



Paiute. Pursuant to this contract, CK delivered a check for a \$30,000 deposit, the balance to be paid at closing. The planned sale was never completed and CK sued to recover the deposit. In that action, CK alleged that the check was to be held in escrow and that Paiute cashed the check and commingled the \$30,000 with its own funds.

That action was brought in the United States District Court for the District of Utah, then C82-0794W. The assigned judge entered a partial summary judgment in favor of CK for the escrowed funds in the amount of \$30,000 plus interest. Paiute then appealed that judgment to the Court of Appeals, posting a \$40,000 supersedeas bond. While the case was pending review in the Court of Appeals, two critical events took place. First, on May 15, 1984, Paiute assigned its interest in the supersedeas bond to its attorney, Mr. Paul Cotro-Manes. Second, on December 18, 1984, Paiute filed for bankruptcy under Chapter 11. The appeal, the bond and its assignment to Cotro-Manes were all described in the Statement of Affairs filed in the bankruptcy court, but no mention of any interest the bankrupt may have in the bond was stated in the asset schedule. The alleged obligation to CK was not listed nor was CK listed as a creditor. CK received no formal notice of the bankruptcy proceeding.

Despite the bankruptcy proceedings, the Court of Appeals reversed the summary judgment in C82-0794 in March 1985 and remanded the case. The supersedeas bond posted for that appeal

was then, on Paiute's motion and with CK's stipulation, released by the clerk of the District Court to Paiute on August 8, 1985.<sup>2</sup> In November of 1985, CK filed the motion that is the subject of this appeal.

CK's motion asked for several alternative forms of relief:

1) CK requested that the funds from the supersedeas bond be declared subject to a constructive trust in favor of CK.

2) CK sought a declaration from the court that the listing of the supersedeas bond in the Statement of Affairs constituted sufficient proof of claim for purposes of the bankruptcy proceeding. In connection with this request, CK argued that the circuit court decision reversing the summary judgment was void, jurisdiction having been removed from the court of appeals by virtue of the automatic stay provisions of the bankruptcy code. 11 U.S.C. § 362. Thus, CK argued, not only was there sufficient proof of claim, but CK's claim was liquidated in the amount of the summary judgment for \$30,000 plus interest.

3) If the passage in the Statement of Affairs would not

<sup>2</sup> The funds were released to Paiute "by and through its attorney of record, Paul N. Cotro-Manes, Esq." CK Resources, Inc. v. Paiute Oil & Mining Corp. No. 82-C-0794J (D. Utah Aug. 8, 1985) ("Order Releasing Cash Supersedeas Bond and Turning Proceeds Over to Defendant") R.I. at 201-02. Nothing in the record on appeal indicates that any notice of Paiute's bankruptcy was given to the court releasing the bond. Nevertheless, upon filing its petition in the bankruptcy court, Paiute, as debtor in possession, became subject to the duties of a chapter 11 trustee. 11 U.S.C. 1107. See also R.I. at 143. Therefore, Cotro-Manes received the funds in question as attorney for the debtor in possession and on behalf of the bankruptcy estate. The funds should be the subject of an appropriate report and account filed by the debtor in possession with the bankruptcy court and subject to that court's audit and order.

serve as proof of CK's claim, CK sought to have the schedules and filings amended to include CK as a creditor, along with leave "to file a proof of claim after the deadline." R.I. at 148.

4) If all of the above relief was refused, CK requested either a modification of the section 362 stay with respect to the civil action in the 1982 case, or a declaration that the stay was inapplicable to that case. In either of these latter two possible outcomes, the contract action in C82-0794J could proceed and CK's claim, if any, could be determined.

The bankruptcy court, in a decision by Judge Mai, refused to grant any of CK's alternative motions. In doing so, the bankruptcy court specifically did not rule on whether or not CK could file a valid proof of claim, amended or otherwise.

#### I. THE TRUSTEE'S MOTION TO DISMISS

Shortly before the hearing on this appeal was held, Paiute's trustee in bankruptcy entered her first appearance in this matter. The trustee moved for dismissal, arguing that none of the issues were final orders or otherwise appropriate for interlocutory review. However, this court has jurisdiction to hear appeals from such orders, whether final or interlocutory in nature, under 28 U.S.C. § 158(a). CK's constructive trust theory, if successful, would significantly effect later proceedings. Ascertaining the status of the funds in question is, in any event, necessary for a proper determination of the bankruptcy estate. The bankruptcy court's ruling purports to bar

CK from reasserting its claim to a constructive trust on the funds from the supersedeas bond. See infra n.3. Finally, it is unclear whether the trustee asserts an interest in the disputed fund--either that which Paiute received or that which Cotro-Manes currently has on hand. It is unclear whether the trustee contests the purported assignment to Cotro-Manes as to all or part. There is ample cause for review at this point. The trustee's motion to dismiss is denied.

## II. CK'S MOTIONS

### A. Jurisdiction of the Court of Appeals

As a preliminary matter, CK's claim that the court of appeals lacked jurisdiction to reverse the summary judgment in C82-0794J cannot be heard by this court. That is a matter for the Court of Appeals. The Court of Appeals having reversed and remanded the summary judgment, there is at this time no present resolution of CK's claim to the \$30,000 in escrow funds.

### B. CK's Constructive Trust Claim

In order to regain the \$30,000 deposit, CK seeks the equitable remedy of a constructive trust. A constructive trust is "a device used . . . to compel one who unfairly holds a property interest to convey that interest to another to whom it justly belongs." Bogert, Trusts and Trustees § 471 (2d ed. rev.

1978). Properly presented with a claim that funds purportedly in the bankruptcy estate are subject to a constructive trust, a bankruptcy court can declare a constructive trust and order appropriate relief. In re Butts, 46 Bankr. 292 (Bankr.N.D. 1985); In re Martin Fein & Co., Inc., 43 Bankr. 623, 627 (Bankr. S.D.N.Y. 1984). However, in this case CK brought its claim to the court in the form of a motion. As a result, the court based its denial of that motion on two reasons: first, that a motion was not a correct method of establishing the claimed trust, and second, that the case at hand did not merit imposition of a constructive trust.<sup>3</sup>

Judge Mai's ruling that a motion was an inappropriate way of establishing the claimed trust is correct. Bankruptcy Rule 9014 permits motions to be made in "contested matters . . . not otherwise governed by these rules." The rules covering adversary proceedings adequately govern claims such as the constructive trust claimed by CK. Bankruptcy Rule 7001 defines an adversary proceeding, in part, as "a proceeding in a bankruptcy court . . .

<sup>3</sup> Judge Mai's decision is set out in the transcript of the ruling on December 18, 1985:

The COURT: WELL, I'VE HEARD THE ARGUMENTS AND I'VE READ A GOOD PART OF THE RECORD, . . . I THINK THAT THE \$30,000 WAS A SUPERSEDEAS BOND, WHICH HAS BEEN RELEASED. I DON'T BELIEVE THAT A MOTION IS A PROPER WAY TO ESTABLISH A TRUST FUND, AND I DON'T BELIEVE THAT THIS IS AN APPROPRIATE CASE FOR A TRUST FUND AT ANY RATE. SO I'M GOING TO DENY THE MOTION TO ESTABLISH A TRUST ON THE RELEASED MONEY.

Transcript of Ruling on Motion by CK Resources for Declaration of Trust, Relief From Stay or for Alternative Relief, Bankruptcy No. 84C-03451, December 18, 1985, at 3. (hereinafter cited as "Ruling").

to recover money or property . . . [or] . . . to determine the validity, priority, or extent of a lien or other interest in property . . . " See also In re Butts, 46 Bankr. 292 (Bankr. N.D. 1985) (adversary proceeding used to declare constructive trust). Because CK should have raised its constructive trust claim by initiating an adversary proceeding, that portion of Judge Mai's ruling denying the motion on procedural grounds is affirmed.

The second reason Judge Mai offered for denying the motion for declaration of a trust was that this case was not "appropriate" for a trust. This would seem to preclude CK from seeking to establish its constructive trust claim in a later adversary proceeding. To that extent, Judge Mai's ruling was premature.

Under Utah law,<sup>4</sup> a constructive trust may be imposed in order to prevent unjust enrichment which would result, for instance, from a breach of fiduciary duty. Parks v. Zions First National Bank, 673 P.2d 590 (Utah 1983), citing Restatement of Restitution §160 (1937). See also, Hawkins v. Perry, 123 Utah 16, 253 P.2d 372 (1953) (recognizing that a breach of fiduciary duty may raise a constructive trust). A person holding property subject to a constructive trust, other than a bona fide purchaser without notice, holds only bare legal title and is subject to a

---

<sup>4</sup> Utah law concerning constructive trusts is the law required to be applied in this case. Jaffke v. Dunham, 352 U.S. 280, 281 (1957).

duty to reconvey the property to the rightful owner. See Corporation of the President of the Church of Jesus Christ of Latter-Day Saints v. Jolley, 24 Utah 2d 187, 467 P.2d 984 (1970) (constructive trust imposed on two automobiles purchased with embezzled funds and evidently given to the defendant). Under the logic of the Jolley case, the equitable right of ownership remains at all times with the one who has been unjustly deprived of his property.

In bankruptcy proceedings, these same principles yield the result that property originally held subject to a constructive trust by the debtor retains that character in the bankruptcy estate. 11 U.S.C. §541(d); In re Quality Holstein Leasing, 752 F.2d 1009 (5th Cir. 1985); In re Martin Fein & Co., Inc., 43 Bankr. 623 (Bankr. S.D.N.Y. 1984); 4 Collier on Bankruptcy ¶541.13 (15th ed. 1986). The estate holds merely legal title, no more. In re Martin Fein & Co., Inc., 43 Bankr. at 627; 4 Collier on Bankruptcy ¶541.13; see also United States v. Whiting Pools, Inc., 462 U.S. 198, 205 n.10 (1983) ("Congress plainly excluded [from the estate] property of others held by the debtor in trust at the time of filing the petition"). Thus, once a claimant has met his burden of proving both the existence of the original trust relationship and the identity of trust property, he "is entitled to priority over the general creditors of the wrongdoer", In re Martin Fein & Co., Inc., 43 Bankr. at 627, and the trustee will be ordered to turn over the property or its proceeds. See 4 Collier on Bankruptcy ¶541.13 at 541-72.1 to



72.2. (15th ed. 1986). This does not prejudice the creditors of the estate, as they have no right to profit from the debtor's wrongs. See, In re Martin Fein & Co., 43 Bankr. at 628, quoting 5 Scott on Trusts § 515, at 3610-11 (3d ed. 1967). The beneficiary of a constructive trust, on the other hand, should not be required to proceed as merely a creditor, as he has not voluntarily placed his property at the debtor's disposal. Id. It is this favorable status that CK sought to establish with its motion.

In order to gain recognition as a constructive trust beneficiary, CK is confronted with two hurdles. CK must establish the trust relationship and identify the specific property subject to the alleged trust. Both of these requirements remain at issue in the present case. Both depend on several unresolved questions of fact. Without resolution of these issues the bankruptcy court's ruling that no constructive trust existed cannot be sustained.

The first requirement--that of demonstrating that Paiute originally held the \$30,000 as a constructive trustee--goes to the merits of the original civil action in C82-0794J. The summary judgment having been reversed and remanded, the issues in that case remain unresolved.<sup>5</sup> No valid determination has been

<sup>5</sup> The Circuit Court of Appeals reversed the summary judgment on the basis that issues of fact remained as to what the intent of the parties was with regard to the escrow funds. CK Resources, Inc. v. Paiute Oil & Mining Corp., No. 84-1288 (10th Cir. March 28, 1985) (order and judgment).

made as to whether Paiute held the funds as a fiduciary or  
that duty was breached. CK is entitled to specific  
findings of fact and conclusions of law with regard to its claim  
that the \$30,000 was held in constructive trust.

The second obstacle CK encounters with its constructive  
trust theory is identifying some reachable assets on which a  
trust can fairly be imposed. As yet, as far as the record shows,  
there is no showing that the funds from the supersedeas bond<sup>6</sup>  
are in the hands of the trustee or in the bankruptcy estate.  
However, it is the trustee's duty to recover those funds if they  
are property of the estate. This presents a problem for CK,  
because for purposes of the present case, tracing the funds  
allegedly subject to the constructive trust may depend on the  
trustee pursuing that course of action. Failing that, CK may  
have an action against Cotro-Manes or the trustee.

Finding assets that can be imposed with the trust depends  
on the application of traditional, equitable tracing principles.  
In re Independent Clearing House Co., 41 Bankr. 985 (Bankr. Utah

---

<sup>6</sup> As stated above, the supersedeas bond was transferred to  
Paiute's attorney, Paul Cotro-Manes. While the trust might  
follow the funds into Cotro-Manes' hands, See Corporation of  
the President of the Church of Jesus Christ of Latter-Day  
Saints v. Jolley, 24 Utah 2d 187, 467 P.2d 984 (1970),  
Cotro-Manes has not been made a party to this action by  
either CK or the bankruptcy trustee. However, the assignment  
to Cotro-Manes was not unconditional. Record at 204 (Exhibit  
H). The estate retains at least some interest in the funds,  
as the assignment was subject to an accounting which has yet  
to be performed. Moreover, at the time Cotro-Manes received  
possession of the funds, he was acting not for himself but as  
attorney for the debtor in possession. See infra n. 2.

1984). See also, Bogert, Trusts and Trustees §§ 921-30 (2d ed. 1982). In the case at hand, the funds allegedly subject to the trust were first commingled and later, under CK's theory, used to purchase a certificate of deposit to serve as a supersedeas bond. But the fact that money is commingled with funds not subject to a constructive trust does not prevent the trust from being imposed on the entire account. As long as some funds remain in the account, it is presumed that withdrawals from the account, if made for non-trust purposes, do not diminish the amount in the account held subject to the trust. In re Hurricane Elkhorn, 32 Bankr. 737 (W.D. Tenn., 1983) aff'd, 763 F.2d 188 (6th Cir. 1985); Bogert, supra, at §924; 76 Am. Jur. Trusts §263 (1975). On the other hand, if the trustee purchases an investment with the commingled account and the remainder of the account is used for non-trust purposes, the trust may be imposed on the investment. In re Property Leasing & Management, Inc., 46 Bankr. 903 (Bankr. E.D. Tenn. 1985), citing Bogert, supra, at § 582. This is especially true if, as in the present case, the funds taken out of the account are set aside for satisfaction of a judgment arising out of the subject of the original constructive trust relationship. In such a case, those separated funds might now constitute an identifiable res, having been set aside for an ostensible trust purpose. See In re Flight Transportation Corporation Securities Litigation, 730 F.2d 1128 (8th Cir. 1984). If CK is entitled to the constructive trust remedy, additional detailed findings are required to determine whether the funds can fairly be traced to the supersedeas bond or other property of

Paiute in the hands of the trustee. This tracing would necessarily depend on a close examination of Paiute's account history and, more specifically, on whether the \$40,000 certificate of deposit used for the bond can be said to have been purchased with trust funds. Even if the funds were originally held subject to a constructive trust, no remedy exists in the bankruptcy court if the res cannot be traced to the estate or has been exhausted.

No specific factual findings exist as to CK's claim that the \$30,000 was held in constructive trust and whether that trust can now be traced to some reachable asset within the jurisdiction of the bankruptcy court. These issues still await resolution, and the question of the appropriateness of this case for imposition of a trust cannot be determined without resolutions of those specific questions of fact. In addition, further proceedings may allow the validity of Cotro-Manes' possession of the funds from the supersedeas bond to be brought into question. Accordingly, the bankruptcy court's ruling that this case is inappropriate for imposition of a constructive trust is vacated and remanded for further proceedings.

#### C. CK's Proof of Claim .

CK's alternative strategy, should it fail in gaining constructive trust status for its claim, is to pursue the funds as a creditor in the bankruptcy proceeding. Pursuant to this

theory, CK requested that the bankruptcy court rule that the mention of the supersedeas bond and pending appeal of C82-0794J in the Statement of Affairs filed for Paiute's bankruptcy is sufficient proof of claim within the requirements of the bankruptcy code, 11 U.S.C. §1111. As an alternative to this route, CK also moved for amendment of the schedules and filings and permission to file a proof of claim after the statutory deadline.

§1111 of the bankruptcy code provides that any claim "that appear[s] in the schedules filed under . . . this title, except a claim . . . that is scheduled as disputed, contingent, or unliquidated" shall be deemed filed. 11 U.S.C. § 1111. The purpose of section 1111 is to relieve the holder of a clear and undisputed claim from the necessity of filing a claim. When both the debtor and the claimant agree on the existence and amount of a claim, no purpose is served by requiring the formality of filing. CK's claim does not fit within the policy of section 1111. This claim has been the subject of a civil suit and a subsequent appeal and later a contested motion in the bankruptcy court followed by this appeal. Even if the term "schedules" as used in section 1111 is elastic enough to include the Statement of Affairs, the claim is clearly in dispute or at least contingent on the eventual outcome of C82-0794J. If CK must proceed as a creditor, it must file a proof of claim.

As its second argument relating to its proof of claim, CK

also appeals what it perceived as a refusal by the bankruptcy court to allow CK to file a proof of claim. This argument appears to stem from a misconception, on CK's part, of Judge Mai's order. That ruling, while denying CK's request that the passage in the Statement of Affairs serve as proof of CK's claim, specifically did not rule on whether or not CK could file a late, or amended, proof of claim. Order denying Declaration of Trust, Bankr. No.84C-03451, Record at 166, Ruling, supra, at 3-5. CK apparently initially comprehended the ruling to deny all requested relief, including the opportunity to file a proof of claim after the statutory deadline. While the bankruptcy court did deny the motion in entirety, this court does not interpret that ruling as foreclosing CK from filing such a claim and letting its validity be tested at a later date. Rather, the bankruptcy court merely refused to explicitly authorize CK's belated proof of claim. Indeed, since Judge Mai's ruling CK has filed such a proof of claim.

That proof of claim has not been challenged or disallowed in the bankruptcy court. Therefore, it is simply too early to rule whether or not CK is entitled to present a valid claim as a matter of right. Paiute's trustee was correct in arguing that the issues relating to whether or not CK had filed or could file a valid proof of claim are inappropriate for interlocutory review at present. Should an objection to CK's proof of claim be raised at a later point, those issues can then be tried. Those portions of the bankruptcy court's ruling relating to a proof of claim are

affirmed.

D. CK's Request for Modification of the § 362 Stay.

Finally, CK appeals the bankruptcy court's refusal to modify the automatic stay instituted by section 362 of the bankruptcy code.<sup>7</sup> 11 U.S.C. § 362. The modification that CK argues for would allow CK to continue to pursue its constructive trust claim against Paiute in district court, as begun in C82-0794J. The bankruptcy court has broad power to issue an order modifying the section 362 stay for cause. 11 U.S.C. § 362(d). Indeed, the language of that section is mandatory. Id.; 2 Collier on Bankruptcy ¶362.07 (15th ed. 1986). The decision whether or not a stay is necessary, however, requires a balancing of the relative harms to the parties--a determination that is within the sound discretion of the bankruptcy court. In re Olmstead, 608 F.2d 1365 (10th Cir. 1979); In re MacDonald, 755 F.2d 715 (9th Cir. 1985). That decision must be based primarily on

---

<sup>7</sup> CK also sought a declaration that the stay was inapplicable to the action in C82-0794J, on the grounds that title to the funds in question has always been held by CK, so the funds are not a part of the bankruptcy estate. There are at least two problems inherent in this argument. First, the argument goes to the jurisdiction of the district court in C82-0794 and is properly addressed to that court, and not the bankruptcy court. Unlike the request for modification of the stay, this request would require the bankruptcy court to pass on the jurisdiction of the district court. Second, the argument begs the entire question of whether a constructive trust exists. Obviously, upon a finding that the funds belong to CK, the bankruptcy court would direct the trustee to turn over any funds within the jurisdiction of the court to the rightful owner. But that presumes such a finding. The bankruptcy court was correct in refusing to grant this portion of CK's motion.

facilitating a fair and efficient administration of the bankruptcy estate.

In denying CK's motion, the bankruptcy court gave no explanation for refusing the requested modification of the stay. Without some statement of reasons, review for any possible abuse of discretion is impossible. The refusal to issue the stay may also have been a result of the lower court's premature rejection of CK's constructive trust theory. For these reasons, that portion of the ruling denying the requested modification of the stay is also remanded for further consideration.

In the present case, the issuance or non-issuance of an order modifying the stay will determine in which court CK's constructive trust claim can be tried, properly a choice for the bankruptcy court. See, In re Olmstead, 608 F.2d at 1367. This choice depends on a balancing of the prejudice that CK, Paiute, the trustee or any other party might suffer as a result of the claim being heard in either court. If practicable, the result should not require CK to bring separate actions to regain the funds from Paiute, the trustee or Cotro-Manes. The court below must consider, after applying the above tracing principles, over what part of the funds the bankruptcy court can obtain jurisdiction. On the other side of the consideration is the extent defending an action in district court might prejudice Paiute or the administration of its estate. Only after a careful weighing of all these factors can the bankruptcy court make an



informed ruling as to whether or not the stay should be modified.

### III. CONCLUSION

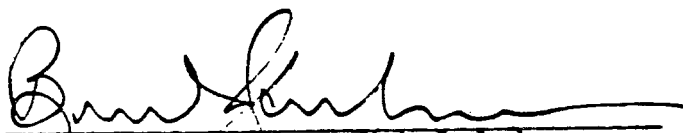
In summary, CK's claim to a constructive trust should be heard and specific findings of fact and conclusions of law should be made with respect to the tracing of any trust funds, jurisdiction over the funds and, if necessary, the existence of a trust relationship. CK must commence an adversary proceeding within 30 days of issuance of this order. If CK does commence an adversary proceeding, the bankruptcy court should first determine whether the trust funds exist and are within the jurisdiction of the bankruptcy court. This may require that the court disregard the merits of the trust claim and proceed to apply the tracing principles discussed above for purposes of this jurisdictional analysis. If, after this analysis, the court determines both that it has jurisdiction and that the claim is appropriately heard in an adversary proceeding in bankruptcy court, it can then proceed to adjudicate whether or not the trust ever existed. Otherwise, the bankruptcy court should issue an appropriate modification of the stay, if applicable. Accordingly, the bankruptcy court's ruling that this case is inappropriate for a constructive trust and its denial of the motion for modification of stay are vacated and the case remanded to the bankruptcy court for further proceedings consistent with this opinion.

On the other hand, the question of whether or not CK is entitled to file a valid proof of claim is not presently justiciable, that claim having been filed and at this point remaining unchallenged and unadjudicated. Likewise, challenges to the Court of Appeals' jurisdiction are no more correctly addressed to this court than to the bankruptcy court. The bankruptcy court correctly denied those portions of CK's motion and this court affirms.

So ordered.

Dated this 21 day of October, 1986.

BY THE COURT



Bruce S. Jenkins, Chief Judge  
United States District Court