NOT FOR PUBLICATION

UNITED STATES BANKRUPTCY APPELLATE PANEL

OF THE NINTH CIRCUIT

In re:	BAP No. AZ-05-1470-AMoS
KENNETH W. MADDUX,	Bk. No. 03-03789-PHX-RTB
Debtor.	Adv. No. 03-00661-PHX-RTB
KENNETH W. MADDUX,	
Appellant,	**M E M O R A N D U M**[1]
v.	
EMILY C. BRATKO,	
Appellee.	

Argued and Submitted on June 22, 2006
at Phoenix, Arizona

Filed - November 28, 2006

Appeal from the United States Bankruptcy Court
for the District of Arizona

Hon. Redfield T. Baum, Sr., Chief Bankruptcy Judge, Presiding.

Before: AHART,[2] MONTALI and SMITH, Bankruptcy Judges.

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[1] This disposition is not appropriate for publication and may not be cited to or by the courts of this circuit except when relevant under the doctrines of law of the case, claim preclusion, or issue preclusion. See 9th Cir. BAP Rule 8013-1.

[2] Hon. Alan M. Ahart, Bankruptcy Judge for the Central District of California, sitting by designation.

I. INTRODUCTION

The dispute before this Panel arose when Debtor Kenneth W. Maddux ("Debtor") liquidated his wholly-owned corporation and did not use the proceeds to pay the claims of the corporation's creditors, including that of Emily C. Bratko ("Creditor"). Upon Creditor's Motion for Summary Judgment, the bankruptcy court found that Debtor received the proceeds of the liquidation of all the corporate assets without satisfying Creditor's claim and held that pursuant to 11 U.S.C. § 523(a)(4)[3] "[Debtor] cannot discharge his liability [to Creditor] for breaching his fiduciary duty owed to the creditors of his corporation."[4] We hold that, on the record before us, Creditor did not meet her burden of proving that Debtor owed an independent and pre-existing fiduciary duty to Creditor arising from an express or technical trust at the time Debtor transferred the corporate funds, and therefore Creditor's claim may be dischargeable under § 523(a)(4). Accordingly, we REVERSE and REMAND.

II. FACTS

Debtor was the sole shareholder of Desert Rose Catering, Inc. ("Desert Rose"). On or around August 31, 2001, Creditor sold her business "Mail and More" to Desert Rose. Under the terms of the

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[3] Unless otherwise indicated, all chapter, section and rule references are to the Bankruptcy Code, 11 U.S.C. §§ 101-1330, and to the Federal Rules of Bankruptcy Procedure, Rules 1001-9036, as enacted and promulgated prior to the effective date of The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. 109-8, 119 Stat. 23, because the case from which this appeal arises was filed before its effective date (generally October 17, 2005).

[4] Bankruptcy court Minute Order, filed May 12, 2005.

sale agreement, the corporation was to pay Creditor the sum of $20,000 in monthly installment payments of $626.73, beginning on September 30, 2001 until paid in full. Desert Rose also agreed to pay Creditor $45,000 on or before December 31, 2001. Only two payments were made.

On March 28, 2002, Creditor initiated a lawsuit against Desert Rose in Arizona Superior Court, Case No. CV2002-004929. One day later, on March 29, 2002, Debtor caused the sale of Desert Rose's warehouse, which appears to have been the corporation's only remaining asset, and deposited the proceeds into his personal account. Shortly thereafter, on June 24, 2002, the Arizona Corporation Commission dissolved Desert Rose. By March 10, 2003, the date on which Debtor filed his voluntary Chapter 7 petition, Debtor no longer possessed any of the proceeds from the sale of the warehouse. Judgment was entered in favor of Creditor and against Desert Rose on August 20, 2003 in the amount of $64,009.91 plus accrued interest from August 31, 2001 ("State Court Judgment").

On July 14, 2003, Creditor filed a non-dischargeability complaint against Debtor and subsequently moved for summary judgment on her claim under § 523(a)(4). Debtor filed his own Motion to Dismiss Adversary Proceeding, or in the alternative, Motion for Summary Judgment, contending before the bankruptcy court that § 523(a)(4) was inapplicable because the requisite fiduciary duty did not exist before the debt was created. The bankruptcy court granted Creditor's Motion for Summary Judgment, and denied Debtor's Cross-Motion for Summary Judgment and Debtor's previously filed Motions to Dismiss, finding Creditor's claim to

be non-dischargeable pursuant to § 523(a)(4). The Notice of Appeal was timely filed. On appeal, Debtor challenges the granting of Creditor's Motion for Summary Judgment and the denial of Debtor's Motions to Dismiss, or in the alternative, Motion for Summary Judgment.

III. ISSUE

Whether Debtor owed Creditor a fiduciary duty when Debtor deposited the corporate funds into his personal account, such that any debt that Debtor owes to Creditor is non-dischargeable under § 534(a)(4).

IV. STANDARD OF REVIEW

We review de novo the bankruptcy court's decision to grant a motion for summary judgment. Oliver v. Keller, 289 F.3d 623, 626 (9th Cir. 2002). The denial of summary judgment, when coupled with the granting of an opposing motion for summary judgment, is also reviewed de novo. Padfield v. AIG Life Ins. Co., 290 F.3d 1121, 1124 (9th Cir. 2002).

V. DISCUSSION

The initial burden is on the party moving for summary judgment to establish the absence of a genuine issue of material fact and entitlement to a judgment in its favor on the relevant claims as a matter of law. Fed. R. Civ. P. 56(c) (incorporated by Fed. R. Bankr. P. 7056). Celotex Corp. v. Catrett, 477 U.S. 317, 322-323 (1986). We view the evidence in the light most favorable to the non-moving party. In re Green, 198 B.R. 564, 566 (9th Cir.

BAP 1996). If the movant meets that initial burden, then the burden shifts to the party opposing summary judgment under Fed. R. Civ. P. 56(e) to go beyond the pleadings and by its own affidavits, or by the "depositions, answers to interrogatories, and admissions on file," to designate "specific facts showing that there is a genuine issue for trial." Fed. R. Civ. P. 56(c) and (e); Celotex, 477 U.S. at 322-323. "Only disputes over facts that might affect the outcome of the suit under the governing law will properly preclude the entry of summary judgment. Factual disputes that are irrelevant or unnecessary will not be counted." Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 248 (1986). A dispute is "genuine" if it would create a factual issue sufficient to overcome a motion for a directed verdict in a jury trial. Id. at 251-52.

Section 523(a)(4) excepts from discharge a debt "for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny." Exceptions to discharge under § 523 are to be narrowly construed in favor of the debtor and against the objecting creditor. Hayhoe v. Cole (In re Cole), 266 B.R. 647, 653 (9th Cir. BAP 1998); Aetna Fin. Co. v. Neal (In re Neal), 113 B.R. 607, 609 (9th Cir. BAP 1990) (citing Klapp v. Landsman (In re Klapp), 705 F.2d 998, 999 (9th Cir. 1983)); American Fed'n of State, County and Municipal Employees, Local 2051 v. Stephens (In re Stephens), 52 B.R. 591, 595 (9th Cir. BAP 1985); Eisen v. Linn (In re Linn), 38 B.R. 762, 763 (9th Cir. BAP 1984). Creditor asserts that the debt at issue resulted from Debtor's defalcation of funds held in trust while acting in a fiduciary capacity. In order for Creditor to prevail under § 523(a)(4), she must demonstrate, by a

preponderance of the evidence, the following: (1) an express or technical trust existed; (2) the debt at issue was caused by fraud or defalcation; and (3) the debtor was a fiduciary to the creditor at the time the debt was created. Nahman v. Jacks (In re Jacks), 266 B.R. 728, 735 (9th Cir. BAP 2001) (citing Otto v. Niles (In re Niles), 106 F.3d 1456, 1459 (9th Cir. 1997)).

Defalcation is defined as a "misappropriation of trust funds or money held in any fiduciary capacity." Jacks, 266 B.R. at 737; see also Moreno v. Ashworth (In re Moreno), 892 F.2d 417, 421 (5th Cir. 1990). The facts in this case tend to show that Debtor's actions satisfy the first element of defalcation, i.e., a misappropriation, when he transferred the proceeds from the liquidation of the corporate assets to himself rather than paying Desert Rose's creditors, as such a distribution is prohibited by Arizona law.[5] However, as with the overall cause of action under § 523(a)(4), to establish a defalcation the plaintiff must prove that the misappropriated funds were from a trust or held in a fiduciary capacity. Therefore, the chief question in this case is whether Debtor owed a fiduciary duty to Creditor at the time of the transfer.

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[5] Arizona law provides that

> distribution shall not be made if, after giving it effect, either: (1) The corporation would not be able to pay its debts as they become due in the usual course of business. (2) The corporation's total assets would be less than the sum of its total liabilities plus...the amount that would be needed, if the corporation were to be dissolved at the time of the distribution, to satisfy the preferential rights on dissolution of shareholders whose preferential rights are superior to those receiving the distribution.

A.R.S. § 10-640(c).

"The definition of 'fiduciary capacity' under section 523(a)(4) is a question of federal law." Cal-Micro Inc. v. Cantrell (In re Cantrell), 329 F.3d 1119, 1125 (9th Cir. 2003). For purposes of § 523(a)(4), the fiduciary duty is narrowly construed to mean only a fiduciary relationship arising out of a technical or express trust. Id. Broader definitions of fiduciary relationships, including relationships arising out of confidence, trust and good faith, "implied or constructive trusts, and trusts ex malefico (trusts created merely on the basis of wrongful conduct)" are inapplicable for purposes of § 523(a)(4). Cantrell v. Cal-Micro, Inc. (In re Cantrell), 269 B.R. 413, 420 (9th Cir. BAP 2001); see also Lewis v. Scott (In re Lewis), 97 F.3d 1182, 1185 (9th Cir. 1996); Lovell v. Stanifer (In re Stanifer), 236 B.R. 709, 714 (9th Cir. BAP 1999) (citing In re Short, 818 F.2d 693, 695 (9th Cir. 1987)). Federal courts must look to state law to determine whether a trust relationship exists. Cal-Micro, 329 F.3d at 1125.

THE TRUST FUND DOCTRINE

Creditor argues that a fiduciary duty was imposed upon Debtor by operation of the Trust Fund Doctrine ("TFD"). The TFD is an equitable doctrine that provides that "all of the assets of a corporation, immediately on its becoming insolvent, exist for the benefit of all of its creditors." A.R. Teeters & Assoc. v. Eastman Kodak Company, 836 P.2d 1034, 1041 (Ariz. Ct. App. 1992) (quoting 15A William Meade Fletcher, Cyclopedia of the Law of Private Corporations, § 7369 (rev. perm. ed. 1990)). Although disfavored in many jurisdictions, "[t]he trust fund [doctrine] has been held to be the law of Arizona." Drew v. U.S., 367 F.2d 828,

830 (Ct. Cl. 1966). Courts in the Ninth Circuit have held that a fiduciary duty arising out of the TFD is sufficient to satisfy both the first and third elements of a § 523(a)(4) claim. Jacks, 266 B.R. at 737 (finding that the TFD "imposes an express trust sufficient for the application of section 523(a)(4)") (citing Flegel v. Burt & Assoc., P.C. (In re Kallmeyer), 242 B.R. 492, 496 (9th Cir. BAP 1999)).

1. Insolvency

Under the TFD, corporate insolvency triggers the fiduciary duty of the corporation's directors or officers.[6] Teeters, 836 P.2d at 1041 ("Trust fund liability is premised upon a finding of insolvency."). In this case, no evidence was presented to establish that Desert Rose was insolvent before the transfer of the sale proceeds to Debtor. Clearly the corporation became insolvent as a result of the transfer, as the sale liquidated the corporation's last remaining asset, while the corporation owed a debt to Creditor. However, no reported Arizona state court decision or any reported decision in the Ninth Circuit has held that the fiduciary duty created by the TFD can be violated by the very transfer that creates the insolvency. See Jacks, 266 B.R. at 739 ("Because a director's fiduciary duties to creditors do not arise until the corporation is insolvent, the timing of the insolvency is critical.") (emphasis added). This prior insolvency requirement is necessary; otherwise certain transfers would

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[6] Although it is not clear from the record, it is likely that Debtor, as Desert Rose's only shareholder, was also one of, if not the only, corporate officer and/or director. The record does disclose that Debtor signed a corporate joint tenancy deed as the President of Desert Rose.

violate fiduciary duties that did not exist until after the transfer was made, i.e., the violating transfer would create the insolvency, which in turn would give rise to the fiduciary duty.

Therefore, because there is no evidence that Desert Rose was insolvent at the time of the transfer, and because the TFD is not invoked in a situation where the corporation was rendered insolvent as a result of the transfer, Creditor has not demonstrated that Debtor owed a fiduciary duty at the time of the transfer.

2. Separate and Independent Fiduciary Duty

A finding of non-dischargeability under § 523(a)(4) also requires that the trust or fiduciary duty be "in existence before and independently of the defalcation." Jacks, 266 B.R. at 736. See also Lewis, 97 F.3d at 1185 ("[T]he fiduciary relationship must be one arising from an express or technical trust that was imposed before and without reference to the wrongdoing that caused the debt.") (citing and quoting Davis v. AETNA Acceptance Co., 293 U.S. 328, 333 (1934) ("It is not enough that, by the very act of wrongdoing out of which the contested debt arose, the bankrupt has become chargeable as a trustee ex maleficio. He must have been a trustee before the wrong and without reference thereto.")); In re Pedrazzini, 644 F.2d 756, 758 (9th Cir. 1981) (holding that a trust relationship must exist before the wrong and not arise as a result of it); Cantrell, 269 B.R. at 420 ("Also inapplicable are fiduciary relationships arising from . . . trusts ex maleficio (trusts created merely on the basis of the wrongful conduct).") (citing Stanifer, 236 B.R. at 714).

As demonstrated above, any fiduciary duty owed by the Debtor

could only have been created under the TFD by the corporation's then-existing insolvency. According to the evidence, Desert Rose's insolvency occurred as a result of the Debtor's transfer of the proceeds to himself. Thus, the duty did not arise separately and independently from Debtor's act, but rather from the act itself. No reference to any duty created under the TFD as a result of Desert Rose's insolvency can be made without consideration of said transfer, as the transfer itself caused the insolvency, i.e., the duty would not have arisen but for the transfer. For this reason, it cannot be said that the fiduciary duty arose independently of and without reference to Debtor's transfer.

The dissent asserts that the transfer of corporate assets to Debtor triggered the fiduciary duty under the TFD and the defalcation occurred at a later point, when Debtor used the funds for his own purposes rather than for paying the obligations of Desert Rose. Thus, it is argued, the fiduciary duty arose separately and apart from the later defalcation. However, under the TFD, the violation or defalcation only occurs when assets are transferred away from an insolvent corporation, as the res of the trust consists of the remaining assets of the corporation. See Teeters, 836 P.2d at 1043 ("When a corporation becomes insolvent, its directors and officers become fiduciaries of the corporate assets for the benefit of creditors."); Norris Chemical Co. v. Ingram, 379 P.2d 567 (Ariz. Ct. App. 1984) (holding that, under the TFD, a dominant shareholder of an insolvent corporation will be liable for transfers where the shareholder "prefers himself over other creditors in violation of his duties as trustee of the

remaining assets"). Accordingly, the TFD doctrine is violated and liability is imposed if "(1) corporate assets were transferred...,(2) the transfer of corporate assets occurred while the corporation was insolvent, and (3) the transfer preferred [the recipient] to the disadvantage of other creditors of the same priority." Teeters, 836 P.2d at 1042. Once the assets leave the corporation, the ultimate disposition of said assets is irrelevant because the officer or director already breached his fiduciary duties and the TFD has been violated. In other words, the duty to the corporate creditors does not follow the assets under the TFD.

In this case, if the transfer to Debtor, which created the insolvency, is said to have triggered the fiduciary duty owed by Debtor under the TFD, then at that exact moment and with the same transfer, Debtor violated his new fiduciary duty and the TFD by transferring the assets away from the corporation.[7] Under the TFD, no further action or inaction on the Debtor's part is necessary for liability to arise and the Debtor, as the recipient of the funds, was no longer holding the funds in trust. Therefore, analysis of this case under the TFD leads to the conclusion that the fiduciary duty and the defalcation did not arise separately and independently from one another. Thus, on this record, the debt cannot be deemed non-dischargeable under § 523(a)(4).

TRANSFEREE LIABILITY

A similar, although lesser used, basis for creditors of an

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[7] Moreover, because the transfer depleted all of Desert Rose's assets, the transfer also effectively discharged Debtor's fiduciary duty under the TFD, as no corporate assets remained for Debtor to hold in trust for the corporation's creditors.

insolvent corporation to seek recovery of assets transferred away from the corporation is commonly referred to as the "transferee liability" theory.[8] In Arizona, this theory is most notably cited in the case of Love v. Bracamonte, 240 P. 351 (Ariz. 1925), in which the court held that "the settled law of this jurisdiction, and generally, is that a transferee of an insolvent corporation takes the assets of such corporation subject to the payment of its legitimate debts and holds the same in trust for that purpose." Id. at 353. The primary difference between the TFD and transferee liability is the basis for recovery by creditors. Under the TFD, liability is imposed upon a director, officer, or shareholder who causes a transfer of an insolvent corporation's assets in violation of the fiduciary duty owed to the corporate creditors. In contrast, transferee liability is simply a theory of recovery of assets transferred from an insolvent corporation without the exchange of reasonably equivalent value. For recovery, a creditor need not show intent or fraud on the part of the transferee, who may in fact be an innocent third party, and the fact that the transferee disposes of or further transfers the assets after receipt does not impact liability. In this sense, transferee liability is very similar to the liability imposed on a transferee of a fraudulent transfer and the provisions for recovery in 11 U.S.C. § 550(a).

As with the TFD, liability of a transferee does not arise

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[8] In fact, for the last several decades in Arizona, this theory only seems to arise in cases involving unpaid taxes and § 6901 of the Internal Revenue Code, which provides that the government may collect unpaid taxes from the transferee of a taxpayer if state law of the jurisdiction allows for recovery of assets from a transferee.

unless the corporation from which the assets were transferred was insolvent at the time of the transfer. Coca-Cola Bottling Co. of Tucson v Commissioner of Internal Revenue, 334 F.2d 875, 877 (9th Cir. 1964) (stating that the "element of insolvency of the transferor" is "essential to transferee liability under [Love]"). However, in cases applying the transferee liability theory, unlike cases involving the TFD, it appears that courts may impose liability upon an transferee when the subject transfer creates the corporate insolvency. See Drew, 367 F.2d at 831 ("[T]he controlling and substantive rule is that upon the liquidation and dissolution of a corporation, the stockholders are liable as transferees when adequate provisions have not been made for payment of the corporation's obligations, in other words, when insolvency results from the liquidation." (citing Coca-Cola)). This is also analogous to recovery for a fraudulent transfer, where liability can be found and recovery of assets had when the transfer at issue causes the transferor to become insolvent.

Given the facts in the present case, it appears that Creditor may have been able to recover from Debtor as the transferee of assets from a corporation rendered insolvent by the transfer. However, establishing liability for the debt does not end the inquiry in this matter, as the issue before the court is the dischargeability of the debt. And again, as above under the TFD analysis but for a different reason, the debt in this case cannot be deemed non-dischargeable. While, under the TFD, Creditor failed to establish a separate and independent fiduciary duty, primarily due to the issue of insolvency, likewise we cannot find the debt to be non-dischargeable under § 523(a)(4) based on the

theory of transferee liability because of the lack of an express or technical trust.

Unlike cases involving the TFD, the Ninth Circuit has not held that transferee liability creates a trust or fiduciary relationship between the transferee and the transferor corporation's creditors sufficient for application of § 523(a)(4). This makes sense, as a transferee may be an innocent third party unaware of such resulting duty or even of the existence of corporate creditors. Similarly, a transferee of a fraudulent transfer under § 548 is not held to be a trustee of the property that was transferred. The transferee merely has to return the property or becomes liable for the value of the property.

Moreover, the use of the word "trust" in the Love case (see supra at 12) does not give rise to an actual trust relationship between the transferee and the corporate creditors under the transferee liability theory. In a similar situation, in a case in which the Ninth Circuit was defining the word "fiduciary" in the context of § 523(a)(4), the court found that "ambiguous" language could have a simple, and not literal, meaning. Cal-Micro, 329 F.3d at 1126, n.4. In that case, the corporate plaintiff relied upon a state appellate case that stated "[t]he fiduciary duty of a controlling shareholder or director to a minority shareholder is based on 'powers in trust.'" Id. (quoting Interactive Multimedia Artists, Inc. v. Superior Court, 62 Cal. App. 4th 1546, 1555 (1998)). In response, the Ninth Circuit held, "as both the bankruptcy court and the BAP recognized, this language is ambiguous and could simply mean that directors and controlling shareholders have a general fiduciary duty to act fairly with

respect to corporate matters." Id. Similarly here, the language in Love should not be read to create an express trust or impose fiduciary duties upon a transferee. Instead, the language should be interpreted to mean that the transferee receives the assets subject to the powers of avoidance and recovery of the transfer by a corporate creditor.

Finally, rather than an actual trust relationship, if anything a transferee of assets from an insolvent corporation may be said to hold the assets as a constructive trustee. "A constructive trust, unlike an express trust, is not a fiduciary relation . . . ." Restatement (First) of Restitution § 160 (1937). Transferee liability is similar to a constructive trust in that

> [a] constructive trust arises whenever another's property has been wrongfully appropriated and converted into a different form. . . . [E]quity impresses a constructive trust upon the new form or species of property, not only while it is in the hands of the original wrongdoer, but as long as it can be followed and identified in whosoever hands it may come, except into those of a bona fide purchaser for value and without notice . . . .

Pioneer Mining Co. v. Tyberg, 215 F. 501, 505 (9th Cir. 1915). Further, like transferee liability, which is merely a theory for recovery of assets, "a constructive trust is purely an equitable remedy." AzStar Casualty Co., et al v. Allied General Agency (In re Allied General Agency), 229 B.R. 190, 196 (D. Ariz. 1998) (internal citations omitted).

On this point, the Supreme Court, in a case dealing with transferee liability for tax obligations of the transferor, expressly held that transferee liability resembled a constructive trust relationship, stating that, "[u]nder the equitable doctrine that the funds of a corporation are a trust fund for the benefit

of creditors, a stockholder receiving funds without adequate consideration from an insolvent corporation may be held, in some jurisdictions, to hold the funds as a constructive trustee." Healy v. Comm. of Internal Revenue, 345 U.S. 278, 282 (1953). Moreover, the Court stated that a "constructive trust is a fiction imposed as an equitable device for achieving justice. It lacks the attributes of a trust trust, and is not based on any intention of the parties." Id. at 282-83.

Because a constructive trust "lacks the attributes" of an express or technical trust and does not arise "based on any intention of the parties," courts in this Circuit have expressly held that constructive trust relationships are insufficient for non-dischargeability under § 523(a)(4). See Jacks, 266 B.R. at 736 ("A trust arising as a consequence of wrongdoing, such as constructive, resulting, or implied trust, is outside the purview of § 523(a)(4).") (citing Evans v. Pollard (In re Evans), 161 B.R. 474, 477 (9th Cir. BAP 1993)).

Therefore, although the facts in this case appear to support a finding of liability on the part of the Debtor under Arizona law as a transferee of assets from an insolvent corporation, any debt arising from such liability would not be non-dischargeable under § 523(a)(4) because no express or technical trust existed. Consequently, because the first element of § 523(a)(4), requiring an express or technical trust, is not satisfied, the debt cannot be deemed non-dischargeable under the transferee liability theory.

DESERT ROSE'S INSOLVENCY

Nonetheless, the evidence presented appears to show that, at the time of the transfer, Desert Rose's debts, particularly

Creditor's State Court Judgment, were nearly equal to the value of the corporate assets, as determined by the sale price received for the warehouse. Therefore, it is conceivable, although not established by the record, that Desert Rose may have been insolvent prior to the transfer. If this were the case, a fiduciary duty would have arisen under the TFD at the point at which Desert Rose became insolvent, before the transfer. In such a situation, the transfer of the proceeds from the insolvent corporation to Debtor could constitute a defalcation of trust funds by a fiduciary. For this reason, we remand the matter back to the bankruptcy court to allow the court to consider further evidence as to Desert Rose's financial condition immediately before the transfer, in order to determine whether the corporation was insolvent.

VI. CONCLUSION

In conclusion, the evidence was insufficient to establish corporate insolvency before the transfer. Therefore, no fiduciary duty existed at the time of the transfer under the TFD. Additionally, as a matter of law, no express trust relationship arises under the transferee liability theory sufficient for application of § 523(a)(4). For these reasons, we REVERSE the order of the bankruptcy court granting Creditor's Motion for Summary Judgment.

However, the record suggests that Desert Rose may have been insolvent before the transfer, which fact, if true, would allow a finding that a fiduciary duty existed under the TFD. Accordingly, we also REMAND this proceeding to the bankruptcy court for further

consideration of this issue.

MONTALI, Bankruptcy Judge, dissenting:

I respectfully dissent. I think that the debt of Debtor to Creditor is non-dischargeable on the existing record and a remand is unnecessary. We should affirm the judgment of the bankruptcy court.

The majority and I agree on several points. We agree that Creditor has not proven that Desert Rose was insolvent before it transferred the proceeds of the warehouse sale (approximately $70,000) to its principal, the Debtor. We also agree that as a result of that transfer Desert Rose was rendered insolvent. The majority states that this transfer violated Arizona law (see supra text accompanying note 5) and I do not disagree. Where we disagree is that the majority treats this transfer as the only relevant wrongdoing by Debtor, and on this basis it invokes well settled law to the effect that § 523(a)(4) does not apply when the trust only arises because of the wrongful act itself, as opposed to arising separately, independently, and prior to the wrongful act. Stated otherwise, the majority charges Debtor with defalcation when he received the proceeds; I call him a fiduciary when he received the proceeds.

In my view the correct analysis involves a two step process, the first establishing Debtor's fiduciary duty and the second constituting the defalcation. First, Debtor's fiduciary duty was established when he transferred all of the corporation's remaining assets into his personal account, clearly rendering the corporation insolvent and just as clearly making Debtor a

fiduciary for Desert Rose's creditors. As noted by the majority: "Under the TFD, corporate insolvency triggers the fiduciary duty of the corporation's directors or officers." (Supra, at 8:9-10 (footnote omitted)). Debtor held the funds that he had received from the corporation in trust. Drew, 367 F.2d at 830; Coca-Cola Bottling Co. of Tucson, 334 F.2d at 877; A.R. Teeters & Associates, Inc., 836 P.2d at 1042. See also Norris Chem. Co. v. Ingram, 139 Ariz. 544, 548 (Ariz. Ct. App. 1984); Thomas v. Walkup, 14 Ariz. App. 140, 141 (Ariz. Ct. App. 1971). At this point, Debtor still could have discharged that trust by paying the corporation's creditors.[1] Debtor committed the defalcation under § 523(a)(4) in the second step when, after he received the funds in trust, he squandered them rather than paying the corporation's creditors, thereby violating his fiduciary duty. Otto v. Niles (In re Niles), 106 F.3d 1456, 1460 (9th Cir. 1997).

The majority focuses on the lack of information in the record reflecting the time when the corporation became insolvent. This issue is irrelevant. I recognize that the corporation may have been solvent before all of its assets were transferred to Debtor, but that only reinforces the above analysis. If a transfer from an already insolvent corporation to its shareholder is held in trust, it would be counterintuitive to hold that taking more funds out of the corporation and rendering it insolvent does not create the same trust obligation.

For the foregoing reasons I am convinced that we should

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[1] Debtor was liable as a guarantor for Desert Rose's debt to Creditor but this does not give rise to, and is irrelevant with regard to, the non-dischargeability of his debt for breach of fiduciary duty.

affirm the decision of the bankruptcy court. Remand is unnecessary.