

NOT FOR PUBLICATION

NOV 28 2006

**HAROLD S. MARENUS, CLERK
U.S. BKCY. APP. PANEL
OF THE NINTH CIRCUIT**

**UNITED STATES BANKRUPTCY APPELLATE PANEL
OF THE NINTH CIRCUIT**

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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,)		
)		
v.)		
)		
EMILY C. BRATKO,)		
)		
Appellee.)		
_____)		

M E M O R A N D U M¹

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.

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.

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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

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.

1 sale agreement, the corporation was to pay Creditor the sum of
2 \$20,000 in monthly installment payments of \$626.73, beginning on
3 September 30, 2001 until paid in full. Desert Rose also agreed to
4 pay Creditor \$45,000 on or before December 31, 2001. Only two
5 payments were made.

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

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

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

6 7 **III. ISSUE**

8 Whether Debtor owed Creditor a fiduciary duty when Debtor
9 deposited the corporate funds into his personal account, such that
10 any debt that Debtor owes to Creditor is non-dischargeable under
11 § 534(a)(4).

12 13 **IV. STANDARD OF REVIEW**

14 We review de novo the bankruptcy court's decision to grant a
15 motion for summary judgment. Oliver v. Keller, 289 F.3d 623, 626
16 (9th Cir. 2002). The denial of summary judgment, when coupled
17 with the granting of an opposing motion for summary judgment, is
18 also reviewed de novo. Padfield v. AIG Life Ins. Co., 290 F.3d
19 1121, 1124 (9th Cir. 2002).

20 21 **V. DISCUSSION**

22 The initial burden is on the party moving for summary
23 judgment to establish the absence of a genuine issue of material
24 fact and entitlement to a judgment in its favor on the relevant
25 claims as a matter of law. Fed. R. Civ. P. 56(c) (incorporated by
26 Fed. R. Bankr. P. 7056). Celotex Corp. v. Catrett, 477 U.S. 317,
27 322-323 (1986). We view the evidence in the light most favorable
28 to the non-moving party. In re Green, 198 B.R. 564, 566 (9th Cir.

1 BAP 1996). If the movant meets that initial burden, then the
2 burden shifts to the party opposing summary judgment under Fed. R.
3 Civ. P. 56(e) to go beyond the pleadings and by its own
4 affidavits, or by the "depositions, answers to interrogatories,
5 and admissions on file," to designate "specific facts showing that
6 there is a genuine issue for trial." Fed. R. Civ. P. 56(c) and
7 (e); Celotex, 477 U.S. at 322-323. "Only disputes over facts that
8 might affect the outcome of the suit under the governing law will
9 properly preclude the entry of summary judgment. Factual disputes
10 that are irrelevant or unnecessary will not be counted." Anderson
11 v. Liberty Lobby, Inc., 477 U.S. 242, 248 (1986). A dispute is
12 "genuine" if it would create a factual issue sufficient to
13 overcome a motion for a directed verdict in a jury trial. Id. at
14 251-52.

15 Section 523(a) (4) excepts from discharge a debt "for fraud or
16 defalcation while acting in a fiduciary capacity, embezzlement, or
17 larceny." Exceptions to discharge under § 523 are to be narrowly
18 construed in favor of the debtor and against the objecting
19 creditor. Hayhoe v. Cole (In re Cole), 266 B.R. 647, 653 (9th
20 Cir. BAP 1998); Aetna Fin. Co. v. Neal (In re Neal), 113 B.R. 607,
21 609 (9th Cir. BAP 1990) (citing Klapp v. Landsman (In re Klapp),
22 705 F.2d 998, 999 (9th Cir. 1983)); American Fed'n of State,
23 County and Municipal Employees, Local 2051 v. Stephens (In re
24 Stephens), 52 B.R. 591, 595 (9th Cir. BAP 1985); Eisen v. Linn (In
25 re Linn), 38 B.R. 762, 763 (9th Cir. BAP 1984). Creditor asserts
26 that the debt at issue resulted from Debtor's defalcation of funds
27 held in trust while acting in a fiduciary capacity. In order for
28 Creditor to prevail under § 523(a) (4), she must demonstrate, by a

1 preponderance of the evidence, the following: (1) an express or
2 technical trust existed; (2) the debt at issue was caused by fraud
3 or defalcation; and (3) the debtor was a fiduciary to the creditor
4 at the time the debt was created. Nahman v. Jacks (In re Jacks),
5 266 B.R. 728, 735 (9th Cir. BAP 2001) (citing Otto v. Niles (In re
6 Niles), 106 F.3d 1456, 1459 (9th Cir. 1997)).

7 Defalcation is defined as a "misappropriation of trust funds
8 or money held in any fiduciary capacity." Jacks, 266 B.R. at 737;
9 see also Moreno v. Ashworth (In re Moreno), 892 F.2d 417, 421 (5th
10 Cir. 1990). The facts in this case tend to show that Debtor's
11 actions satisfy the first element of defalcation, i.e., a
12 misappropriation, when he transferred the proceeds from the
13 liquidation of the corporate assets to himself rather than paying
14 Desert Rose's creditors, as such a distribution is prohibited by
15 Arizona law.⁵ However, as with the overall cause of action under
16 § 523(a)(4), to establish a defalcation the plaintiff must prove
17 that the misappropriated funds were from a trust or held in a
18 fiduciary capacity. Therefore, the chief question in this case is
19 whether Debtor owed a fiduciary duty to Creditor at the time of
20 the transfer.

21 ⁵ Arizona law provides that

22 distribution shall not be made if, after giving it
23 effect, either: (1) The corporation would not be able to
24 pay its debts as they become due in the usual course of
25 business. (2) The corporation's total assets would be
26 less than the sum of its total liabilities plus...the
27 amount that would be needed, if the corporation were to
28 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).

1 “The definition of ‘fiduciary capacity’ under section
2 523(a) (4) is a question of federal law.” Cal-Micro Inc. v.
3 Cantrell (In re Cantrell), 329 F.3d 1119, 1125 (9th Cir. 2003).
4 For purposes of § 523(a) (4), the fiduciary duty is narrowly
5 construed to mean only a fiduciary relationship arising out of a
6 technical or express trust. Id. Broader definitions of fiduciary
7 relationships, including relationships arising out of confidence,
8 trust and good faith, “implied or constructive trusts, and trusts
9 ex maleficio (trusts created merely on the basis of wrongful
10 conduct)” are inapplicable for purposes of § 523(a) (4). Cantrell
11 v. Cal-Micro, Inc. (In re Cantrell), 269 B.R. 413, 420 (9th Cir.
12 BAP 2001); see also Lewis v. Scott (In re Lewis), 97 F.3d 1182,
13 1185 (9th Cir. 1996); Lovell v. Stanifer (In re Stanifer), 236
14 B.R. 709, 714 (9th Cir. BAP 1999) (citing In re Short, 818 F.2d
15 693, 695 (9th Cir. 1987)). Federal courts must look to state law
16 to determine whether a trust relationship exists. Cal-Micro, 329
17 F.3d at 1125.

18 THE TRUST FUND DOCTRINE

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

1 830 (Ct. Cl. 1966). Courts in the Ninth Circuit have held that a
2 fiduciary duty arising out of the TFD is sufficient to satisfy
3 both the first and third elements of a § 523(a)(4) claim. Jacks,
4 266 B.R. at 737 (finding that the TFD “imposes an express trust
5 sufficient for the application of section 523(a)(4)”) (citing
6 Flegel v. Burt & Assoc., P.C. (In re Kallmeyer), 242 B.R. 492, 496
7 (9th Cir. BAP 1999)).

8 1. Insolvency

9 Under the TFD, corporate insolvency triggers the fiduciary
10 duty of the corporation’s directors or officers.⁶ Teeters, 836
11 P.2d at 1041 (“Trust fund liability is premised upon a finding of
12 insolvency.”). In this case, no evidence was presented to
13 establish that Desert Rose was insolvent before the transfer of
14 the sale proceeds to Debtor. Clearly the corporation became
15 insolvent as a result of the transfer, as the sale liquidated the
16 corporation’s last remaining asset, while the corporation owed a
17 debt to Creditor. However, no reported Arizona state court
18 decision or any reported decision in the Ninth Circuit has held
19 that the fiduciary duty created by the TFD can be violated by the
20 very transfer that creates the insolvency. See Jacks, 266 B.R. at
21 739 (“Because a director’s fiduciary duties to creditors do not
22 arise until the corporation is insolvent, the timing of the
23 insolvency is critical.”) (emphasis added). This prior insolvency
24 requirement is necessary; otherwise certain transfers would

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26 ⁶ Although it is not clear from the record, it is likely
27 that Debtor, as Desert Rose’s only shareholder, was also one of,
28 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.

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

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

10 2. Separate and Independent Fiduciary Duty

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

28 As demonstrated above, any fiduciary duty owed by the Debtor

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

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

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

11 In this case, if the transfer to Debtor, which created the
12 insolvency, is said to have triggered the fiduciary duty owed by
13 Debtor under the TFD, then at that exact moment and with the same
14 transfer, Debtor violated his new fiduciary duty and the TFD by
15 transferring the assets away from the corporation.⁷ Under the
16 TFD, no further action or inaction on the Debtor's part is
17 necessary for liability to arise and the Debtor, as the recipient
18 of the funds, was no longer holding the funds in trust.

19 Therefore, analysis of this case under the TFD leads to the
20 conclusion that the fiduciary duty and the defalcation did not
21 arise separately and independently from one another. Thus, on
22 this record, the debt cannot be deemed non-dischargeable under
23 § 523(a)(4).

24 TRANSFeree LIABILITY

25 A similar, although lesser used, basis for creditors of an
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27 ⁷ Moreover, because the transfer depleted all of Desert
28 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.

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

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

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26 ⁸ In fact, for the last several decades in Arizona, this
27 theory only seems to arise in cases involving unpaid taxes and
28 § 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.

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

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

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

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

13 Moreover, the use of the word "trust" in the Love case (see
14 supra at 12) does not give rise to an actual trust relationship
15 between the transferee and the corporate creditors under the
16 transferee liability theory. In a similar situation, in a case in
17 which the Ninth Circuit was defining the word "fiduciary" in the
18 context of § 523(a)(4), the court found that "ambiguous" language
19 could have a simple, and not literal, meaning. Cal-Micro, 329
20 F.3d at 1126, n.4. In that case, the corporate plaintiff relied
21 upon a state appellate case that stated "[t]he fiduciary duty of a
22 controlling shareholder or director to a minority shareholder is
23 based on 'powers in trust.'" Id. (quoting Interactive Multimedia
24 Artists, Inc. v. Superior Court, 62 Cal. App. 4th 1546, 1555
25 (1998)). In response, the Ninth Circuit held, "as both the
26 bankruptcy court and the BAP recognized, this language is
27 ambiguous and could simply mean that directors and controlling
28 shareholders have a general fiduciary duty to act fairly with

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

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

13 [a] constructive trust arises whenever another’s
14 property has been wrongfully appropriated and converted
15 into a different form. . . . [E]quity impresses a
16 constructive trust upon the new form or species of
17 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

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

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

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

9 Because a constructive trust “lacks the attributes” of an
10 express or technical trust and does not arise “based on any
11 intention of the parties,” courts in this Circuit have expressly
12 held that constructive trust relationships are insufficient for
13 non-dischargeability under § 523(a)(4). See Jacks, 266 B.R. at
14 736 (“A trust arising as a consequence of wrongdoing, such as
15 constructive, resulting, or implied trust, is outside the purview
16 of § 523(a)(4).”) (citing Evans v. Pollard (In re Evans), 161 B.R.
17 474, 477 (9th Cir. BAP 1993)).

18 Therefore, although the facts in this case appear to support
19 a finding of liability on the part of the Debtor under Arizona law
20 as a transferee of assets from an insolvent corporation, any debt
21 arising from such liability would not be non-dischargeable under
22 § 523(a)(4) because no express or technical trust existed.

23 Consequently, because the first element of § 523(a)(4), requiring
24 an express or technical trust, is not satisfied, the debt cannot
25 be deemed non-dischargeable under the transferee liability theory.

26 DESERT ROSE’S INSOLVENCY

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

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

15 16 VI. CONCLUSION

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

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

1 consideration of this issue.

2

3 MONTALI, Bankruptcy Judge, dissenting:

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

8 The majority and I agree on several points. We agree that
9 Creditor has not proven that Desert Rose was insolvent before it
10 transferred the proceeds of the warehouse sale (approximately
11 \$70,000) to its principal, the Debtor. We also agree that as a
12 result of that transfer Desert Rose was rendered insolvent. The
13 majority states that this transfer violated Arizona law (see supra
14 text accompanying note 5) and I do not disagree. Where we
15 disagree is that the majority treats this transfer as the only
16 relevant wrongdoing by Debtor, and on this basis it invokes well
17 settled law to the effect that § 523(a)(4) does not apply when the
18 trust only arises because of the wrongful act itself, as opposed
19 to arising separately, independently, and prior to the wrongful
20 act. Stated otherwise, the majority charges Debtor with
21 defalcation when he received the proceeds; I call him a fiduciary
22 when he received the proceeds.

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

1 fiduciary for Desert Rose's creditors. As noted by the majority:
2 "Under the TFD, corporate insolvency triggers the fiduciary duty
3 of the corporation's directors or officers." (Supra, at 8:9-10
4 (footnote omitted)). Debtor held the funds that he had received
5 from the corporation in trust. Drew, 367 F.2d at 830; Coca-Cola
6 Bottling Co. of Tucson, 334 F.2d at 877; A.R. Teeters &
7 Associates, Inc., 836 P.2d at 1042. See also Norris Chem. Co. v.
8 Ingram, 139 Ariz. 544, 548 (Ariz. Ct. App. 1984); Thomas v.
9 Walkup, 14 Ariz. App. 140, 141 (Ariz. Ct. App. 1971). At this
10 point, Debtor still could have discharged that trust by paying the
11 corporation's creditors.¹ Debtor committed the defalcation under
12 § 523(a)(4) in the second step when, after he received the funds
13 in trust, he squandered them rather than paying the corporation's
14 creditors, thereby violating his fiduciary duty. Otto v. Niles
15 (In re Niles), 106 F.3d 1456, 1460 (9th Cir. 1997).

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

25 For the foregoing reasons I am convinced that we should

26
27 ¹ Debtor was liable as a guarantor for Desert Rose's debt
28 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.

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

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