debt would be discharged. However, if Bullock goes back to the Illinois court and raises the issue of the Bank's inequitable conduct, the Illinois court may order the Bank to liquidate the collateral, and as a result, it is possible that the Bank could be paid from the sale and that the judgment debt could be reduced or eliminated.[6] Thus, having Bullock go to the Illinois court to raise the issue of the Bank's inequitable conduct would likely lead to the most equitable resolution of the situation.

V. Conclusion

Accordingly, the decision of the bankruptcy court is AFFIRMED.

[6] The market value of the collateral is not in the record before this Court.

APPENDIX B

IN THE UNITED STATES COURT OF APPEALS
FOR THE ELEVENTH CIRCUIT

[Filed March 16, 2012]

No. 11–11686-DD

In Re: RANDY CURTIS BULLOCK,
Debtor.

RANDY CURTIS BULLOCK,
Plaintiff-Appellant,
v.
BANKCHAMPAIGN, N.A.,
Defendant-Appellee.

Appeal from the United States District Court
for the Northern District of Alabama

BEFORE: BARKETT and PRYOR, Circuit Judges, and BUCKLEW,* District Judge.

PER CURIAM:

The petition(s) for rehearing filed by Appellant is DENIED.

ENTERED FOR THE COURT:

/s/ Rosemary Barkett
UNITED STATES CIRCUIT JUDGE

ORD-41

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* Honorable Susan C. Bucklew, United States District Judge for the Middle District of Florida, sitting by designation.

APPENDIX C

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ALABAMA
NORTHEASTERN DIVISION

[Filed March 22, 2011]

BANKRUPTCY COURT CASE
NO.: 09-84300

IN RE: RANDALL CURTIS BULLOCK,
Debtor.

CASE NO.: CV-10-J-1905-NE
No.: AP-10-80003

RANDALL CURTIS BULLOCK,
Appellant,
v.
BANK CHAMPAIGN, NA,
Appellee.

MEMORANDUM OPINION

This matter is before the court as an appeal from the Bankruptcy Court, pursuant to 28 U.S.C. § 158. The parties have filed appellate briefs, which the court has reviewed. The court finds, in accordance in Fed.R.Bankr.P. 8012, that the facts and legal arguments are adequately presented in the briefs and record and the decisional process will not be significantly aided by oral argument.

FACTUAL BACKGROUND

The facts of this appeal are not in dispute. It arises from an adversarial proceeding in which summary judgment was granted in favor of appellee Bank Champaign and against the debtor/appellant, Randall Bullock ("Bullock"). Bullock at one time was trustee of the Curtis Bullock Trust No. 2, created by Bullock's father as an irrevocable living trust. The only asset was the proceeds of a life insurance policy on the life of the father. Bullock was named trustee and he and his four siblings were the beneficiaries.

Pursuant to trust documents, the trustee could borrow against the policy to provide funds to pay the premiums, or to satisfy any request of a beneficiary for withdrawal of funds. Bullock borrowed against the cash value of the policy three times. The first loan was at the request of the father to benefit his wife (Bullock's mother), in the amount of $117,545.96, to repay a debt she owed to the father's business. The second loan was to Bullock and his mother, for $80,257.04, to purchase Certificates of Deposit. Later, these funds were used toward the purchase of a garage fabrication mill in Ohio. A third loan for $66,223.96, again to Bullock and his mother, was used with other funds to purchase real estate. Bullock alleges that the loans were repaid in full with six percent (6%) interest, but an Illinois trial court ruled the trust made no profit from the loans.

The Illinois case arose in 2001 when Bullock's two brothers filed suit asserting Bullock breached his fiduciary duty and that any profits earned by Bullock and his mother should be relinquished to the trust. The Illinois court held that Bullock was liable for self-dealing and owed the trust $250,000.00 for benefits he received and $35,000.00 in attorney fees. It

also held that the loans were not for either of the two permissible purposes in the trust documents. It found the loans were the result of self-dealing, because each time the money went to entities in which Bullock had an interest. That court declared a constructive trust on Bullock's assets, plus several businesses in which Bullock had an interest, and on his interest in the trust. The Illinois court further named Bank Champaign, NA ("Appellee") as trustee.

According to Bullock, the Illinois court ordered that the defendant in that case, namely Bullock, having an interest in the Springfield mill had to execute a mortgage on the property in favor of the trustee. Appellee has held the assets of the constructive trust since that time without making an effort to liquidate the assets to satisfy the court judgment, and has refused to let Bullock sell or lease the property to satisfy the judgment.

Bullock then filed a Chapter 7 bankruptcy action, seeking to discharge solely this debt. Appellee filed an adversarial proceeding ("AP") against Bullock, alleging that Bullock, in his previous role as trustee of the Trust, committed acts of defalcation while acting in a fiduciary capacity. Such allegations had been raised in the state court action in Illinois, and were the basis of the judgment in favor of other heirs of the trust and against Bullock. Appellee argued in the adversarial proceeding that the debt created by the Illinois judgment was non-dischargeable, and the Bankruptcy court agreed. This issue of the dischargeability of the debt created by the Illinois judgment is the sole issue before this court on appeal.

Bullock's two sisters both asked the Bankruptcy court to release Bullock from the debt because the litigation has been going on for fourteen years and

needed to stop. Bullock had produced a buyer for one of the properties, but Appellee refused to allow the sale. Because it is the trustee, and the trust holds a constructive trust on the assets, nothing may be sold without Appellee's approval. Meanwhile, the properties are essentially abandoned and uninsurable.

In the adversarial proceeding before the bankruptcy court, Appellee argued that Bullock was collaterally estopped from raising any issues raised in the Illinois action. The bankruptcy court assumably agreed, ruling on motion for summary judgment that the Illinois court found fraud and defalcation and that Bullock was collaterally estopped from relitigating such issues.

Standard of Review

This court functions as an appellate court for the decisions of the United States Bankruptcy Courts. *In re Sublett*, 895 F.2d 1381, 1383 (11th Cir. 1990). This court reviews the Bankruptcy court's findings of fact under the clearly erroneous standard of review and conclusions of law under the de novo standard of review. *Whiting-Turner Contracting Co. v. Electric Machinery Enterprises, Inc*., 2006 WL 1679357, *1 (M.D.Fla.2006). De novo review requires the court to make a judgment "independent of the bankruptcy court's, without deference to that court's analysis and conclusions." *In re Sternberg*, 229 B.R. 238, 244 (S.D.Fla.1998); citing *Moody v. Amoco Oil Co*., 734 F.2d 1200, 1210 (7th Cir.1984). The proper construction of the Bankruptcy Code by the bankruptcy court or by the district court is a matter of law; accordingly, such interpretations are subject to de novo review. *In re Colortex Industries, Inc*., 19 F.3d 1371, 1374 (11th Cir.1994); *In re Taylor*, 3 F.3d 1512, 1514 (11th Cir. 1993).

Under Fed.R.Civ.P. 56(c), made applicable to adversary proceedings and contested matters in bankruptcy cases by Fed.R.Bankr.P. 7056 and 9014, summary judgment is proper "if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law." *In re Optical Technologies, Inc*., 246 F.3d 1332, 1334 (11th Cir.2001); citing Fed.R. Civ.P 56(c); *Celotex Corp. v. Catrett*, 477 U.S. 317, 322, 106 S.Ct. 2548, 2552, 91 L.Ed.2d 265 (1986). This court's review of a bankruptcy court's grant of summary judgment is de novo. *See In re Optical Technologies, Inc*., 246 F.3d at 1334; *In re Walker*, 48 F.3d 1161, 1163 (11th Cir. 1995). De novo review requires the court to make a judgment independent of the bankruptcy court's, without deference to that court's analysis and conclusions. *In re Piper Aircraft Corp*., 244 F.3d 1289, 1295 (11th Cir.2001), citing *Moody v. Amoco Oil Co*., 734 F.2d 1200, 1210 (7th Cir.1984).

Legal Analysis

As stated above, the sole issue before this court is whether the Bankruptcy court erred in holding the debt created by the Illinois court judgment was nondischargeable. *See* appellant's brief at 2, appellee's brief at 1. Specifically, Bullock asserts the Bankruptcy Court erred in holding that Bullock committed an act of fraud and/or defalcation pursuant to 11 U.S.C. § 523(a)(4), or that this issue was previously litigated and adjudicated in the Illinois action.[1]

[1] The Bankruptcy court can apply collateral estoppel on the issue of liability or the issue of liability and damages to the extent those issues were litigated in a prior action, but the Bankruptcy court must still determine on the basis of those

He further asserts that the Bankruptcy court failed to consider his affirmative defenses. The appellee responds that the Bankruptcy court correctly determined it was collaterally estopped from reconsidering the Illinois state court judgment.

Pursuant to section 523(a)(4) of the Bankruptcy Code, any debt arising from "fraud or defalcation while acting in a fiduciary capacity" is excepted from discharge. 11 U.S.C. § 523(a)(4). The parties do not dispute that Bullock was, at all times relevant, acting in a fiduciary capacity. Thus, the court considers whether the debt created by the Illinois court judgment arose from fraud or defalcation. The exception from dischargeability created by § 523(a)(4) is construed narrowly. *See In re Fernandez-Rocha*, 451 F.3d 813, 816 (11th Cir. 2006). Although Bullock defines "defalcation" to require a failure to produce funds, the Eleventh Circuit has not recognized the same to be the only definition of "defalcation." Examining this very issue, the Court held:

> Even if a fiduciary relationship exists prior to the act that created the debt, the next question under § 523(a)(4) is whether there was a "defalcation" while acting in a fiduciary capacity. In *Quaif*, this Court further explained that "'[d]efalcation' refers to a failure to produce funds entrusted to a fiduciary," but that "the precise meaning of 'defalcation' for purposes of § 523(a)(4) has never been entirely clear." *Id*. at 955. *Quaif* observed that the best analysis of "defalcation" is that of Judge Learned Hand in *Central Hanover*

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proven facts whether those acts come within the dischargeability sections of the Bankruptcy Code. *In re Lowery*, 440 B.R. 914, 923 (Bkrtcy.N.D.Ga.2010).

> *Bank & Trust Co. v. Herbst*, 93 F.2d 510 (2d Cir. 1937), in which "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.'" *Quaif*, 4 F.3d at 955 (citing *Central Hanover*, 93 F.2d at 512). ***Indeed, "[s]ome 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)."*** *Id*. (emphasis added).

In re Fernandez-Rocha, 451 F.3d at 817 (quoting *Quaif v. Johnson*, 4 F.3d 950 (11th Cir.1993)). Furthermore, the non-dischargeability language of § 523(a)(4) does not require defalcation, the statute addresses fraud as well. *See e.g., Hosey v. Hosey* (*in re Hosey*), 355 B.R. 311, 321 (Bankr.N.D.Ala.2006).

Bullock's arguments otherwise arise from a linguistic misinterpretation of the term "failure to produce funds entrusted to a fiduciary." Even though Bullock repaid the funds, this is not the same as never having taken them out of the trust in the first place. Rather, defalcation includes the fiduciary's failure to account for funds due to any breach of duty whether it was intentional, willful, reckless, or negligent. Proof of fraud is not needed. *See In re Moreno*, 892 F.2d 417, 421 (5th Cir.1990); *In re Wang*, 247 B.R. 211 (Bankr.E.D.Tex.2000); *In re Storie*, 216 B.R. 283 (10th Cir. 1997).

More specifically, "[a] defalcation is a willful neglect of duty, even if not accompanied by fraud or embezzlement." *In re Moreno*, 892 F.2d at 421, citing L. King, 3 Collier on Bankruptcy ¶ 523.14, at 523-93 to 523-95 (15 ed. 1988), *quoting Central Hanover*

Bank & Trust Co. v. Herbst, 93 F.2d 510 (2nd Cir.1937) (L. Hand, J.). Bullock's fiduciary duty "encompassed, at least, a responsibility not to lend [the trust]'s money to himself or corporations controlled by him on less than an arms-length basis." *In re Moreno*, 892 F.2d at 421 (citing *Gearhart Industries, Inc. v. Smith International, Inc*., 741 F.2d 707, 719 (5th Cir. 1984); *International Bankers Life Insurance. Co. v. Holloway*, 368 S.W.2d 567 (Tex. 1963).).

In consideration of the foregoing, the court finds nothing erroneous in the Bankruptcy court's determination that the Illinois state court judgment was non-dischargeable pursuant to 11 U.S.C. § 523 (a)(4). However, even if this court disagreed with the determination of the Bankruptcy court and the Illinois court concerning the legitimacy of the loans to Bullock, this court finds the Bankruptcy court further was correct in its finding that it was collaterally estopped from reopening this issue.

A court's application of estoppel determinations made originally by a bankruptcy court presents questions of law reviewed de novo. *In re Piper Aircraft Corp*., 244 F.3d 1289, 1295 (11th Cir.2001), citing *Richardson v. Miller*, 101 F.3d 665, 667-68 (11th Cir. 1996); *In re Justice Oaks II, Ltd*., 898 F.2d 1544, 1550 (11th Cir. 1990). Collateral estoppel prevents the relitigation of issues already litigated and determined by a valid and final judgment in another court. It is well-established that the doctrine of collateral estoppel applies in a discharge exception proceeding in bankruptcy court. *In re Bilzerian*, 100 F.3d 886, 892(11thCir.1996), citing *Grogan v. Garner*, 498 U.S. 279, 284 n. 11, 111 S.Ct. 654, 658 n. 11, 112 L.Ed.2d 755 (1991); *Hoskins v. Yanks* (*In re Yanks*), 931 F.2d

42, 43 n. 1 (11th Cir. 1991). For collateral estoppel to apply, the following elements must be present:

> (1) The issue in the prior action and the issue in the bankruptcy court are identical;
>
> (2) The bankruptcy issue was actually litigated in the prior action;
>
> (3) The determination of the issue in the prior action was a critical and necessary part of the judgment in that litigation; and
>
> (4) The burden of persuasion in the discharge proceeding must not be significantly heavier than the burden of persuasion in the initial action.

Bilzerian, 100 F.3d at 892 citing *Bush v. Balfour Beatty Bahamas, Ltd*. (*In re Bush*), 62 F.3d 1319, 1322 (11th Cir.1995) (citation omitted).

As set forth above, the court has already found that the issue of the propriety of Bullock's actions in handling the trust monies was before both the Illinois court and the Bankruptcy court. The issue in both cases, namely the question of breach of fiduciary duties, was actually litigated in the Illinois action. As the only issue before the Illinois court, it was a critical and necessary part of the judgment in that action. In the Bankruptcy court, Bullock challenged the finding that his actions were within the definition of fraud or defalcation. That court rendered its decision on the non-dischargeability of the debt based on the Illinois court's finding that Bullock breached his fiduciary duties. Therefore, the fourth element for finding Bullock collaterally estopped from relitigating the Illinois determination, is also satisfied. The court finds no error in the Bankruptcy court's finding of

collateral estoppel barring Bullock from reopening the finding of breach of fiduciary duties.

Bullock next complains that the Bankruptcy Court failed to consider his affirmative defenses. He asserts that the Appellee has wrongfully and unreasonably refused to allow his assets to be used toward the satisfaction of the state court judgment. Appellant's brief, at 11, 19. Because the Illinois court awarded a constructive trust over property of Bullock, Bullock is unable to liquidate those assets without the approval and cooperation of Appellee. According to Bullock, the Appellee has wrongfully withheld this consent, in violation of its fiduciary duties to the beneficiaries of the trust (which includes the Appellant). *Id*., at 19. Furthermore, Bullock is correct that the Bankruptcy court failed to consider the effect of Appellee's refusal to allow Bullock to liquidate the assets he has to satisfy the debt it deemed non-dischargeable.

The Appellee responds that the fact that the state court granted the Trust a security interest in the debtor's property does not create an affirmative obligation on the Trust to liquidate that collateral. Appellee's response, at 15. Naturally, Bullock asserts without liquidating the collateral, he cannot satisfy the judgment. Without the consent of the Appellee, he cannot liquidate the collateral. The court finds the parties to this action have created a scenario akin to trying to determine whether the chicken or egg came first.

Unfortunately, it further raises questions of the propriety of Appellee's actions since obtaining the constructive trust, not an issue of the enforceability or dischargeability of the judgment. Given the conclusion that Bullock continues to owe this debt to the Trustee, what obligation does the Appellee, as

Trustee, have to replace those funds into the trust through the most expedient means possible? Surely, when the Illinois Court permitted Trustee a constructive trust on Bullock's assets, it was not for the purpose of a lien in perpetuity. Rather, the sale of collateral to repay a debt is the general purpose for granting a security interest in collateral in the first place. If the collateral is sold and the debt repaid, that the lienholder no longer needs the security interest. Preventing the sale of the collateral perpetuates the lien but prevents payment of the debt. Even the case cited by Appellee in support of its statement that "the only way in which a money judgment can be satisfied is by payment in money unless the parties agree otherwise" (Appellee brief at 14), recognizes that holding collateral hostage in perpetuity is impermissible. *See Heller v. Lee*, 474 N.E. 2d 856, 858 (Ill.App.Ct. 1985). *In Heller*, the court stated

> The plaintiffs contend that they took the property as security for eventual cash payment of the judgment. We agree. But, as matters now stand, the plaintiffs can sit on the property indefinitely and institute supplemental proceedings to recover the rest of the judgment. Thus the plaintiffs have the use and enjoyment of a valuable piece of property while the defendants, who put the property up as bond expecting it to satisfy the judgment, are not only deprived of the property, but may also be compelled to dig even deeper in order to pay the judgment. Such a result is inequitable. The plaintiffs have received a windfall at the defendants' expense. If, as the plaintiffs contend, the transfer of the real estate was intended to secure the judgment, then by taking the deed, the plaintiffs acquired only a lien. Rather than proceed against the defendants

> to recover the judgment, the equitable solution is for the plaintiffs to foreclose on their lien by selling the property.
>
> We are guided in this result by the maxim that equity regards as done that which ought to be done. The parties intended the property to secure the judgment. Therefore, the property should be used to satisfy the judgment.

Heller v. Lee, 474 N.E.2d 856, 858 (Ill.App.Ct.1985). More recently, another Illinois court also held

> Those contractual rights as to the collateral, however, are limited by equitable principles, which do not allow a creditor to forever sit on collateral, seek alternative relief, and have the use of the collateral, which the debtor expected would satisfy the obligation, to the debtor's hardship. *See Heller v. Lee*, 130 Ill.App.3d 701, 703, 85 Ill.Dec. 896, 474 N.E.2d 856, 858 (1985); *see also* Restatement (Third) of Suretyship & Guaranty § 51(2)(b) (1996) (a creditor may be required to liquidate collateral to satisfy a debt when to do otherwise would cause undue hardship).

International Supply Co. v. Campbell, 907 N.E.2d 478, 488 (Ill.App.Ct.2009).

While this court is convinced Appellee is abusing its position of trust by failing to liquidate the assets, this issue is not properly before this court, but rather should brought by Bullock in an action in Illinois to consider the malfeasance of the trustee.

CONCLUSION

Having considered the arguments of the parties, the court finds that the decision of the Bankruptcy Court is due to be affirmed. The court therefore

ORDERS that the Order of the Bankruptcy Court will be **AFFIRMED** by separate Order.

DONE and **ORDERED** this the 22nd day of March, 2011.

/s/ Inge Prytz Johnson
INGE PRYTZ JOHNSON
U.S. DISTRICT JUDGE

APPENDIX D

UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF ALABAMA
NORTHERN DIVISION

CASE NO. 09-84300-JAC-7
CHAPTER 7
A.P. No. 10-80003-JAC-7

In the Matter of: RANDY CURTIS BULLOCK
SSN: XXX-XX-2223
Debtor(s).

BANKCHAMPAIGN, N.A., as Successor Trustee of the Curt Bullock Trust No. 2,
Plaintiff(s),

v.

RANDY CURTIS BULLOCK,
Defendant(s).

MEMORANDUM OPINION

This matter is before the Court on BankChampaign's motion for summary judgment on its complaint to determine the dischargeability of a state court judgment entered against the debtor, Randy Bullock ("Bullock"), in the Circuit Court of Illinois of Vermilion County, Danville Illinois. For the reasons set for below, the Court finds that the debtor is collaterally estopped from attacking the Illinois court's judgment because the issues determined by the state court are the same as the issues arising under 11 U.S.C. § 523(a)(4).

I. BACKGROUND

On June 11, 2002, the Illinois court entered a memorandum opinion and order granting summary judgment in favor of BankChampaign. The court determined that Bullock breached his fiduciary duty by self-dealing while serving as trustee of a living trust. After a subsequent trial on the issue of damages, the Illinois court entered an order dated December 22, 2002 awarding damages in favor of BankChampaign against Bullock in the amount of $250,000, plus attorney fees in the amount of $35,000 based on Bullock's breach of fiduciary duty. The damages awarded represented the benefits Bullock received from his breaches of fiduciary duty.

On October 21, 2009, Randy Bullock filed for bankruptcy relief in this Court under Chapter 7 of the Bankruptcy Code. On January 11, 2010, BankChampaign filed this complaint to determine dischargeability of the judgment debt owed to the bank pursuant to § 523(a)(4). BankChampaign seeks summary judgment based on the doctrine of collateral estoppel by applying the findings of fact and conclusions of law made by the Illinois court to the elements of its § 523(a)(4) claim in this adversary proceeding as a debt for "fraud or defalcation while acting in a fiduciary capacity[.]" 11 U.S.C. § 523(a)(4).

II. STANDARD FOR SUMMARY JUDGMENT

Pursuant to Federal Rule of Civil Procedure 56(c) and Federal Rule of Bankruptcy Procedure 7056, summary judgment is appropriate "if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to judgment as

a matter of law." *Gray v. Manklow* (*In re Optical Tech., Inc.*), 246 F.3d 1332, 1334 (11th Cir. 2001) (quoting *Celotex Corp. v. Catrett*, 477 U.S. 317, 322, 106 S.Ct. 2548, 2552 (1986)). "In making this determination, the court must view all evidence and make all reasonable inferences in favor of the party opposing summary judgment." *In re Optical Tech, Inc*., 246 F.3d at 1334 (11th Cir. 2001) (quoting *Chapman v. A1 Transp*., 229 F.3d 1012, 1023 (11th Cir. 2000). "Where the record taken as a whole could not lead a rational trier of fact to find for the non-moving party, there is no 'genuine issue for trial.'" *In re Optical Tech, Inc*., 246 F.3d at 1334 (11th Cir. 2001) (quoting *Matsushita Elec. Indus. Co. v. Zenith Radio Corp*., 475 U.S. 574, 587 (1986). "[A] bankruptcy court deciding a summary judgment motion . . . must determine whether there are any genuine issues of material fact." *In re Optical Tech, Inc*., 246 F.3d at 1334.

"When a party seeks summary judgment based on the doctrine of collateral estoppel, the nonmoving party may not defeat the motion simply by establishing that it has evidence that conflicts with the factual conclusions of the trier of fact in the previous case. Even if the nonmoving party produces evidence that contradicts a prior judgment, collateral estoppel bars the party from relitigating facts decided in the previous case." *Southern California Gas Co. v. Collier* (*In re Collier*), 2010 WL 1241778, at *2 (Bankr. N.D. Ill. 2010); *Multiut Corp. v. Draiman* (*In re Draiman*), 2006 WL 1876972, at *4 (Bankr. N.D. Ill 2006). While the movant bears the burden of showing that collateral estoppel applies in the first instance, the nonmoving party may oppose the motion by arguing that the movant has not satisfied each of the elements of collateral estoppel. *Id*.

III. STANDARD FOR COLLATERAL ESTOPPEL

The doctrine of collateral estoppel or issue preclusion refers to the effect of a judgment in foreclosing the relitigation of a matter that has already been litigated and decided. *Quinn v. Monroe County*, 330 F.3d 1320, 1328 (11th Cir. 2003); *See St. Laurent, v. Ambrose* (*In re St. Laurent*), 991 F.2d 672, 675 (11th Cir. 1993) ("Collateral estoppel, or issue preclusion bars relitigation of an issue previously decided in judicial or administrative proceedings . . ."). "A bankruptcy court may rely on collateral estoppel to reach conclusions about certain facts, foreclose relitigation of those facts, and then consider those facts as 'evidence of nondischargeability.'" *Thomas v. Loveless* (*In re Thomas*), 288 Fed. Appx. 547, at *1 (11th Cir. 2008). While collateral estoppel may bar a bankruptcy court from relitigating the factual issues previously decided in another judicial proceeding, "the ultimate issue of dischargeability is a legal question to be addressed by the bankruptcy court in the exercise of its exclusive jurisdiction to determine dischargeability." *In re St. Laurent*, 991 F.2d at 675.

The Eleventh Circuit gives "preclusive effect to the judgment of a state court provided that two conditions are met: (1) the courts of the state from which the judgment emerged would do so themselves; and (2) the litigants had a full and fair opportunity to litigate their claims and the prior state proceedings otherwise satisfied the applicable requirements of due process." *Quinn*, 330 F.3d at 1329. "If the prior judgment was rendered by a state court, then the collateral estoppel law of that state must be applied to determine the judgment's preclusive effect." *In re St. Laurent*, 991 F.2d at 675-676. Under Illinois law,

the following elements must be established before collateral estoppel may be invoked:

> (1) the issue decided in the prior litigation was identical to the current one;
>
> (2) there was a final judgment on the merits;
>
> (3) the party against whom estoppel is asserted was a party to the prior action or in privity with it; and
>
> (4) the factual issue at stake has actually and necessarily been litigated and determined in the prior action.

Multiut Corp. v. Draiman (*In re Draiman*), 2006 WL 1876972, at *4 (Bankr. N.D. Ill 2006). When a party seeks to bar the relitigation of certain facts decided in a prior action, a court "must carefully review the prior judgment to determine whether the factual or legal issue at issue in the later proceeding was in dispute and finally resolved in the earlier proceeding." *Id*.

IV. ILLINOIS COURT'S FINDINGS

The suit filed by BankChampaign in the Illinois state court sought a determination that Bullock's actions as the trustee of an irrevocable living trust known as the Curt Bullock Trust No. 2, a trust established by the debtor's father, constituted a breach of his fiduciary duty not to self-deal. The Illinois court issued an opinion granting summary judgment in favor of the beneficiaries of the trust, finding in part as follows:

(1) In December of 1978, Bullock's father created an irrevocable living trust and named Bullock as the trustee. The sole asset of the trust was a life insurance policy on the life of the debtor's father.

(2) Bullock borrowed funds against the cash value of the life insurance policy on three occasions and loaned the proceeds to his mother and to business entities in which he had an interest. Bullock and his mother used the money to repay a debt owed by Bullock's mother and to purchase real estate.

(3) Bullock lent money to entities in which he had a financial interest or to relatives which clearly placed him in a position where he would be tempted to act in his interest and possibly against the interest of the beneficiaries.

(4) Bullock placed himself in a position of conflict with the beneficiaries.

(5) The trust did not earn any profits on the loans.

(6) Bullock "was clearly involved in self-dealing and no exception to the prohibition against self-dealing is applicable." Memorandum and Order, p. 2.

(7) The loans made by Bullock while acting as trustee were self-dealing transactions as all of the loans were made to entities Bullock had a financial interest in or were made to a relative.

(8) Bullock's act of self-dealing constituted a breach of the defendant's fiduciary duty while acting as a trustee.

(9) The loans were self-dealing and Bullock failed to produce any evidence to show that an exception to the prohibition against self-dealing applied in the case.

(10) Summary judgment was not appropriate on plaintiff's contention that Bullock breached his fiduciary duty by constructive fraud because Bullock claimed that he acted in good faith.

(11) Although Bullock did not appear to have had a "malicious motive" in borrowing funds from the trust, the state court affirmatively found that neither the facts nor the circumstances surrounding the loans nor Bullock's motives excused him from liability. There was a clear breach of the Bullock's fiduciary duty entitling the plaintiffs to damages.

(12) The court concluded that the plaintiffs were entitled to an award of $250,000 plus attorney fees based on the benefit received by Bullock from the breaches he committed. The fact that Bullock had in fact repaid the loans did not excuse his conduct.

V. APPLICATION OF ILLINOIS' COLLATERAL ESTOPPEL STANDARDS

1. IDENTITY OF ISSUES

While the bankruptcy court must look to the law of the state that issued the judgment at issue to determine whether the elements of collateral estoppels are satisfied, the ultimate issue of dischargeability is matter of federal law. *Southern California Gas Co. v. Collier* (*In re Collier*), 2010 WL 1241778 (Bankr. N.D. Ill. 2010); *See also In re St. Laurent*, 991 F.2d at 676. Section 523(a)(4) of the Bankruptcy Code excepts from discharge any debt for "fraud or defalcation while acting in a fiduciary capacity." 11 U.S.C. § 523(a)(4). Before the Court can find a debt nondischargeable for fraud or defalcation under this exception, the Court must find that: (1) a fiduciary relationship existed between the debtor and creditor; and that (2) the debtor committed fraud or defalcation in the course of that fiduciary relationship. *Hosey v. Hosey* (*In re Hosey*), 355 B.R. 311, 321 (Bankr. N.D. Ala. 2006); *Bookbinder v. Pleeter* (*In re Pleeter*), 293 B.R. 812, 815 (S.D. Fla. 2003); *Eavenson v. Ramey* (*In*

re Eavenson), 243 B.R. 160, 164 (N.D. Ga. 1999). In *Grogan v. Garner*, 498 U.S. 279 (1991), the Supreme Court held that the standard of proof to be applied in all dischargeability proceedings under § 523(a) is the preponderance of the evidence standard.

To prove breach of fiduciary duty in Illinois, a plaintiff must establish: (1) a fiduciary duty on the part of the defendant; (2) the defendant's breach of that duty; and (3) damages that were proximately caused by the defendant's breach. *DOD Technologies v. Mesirow Ins. Services, Inc.*, 887 N.E.2d 1, 6 (1st Dist. 2008). The burden of pleading the existence of a fiduciary relationship lies with the party seeking relief to establish same by clear and convincing evidence. *See Hensler v. Busey Bank*, 596 N.E.2d 1269, 1275 (4th Dist. 1992). The burden of proof by clear and convincing evidence standard "is more exacting than the 'preponderance of the evidence' standard[.]" *Jove Engineering, Inc. v. Internal Revenue Service* (*In re Jove*), 92 F.3d 1539, 1545 (11th Cir. 1996).

FIDUCIARY CAPACITY

The term "fiduciary" has traditionally been defined as a special relationship of confidence, trust, and good faith, but most courts have found this definition to be far too broad for purposes of § 523(a)(4). The Eleventh Circuit has discussed the definition of fiduciary capacity under § 523(a)(4) in *Quaif v. Johnson* (*In re Quaif*), 4 F.3d 950, 953-54 (11th Cir. 1993) and *Guerra v. Fernandez-Rocha* (*In re Fernandez-Rocha*), 451 F.3d 813, 816 (11th Cir. 2006) and explained in both cases that the exception to dischargeability is to be narrowly construed. The Eleventh Circuit most recently explained the breadth of the term fiduciary for purposes of § 523(a)(4) as follows:

> In *Quaif*, this Court further noted that the 1934 *Davis* decision is the last Supreme Court case to speak to the issue and that the Supreme Court has left "the lower courts to struggle with the concept of 'technical' trust." *Quaif*, 4 F.3d at 953. Quaif also discussed the trends in judicial interpretation of the § 523(a)(4) exception and noted that courts seemed to include the **voluntary, express trust created by contract** within the scope of "fiduciary capacity" as used in § 523 (a)(4). In contrast, courts have excluded the involuntary resulting or constructive trust, created by operation of law, from the scope of the exception. *Id*. Additionally, *Quaif* noted that cases have "also articulated a requirement that the trust relationship have existed prior to the act which created the debt in order to fall within the statutory [fidiciary capacity] exception." Accordingly, "constructive" or "resulting" trusts, which generally serve as a remedy for some dereliction of duty in a confidential relationship, do not fall within the § 523(a)(4) exception "because the act which created the debt *simultaneously* created the trust relationship." *Id*.

In re Fernandez-Rocha, 451 F.3d at 816. (emphasis added).

In *Quaif*, the Eleventh Circuit determined that a Georgia insurance statute created a technical trust for purposes of § 523(a)(4), while the court determined that a Florida physician licensing statute did not create a technical trust in *Fernandez-Rocha*. In this case, Bullock's fiduciary duty as trustee of the Curt Bullock Trust No. 2 arose under an express trust agreement entered into voluntarily by contract for purposes of § 523(a)(4). The Illinois court found

that Bullock's father created an irrevocable living trust naming Bullock as trustee and further found Bullock liable for breach of his fiduciary duties while serving as trustee of same. The state court's findings clearly establish that Bullock owed a fiduciary duty to BankChampaign for purposes of § 523(a)(4) as the trustee of an express trust. Accordingly, BankChampaign has established that collateral estoppel applies for purposes of determining whether a fiduciary relationship existed between BankChampaign and Bullock.

FRAUD OR DEFALCATION

BankChampaign argues that the issues decided by the state court are identical to the issue before this Court of whether Bullock committed fraud or defalcation. Bullock counters that collateral estoppel cannot apply to establish defalcation for purposes of § 523(a)(4) because the state court opinion did not specifically use the term "defalcation." The state court judgment need not, however, have specifically used the term "defalcation" for collateral estoppel to apply. *Multiut Corp. v. Draiman* (*In re Draiman*), 2006 WL 1876972, at *5 (Bankr. N.D. Ill 2006) (finding previous court need not have used the word "malicious" for collateral estoppel to apply in a § 523(a)(6) determination). Instead, this Court must closely review the state court decision to determine whether the factual or legal issues that are currently before this Court were in dispute and finally resolved in the state court proceeding. *In re Collier*, 2010 WL 1241778, at *2.

While the term defalcation generally refers to a failure to produce funds entrusted to a fiduciary, the Eleventh Circuit has observed that the "best analysis of 'defalcation' is that of Judge Learned Hand in *Central Hanover Bank & Trust Co. v. Herbst*, 93 F.2d

510 (2d Cir.1937), in which '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.'"** *In re Fernandez-Rocha*, 451 F.3d at 817 (quoting *In re Quaif*, 4 F.3d at 955 (citing *Central Hanover*, 93 F.2d at 512)). Indeed, the court of appeals observed that that "[s]ome 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)." *Id*. (emphasis added.) The term defalcation has been further defined by courts in the Eleventh Circuit to include a **"fiduciary's failure to account for funds due to any breach of duty whether it was intentional, willful, reckless, or negligent. Proof of fraud is not even needed."** *Fish v. Sadler* (*In re Sadler*), 2007 WL 4199598, at *2 (Bankr. N.D. Fla. 2007) (emphasis added).

In *McDowell v. Stein* (*In re McDowell*), 415 B.R. 584 (S.D. Fla. 2009), a Florida District Court found that a state court judgment debt arising from a debtor's breach of fiduciary duty by self-dealing fell within the discharge exception for defalcation under § 523(a)(4). The district court found that the debtor's self-dealing and exclusion of the rightful owners from the use and operation of a company formed by the parties as equal co-owners resulted in the wrongful withholding of funds from the rightful owners for purposes of § 523(a)(4) where the debtor's conduct rose "above a purely innocent mistake" and constituted "a failure to produce funds entrusted to a fiduciary." *In re McDowell*, 415 B.R. 584, 598 (S.D. Fla. 2009). To the extent the state court imposed damages for breach of fiduciary duty, the district court deter-

mined that the debt was non-dischargeable under § 523(a)(4).

Here the state court found that Bullock, while acting in a fiduciary capacity, lent monies or misappropriated funds held in Bullock's fiduciary capacity to entities in which he had a financial interest or to relatives which clearly placed Bullock in a position where he would be tempted to act in his own interest and possibly against the interest of the trust beneficiaries; Bullock placed himself in a position of conflict with the trust beneficiaries; Bullock was clearly involved in self-dealing; and Bullock's self-dealing constituted a breach of his fiduciary duty as trustee. Additionally, the court determined that Bullock failed to produce any evidence that an exception to the prohibition against self-dealing applied. The state court further accounted for the fact that Bullock had repaid the misappropriated funds to the trust when the court calculated BankChampaign's damages. Despite the fact that Bullock had shown a willingness to repay the loans, the state court found that BankChampaign was entitled to an award of $250,000, plus attorney fees, based on the benefit Bullock received from his breach of fiduciary duty. The findings of fact and conclusions of law entered by the Illinois state court are clearly sufficient to establish defalcation for purposes of § 523(a)(4). Bullock's conduct, i.e Bullock's use of trust funds to make loans to entities in which he had a financial interest or to relatives, was certainly not unintentional, nor a purely innocent mistake. Bullock intentionally misappropriated trust assets and by doing so placed himself in a position of conflict with the trust beneficiaries. Accordingly, to the extent the Illinois court imposed damages for breach of fiduciary duty by self-dealing, such debt is non-dischargeable under

§ 523(a)(4) as a debt for defalcation while acting in a fiduciary capacity.

Alternatively, the Court finds that the state court judgment supports a findings of fraud while acting in a fiduciary capacity for purposes of § 523(a)(4). Under Illinois law, a breach of fiduciary duty by self-dealing is fraudulent. *Maksym v. Loesch*, 937 F.2d 1237, 1241 (7th Cir. 1991) ("self-dealing in the course of a fiduciary relationship is . . . a form of fraud."). While Bullock concedes that the Illinois court found that he breached his fiduciary duty to BankChampaign by self-dealing, Bullock argues that the state court judgment specifically denied BankChampaign's motion for summary judgment on the issue of constructive fraud and further argues the presumption that self-dealing by a fiduciary is fraudulent is a rebuttable presumption. While the Illinois court refused to grant summary judgment in favor of BankChampaign on the issue of whether Bullock breached his fiduciary duty by constructive fraud, the state court did specifically find breach of fiduciary duty based on self-dealing which raises a presumption of fraud under Illinois law. Moreover, the state court specifically found that Bullock failed to raise any facts that would suggest that an exception to the finding of breach of fiduciary duty by self-dealing applied.

To state a claim for common law fraud in Illinois, "a plaintiff must allege that any misrepresentations were: (1) a false statement of material fact; (2) known or believed to be false by the party making them; (3) intended to induce the other party to act; (4) acted upon by the other party in reliance upon the truth of the representations; and (5) damaging to the other party as a result." *See Cwikla v. Sheir*, 801 N.E.2d 1103, 1110-111 (1 Dist. 2003). Similarly, to prove

fraud under § 523(a)(4), the plaintiff must prove that: (1) the debtor made a representation; (2) the debtor knew the representation was false; (3) the debtor made a false representation with intention and purpose of deceiving the creditor; (4) creditor relied upon the debtor's representation; and (5) the creditor suffered loss or damage as the proximate result of the representation. *In re Wells*, 368 B.R. 506, 514 (Bankr. M.D. La. 2006). In Illinois, the elements of fraud must be proven by clear and convincing evidence which is a higher standard than required for establishing the elements of fraud by a preponderance of the evidence for purposes of § 523(a)(4). *Cwikla v. Sheir*, 801 N.E.22 at 1110-111. Accordingly, the Court finds that the finding of breach of fiduciary duty by self-dealing which is a form of fraud in Illinois supports a finding of fraud for purposes of § 523(a)(4).

2. FINAL JUDGMENT ON THE MERITS AND PARTY TO THE ACTION

The Court further finds that the state court judgment satisfies the second and third elements of collateral estoppel under Illinois law. The judgment was a final decision on the merits to which Bullock was a party. The state court resolved all of the issues before it and entered damages in favor of BankChampaign based on Bullock's breach of fiduciary duty by self-dealing.

3. ACTUALLY AND NECESSARILY LITIGATED

Bullock argues that the judgment is not entitled to collateral estoppel effect because the state court entered the judgment on summary judgment without a trial. An order entered based on summary judg-

ment does, however, satisfy the actually litigated element of collateral estoppel. *Brown v. Manty* (*In re Brown*), 2010 WL 1286078 (D. Minn. 2010) (finding debtor's invocation of Fifth Amendment did not prevent judgment that was entered by state court at summary judgment stage of the proceedings from having collateral estoppel effect in later § 523(a)(4) proceeding where the debtor participated and opposed plaintiff's motion for summary judgment and the state court then carefully considered the record and concluded that there was no genuine issue of fact); *See also Little v. Tapscott*, 2002 WL 1632519, at *8 (N.D. Ill. 2002) ("A granting of summary judgment operates to bar the cause of action for purposes of issue preclusion."); *Union Fed. Sav. and Loan Ass'n v. Champion Federal*, 557 N.E. 2d 950, 952 (Ill. App. 3 Dist. 1990) (summary judgment is the procedural equivalent of a trial and is an adjudication of the claim on the merits for purposes of collateral estoppel). Bullock was represented by counsel in the state court litigation and fully participated in the action. Accordingly, the state court judgment satisfies the actually and necessarily litigated element for purposes of collateral estoppel.

VI. CONCLUSION

Bullock is barred from re-litigating the issue of breach of fiduciary duty by fraud or defalcation for purposes of § 523(a)(4). The state court judgment which found that Bullock misappropriated trust assets by self-dealing and breached his fiduciary duties while acting as a trustee falls within the discharge exception for fraud or defalcation while acting in a fiduciary capacity. The issues determined by the Illinois court in the prior lawsuit finding that Bullock breached his fiduciary duty by self-dealing

were the same for purposes of Illinois's doctrine of collateral estoppel as the issues arising in this adversary proceeding to discharge the resulting debt for "fraud or defalcation while acting in a fiduciary capacity" under § 523(a)(4). The Illinois court's judgment is nondischargeable.

A separate order will be entered consistent with this opinion.

DONE and ORDERED this date: May 27, 2010.

/s/ Jack Caddell
Jack Caddell
United States Bankruptcy Judge

APPENDIX E

IN THE CIRCUIT COURT FOR THE
FIFTH JUDICIAL CIRCUIT OF ILLINOIS
VERMILION COUNTY, DANVILLE, ILLINOIS

[Filed Dec. 23, 2002]

Case No. 99-CH-34

DAVID S. BULLOCK, *et al*.,
Plaintiffs,

vs.

RANDALL C. BULLOCK, *et al*.,
Defendants.

ORDER

The Court has already determined that the Defendant, while acting as trustee, breached his fiduciary duties. The only issue remaining is what damages are available to the Plaintiffs for these breaches.

The Defendant in this case does not appear to have had a malicious motive in borrowing funds from the trust. Up until the time the first loan was made by the Trust, the evidence shows that the Defendant was unaware of the existence of the Trust or of his position as trustee. The first loan was taken at the request of the Defendant's father, who was also the settlor of the Trust, for the benefit of the Defendant's mother. The evidence shows the Plaintiffs were unaware of the existence of the Trust at that time. The Defendant has shown his willingness to make the Trust whole by a pattern of payments he has made to repay the loans from the Trust. The evidence shows the loans have been, in fact, repaid in full.

However, neither the facts and circumstances surrounding the loans nor the motives of the Defendant can excuse him from liability. There has been a clear breach of the Defendant's fiduciary duty, and the Plaintiffs are entitled to damages. The Defendant has suggested two different approaches for measuring damages. The first approach relies on the value of the Trust had the Defendant opted to convert the interest paid to a variable rate policy. This measure of damages is inappropriate. It has no relation to the actual breaches of trust committed by the Defendant. There has been no suggestion, nor any evidence, to say that the Defendant breached his fiduciary duties by failing to convert the policy. The investment decisions of a trustee are governed by the prudent investor rule. While hindsight may show that had the Defendant chosen to invest the Trust assets differently he may have reaped a greater return for the Trust, there is nothing to establish that the Defendant's choice was not acceptable under the prudent investor rule. Given the lack of evidence showing the decision not to convert the policy was imprudent and the lack of any connection with the actual breaches committed by the Defendant, the hypothetical value of the policy had it been converted to a variable rate policy is not an appropriate measure of damages.

The other alternative suggested is the benefit received by the Defendant from breaches he committed. The actual monetary benefit received by the Defendant from the inappropriate loans is difficult to ascertain. However, a court in equity has broad power to fashion a remedy that will produce an equitable outcome. The Court has considered the fact that the Defendant has, in fact, repaid the loans in computing the damages awarded to the Plaintiffs. But that cannot completely excuse the Defendant's conduct.

Therefore, IT IS HEREBY ORDERED as follows:

A. As to Count I of the Second Amended Complaint against Defendant Randy Bullock, judgment is rendered against the Defendant and in favor of the Plaintiffs, and Defendant Randy Bullock is ordered to pay the Trust $250,000.00 to represent the benefits he received from his breaches. The Defendant is also ordered to pay the Trust the sum of $35,000.00 for attorney's fees and litigation costs, which shall be used to reimbursement to the Plaintiffs for their attorneys' fees and litigation costs in accordance with paragraph E below. The Defendant has 365 days to pay this judgment or as ordered by the Court. Interest at the rate of six percent (6%) per annum, shall accrue on any unpaid portion of this judgment award from the date of this order until paid in full.

B. As to Count II of the Second Amended Complaint against Defendants Randy Bullock, Curt Bullock Builders, Inc. 101381) and American Builders Financial Corporation (ABFC) a constructive trust against their assets is awarded in the same amount as the total monetary judgment rendered against Defendant Randy Bullock in Count I. Given that the mill located in Springfield, Ohio, was the first property acquired through the wrongful use of Trust property, this Court holds that the Defendants do not hold any equity in that property. A constructive trust is therefore specifically placed on the mill that will act as a lien against it and as security for the money judgment awarded to the

Trust under Count I above. ABFC, and any other Defendant who has a legal interest in the mill, is ordered to make a Mortgage on that property in favor of "Trustee of the Curt Bullock Trust No. 2 dated December 19, 1978" as evidence of this constructive trust award and to record it in the Clark County, Ohio, Recorder's office. In addition, a constructive trust is specifically placed upon the beneficial interest of Randy Bullock in the Trust. When the monetary judgment of Count I is paid in full by Defendant Randy Bullock, this constructive trust shall be deemed satisfied in full and thereby dissolved.

C. As to Count III of the Second Amended Complaint, given the awards made on Counts I and II above, count III is rendered moot.

D. The Defendant's Cross-Complaint against BankChampaign, NA, as current Trustee of the Trust, is denied.

E. As to the Plaintiffs' petition for an award of attorney's fees, BankChampaign NA as Trustee of the Trust should reimburse the Plaintiffs for attroneys' fees and litigation costs as this lawsuit was for the benefit of the common fund. Illinois law has long held that if a party, having a common interest in a trust fund, takes proper proceedings to save it from destruction and restore it to the purposes of the trust, then that party is entitled to an award of attorney fees out of the fund itself. *State Life Insurance Co. v. Board of Education of Chicago*, 401 111.252, 81 N.E.2d 877 (1948); *Rennacker v. Rennacker*, 156 111.App.3d 712, 509 N.E.2c1798, 109 III. Dec. 137 (3rd Dist.

1987); *Brown v. Commercial National Bank of Peoria*, 94 111.App.2d 273, 237 N.E.2d 567 (3rd Dist, 1968). The amount of reimbursement from the Trust shall be $25,000.00.

ENTERED this 22 day of December, 2002.

/s/ Thomas J. Fahey
Thomas J. Fahey
Circuit Court Judge

APPENDIX F

IN THE CIRCUIT COURT FOR THE
FIFTH JUDICIAL CIRCUIT OF ILLINOIS
VERMILION COUNTY, DANVILLE, ILLINOIS

[Filed June 11, 2002]

Case No. 99-CH-34

DAVID S. BULLOCK, *et al*.,
Plaintiffs,

vs.

RANDALL C. BULLOCK, *et al*.,
Defendants.

MEMORANDUM AND ORDER

In December 1978 Curt Bullock created an irrevocable living trust, "Curt Bullock Trust No. 2." The Defendant was named as the trustee and Defendant and Plaintiffs were named as beneficiaries of the trust. The sole asset of the trust was a life insurance policy on the life of Curt Bullock. The Defendant borrowed against the cash value of the life insurance policy on three occasions. He then loaned the proceeds to his mother and to business entities he had an interest in. They used the money to repay a debt owed by his mother and to purchase real estate. Defendant made these loans at the same interest rate the trust was charged for borrowing from the life insurance policy. The trust did not earn any profit on the loans. The Defendant claims all loans have been repaid.

The Plaintiffs have moved for partial summary judgment on Count I of the Second Amended Com-

plaint, alleging that Defendant is liable for a number of breaches of his fiduciary duty as trustee of the Curt Bullock Trust No. 2.

ISSUES PRESENTED

1. Is summary judgment appropriate on Plaintiffs' contention that Defendant breached his fiduciary duty by failing to ascertain the trust res, beneficiaries, and duties as trustee?
2. Is summary judgment appropriate on Plaintiffs' contention the loans made by the Defendant, acting as trustee, breached the provisions of the trust?
3. Is summary judgment appropriate on Plaintiffs' contention that Defendant breached his fiduciary duty by self-dealing with trust assets?
4. Is summary judgment appropriate on Plaintiffs' contention that Defendant breached his fundamental fiduciary duty to avoid conflicts of interest?
5. Is summary judgment appropriate on Plaintiffs' contention that Defendant breached his fiduciary duty by constructive fraud?
6. Is summary judgment appropriate on Plaintiffs' contention that Defendant breached his fiduciary duty by failing to make an accounting of the trust?

BRIEF ANSWERS

1. Yes. No material facts are in dispute. The Defendant had a duty to ascertain the trust res, beneficiaries, and his duties as trustee. Defendant was under a duty to read and

became bound by the trust document when he signed it.

2. No. Defendant claims he made the loans pursuant to his broad powers to reinvest the trust assets, thus creating a material issue of fact.
3. Yes. Defendant was clearly involved in self-dealing and no exception to the prohibition against self-dealing is applicable.
4. Yes. It is undisputed that Defendant put himself in a position in conflict with the interests of the beneficiaries.
5. No. There were no transactions between the parties. Even if there were, Defendant claims he acted in good faith.
6. Yes. Any reasonable interpretation of the statute requires the Defendant to make an accounting. It is undisputed that the Defendant failed to make such an accounting.

ANALYSIS

Issue 1

Case law supports Plaintiffs' claim that Defendant, after his appointment as trustee, had a duty to promptly ascertain the trust res, beneficiaries, and his duties. *Bullis v. DuPage Trust Company*, 72 Ill. App. 3d 927, 391 N.E. 2d 227, 31 (2nd Dist. 1979). Defendant does not dispute a trustee has certain duties after accepting the position. However, Defendant claims that he was unaware he was the trustee until 1981, three years after the trust was executed. Defendant claims he has no knowledge of signing the trust document, and his father, the settlor of the trust, does not recall the circumstances surrounding

its creation. Defendant admits the signature on the trust document appears to be his, and he does not allege any fraud or misrepresentation to induce his signature. His only claim is that around the time the trust was executed he would come to Danville from Ohio every couple of months and sign a number of documents given to him by the comptroller of Curt Bullock Builders, Inc.

After 1981 there is no dispute that Defendant was aware he was the trustee, and there is no evidence that he ascertained the trust res, beneficiaries, or his duties. Prior to 1981, the only issue in dispute is whether Defendant had accepted the position of trustee in spite of his claims of ignorance. It is a general principle that one cannot avoid the effects of an instrument on the grounds that the signer was ignorant of its contents, where the ignorance is due to the signer's negligence. *Flannery v. Flannery*, 320 Ill. App. 421, 51 N.E.2d 349, 353 (4th Dist. 1943). The rule in this state has long been that a person has a duty to read contracts before signing them. *Mt. Zion State Bank & Trust v. Weaver*, 226 Ill. App. 3d. 783, 589 N.E.2d 983, 986 (4th Dist. 1992). Even assuming the comptroller had told him it was a routine business document, the Defendant cannot complain about such a misrepresentation when he had the opportunity to read the document. *Flannery*, 51 N.E.2d at 353. Defendant became the trustee when he signed the document, and thus became subject to the legal obligations of a trustee. There are no material issues of fact on this issue and summary judgment for the plaintiff is GRANTED.

Issue 2

Plaintiff alleges that Defendant breached the provisions of Article VII of the trust by borrowing money

from the life insurance policy to make loans to his mother and to entities he had an interest in. Article VII of the trust only allows borrowing from the trust in two circumstances, to pay the policy premiums or to satisfy a beneficiary's request for a withdrawal. It is undisputed that the borrowed money was not used in either of those two ways. However, Article VII also gives the trustee broad power and discretion to reinvest trust assets as he sees fit. Defendant claims he made the loans to shift trust assets from what he deemed to be an insurance industry in financial trouble to a less risky investment. There is clearly a disputed issue of material fact as to whether the loans were investments and, therefore, within the trustee's power. Summary judgment is DENIED on this issue.

Issue 3

It cannot be disputed the loans made by the Defendant while acting as trustee are considered self-dealing transactions. All of the loans were made to entities he had a financial interest in or to a relative. The only question is whether the self-dealing in this case constituted a breach of Defendant's fiduciary duty.

The Plaintiffs cite a number of cases holding that a trustee is prohibited from dealing with trust property for his own benefit, including the loaning of money or leasing of trust property to himself. *See*, *Dick v. Peoples Mid-Illinois Corp*, 242 Ill. App. 3d 297, 609 N.E.2d 997 (Ill. 1993); *In re Will of Gleeson*, 5111. App. 2d 61, 124 N.E.2d 624 (3rd Dist. 1955); *Campbell v. Albers*, 313 Ill. App. 152, 39 N.E.2d 672 (2nd Dist 1942). The prohibition against self-dealing also prevents a trustee from transacting business on behalf of the trust with entities he has financial

interests in. *Matter of Estate of Allison*, 140 Ill. App. 3d 183, 488 N.E.2d 1035 (3rd Dist. 1986). In addition, using trust assets for the benefit of family members is also considered self-dealing. *Estate of Hawley*, 183 Ill. App. 3d 107, 538 N.E.2d 1220 (5th Dist. 1989).

Defendant correctly points out that the prohibition against self-dealing is not absolute. Courts have recognized two exceptions: where the trust instrument contemplates, creates, or sanctions the conflict of interests; or where the creator has waived the rule of undivided loyalty by expressly giving the trustee authority to act in a dual capacity, or by implication where the creator knowingly places the trustee in a position that might be in conflict with the beneficiaries. *People's Mid-Illinois Corp*., 242 Ill. App. 3d at 300. However, the Defendant has not alleged any facts that suggest an exception should be applied in this case. Defendant does assert that the trust document does not expressly prohibit self-dealing, but it is permission to self-deal that must be expressly provided for, not a prohibition against it. *Id*.

Defendant cites *Humpa v. Hedstrom*, 345 Ill. App. 289, 102 N.E.2d 686 (1951) and *Conant v. Lansden*, 409 Ill. 149, 98 N.E.2d 773 (1951) for the proposition that self-dealing is not always prohibited. Defendant's reliance on *Humpa v. Hedstrom* is misplaced and erroneous, the case cited dealt only with a reversal of a contempt citation against the trustee for failing to pay back the trust and a finding that the trustee was not liable for interest. The underlying case addressing the merits is *Humpa v. Hedstrom*, 341 Ill. App. 605, 94 N.E.2d 614 (1st Dist. 1950). The court, in fact, found that the trustee breached his fiduciary duty. *Id*. at 620. The real issue in the case was whether an exception to the self-dealing pro-

hibition applied. In that case the trust document expressly allowed the trustee to invest trust assets in bonds and indebtedness of a company the trustee had an interest in, but the court found the loans made by the trustee were not of the type allowed by the trust provisions. *Id*. at 619.

Defendant also is mistaken in claiming *Conant v. Lansden* supports his position. The court did find a loan to a company in which the trustee was involved to be proper. However, the court was not faced with a true self-dealing problem in that case. The trustee had an insignificant ownership interest in the company and the trust itself had a substantial interest in the company. *Conant v. Lansden*, 98 N.E.2d at 778. In the present case, the trust had no interest in any of the entities to which the Defendant lent trust money. The other questionable loan was made to a company the trustee was secretary of. The court noted there was no evidence to show he was a stockholder or that he received any benefit from the company. *Id*. The court did not need to apply self-dealing analysis, and found the loans proper based on the trustee's investment power. *Id*.

Finally, Defendant is incorrect in claiming that *Smith v. First National Bank of Danville*, 254 Ill. App. 3d 251, 624 N.E.2d 899 (4th Dist. 1993) stands for the proposition that some courts follow the "better rule" that self-dealing by a trustee with trust property only raises a presumption of impropriety. *Smith* deals with dealings between the trustee and the trust's beneficiaries, not with a trustee's dealing with trust property. While dealings between a trustee and a trust beneficiary may be redeemed by showing the transactions were fair to the beneficiaries, self-dealing with trust property cannot be.

It is undisputed the loans were self-dealing and the Defendant has produced no evidence to show an exception to the prohibition against self-dealing is applicable to this case. Summary judgment for the Plaintiffs on this issue is GRANTED.

Issue 4

Defendant concedes in his response to Plaintiffs' Motion that a trustee must not put himself in a position which would expose him to the temptation to act contrary to his duties as trustee. *Id*. at 719. It is undisputed that Defendant lent money to entities in which he had a financial interest or to relatives. Clearly this placed him in a position where he would be tempted to act in his interest, possibly against the interests of the beneficiaries. Defendant claims only a presumption of impropriety arises and that presumption may be rebutted by evidence the transaction was fair to the beneficiary. Defendant relies on *Matter of the Estate of Allison*, 488 N.E.2d 1035. A fair reading of the case does not support Defendant's interpretation. The court held that even though the trustee acted in good faith, any profits he earned through self-dealing belonged to the trust. *Id*. at 1039.

Defendant has failed to cite any case law establishing that only a presumption of impropriety arises when a trustee puts himself in a position in conflict with the beneficiaries. It is undisputed Defendant placed himself in such a situation, therefore, summary judgment for the Plaintiffs is GRANTED on this issue.

Issue 5

Plaintiffs allege that when a fiduciary relationship exists, any transaction between the parties is presumptively fraudulent, only rebuttable by clear and

convincing evidence of good faith. As Defendant points out, there are no transactions between the parties in this case. Even if there were transactions there is a material issue as to whether the Defendant acted in good faith. Summary judgment is DENIED on this issue.

Issue 6

Defendant does not deny he failed to make an annual accounting of the trust until approximately 1997, but he does deny he was required to do so. A trustee must, at least annually, furnish any beneficiary entitled to receive income from the trust with an accounting detailing the receipts, disbursements, and inventory of the trust. 760 ILCS 5/11(a) (West 1998). Defendant argues the statute is not applicable because there were no beneficiaries entitled to receive income from the trust. That interpretation is patently incorrect. Article VII of the trust expressly allows the beneficiaries to withdraw $3000 annually. Defendant argues that in the alternative, even if the statute does apply there was nothing to account for, so an accounting was unnecessary. Defendant does not dispute that he borrowed money from the life insurance policy and then loaned it out. This clearly is a transaction that must be accounted for. In addition, the Plaintiffs point out that premiums were paid on the policy and that it was a whole life policy that accumulated value. The only dispute is the interpretation of the statute, which is a legal issue. Summary judgment for Plaintiffs on this issue is GRANTED.

ENTERED this 11 day of June, 2002.

/s/ Thomas J. Fahey
THOMAS J. FAHEY
Circuit Court Judge