81

IN THE UNITED STATES BANKRUPTCY COURT

FOR THE DISTRICT OF UTAH

COUNTER COPY - DO NOT REMOVE -

In re RONALD WILLIAM HAYCOCK, Debtor.	Bankruptcy Case No. 81-00405 Civil Proceeding No. 81PC-0314
R. KEITH ANDERSEN and G. RAY HALE, dba COPPERVIEW VILLAGE ASSOCIATES, Plaintiffs. -vs- RONALD WILLIAM HAYCOCK, Defendant.	MEMORANDUM DECISION ON FRAUD, FIDUCIARY CAPACITY, AND FIDUCIARY DEFALCATION

Appearances: Richard L. Bird, Richards, Bird & Kump, Salt Lake City, Utah, for plaintiffs; John Walsh, Salt Lake City, Utah, for defendant.

INTRODUCTION

This is an action under 11 U.S.C. §§ 523(a)(2)(A) and 523(a)(4) to determine whether defendant obtained $37,000 from plaintiffs by means of false pretenses, false representations, or actual fraud and whether defendant is guilty of fraud or defalcation while acting in a fiduciary capacity.

Trial was held and the parties submitted post-trial memoranda. Having considered the evidence and the arguments, the

Court now files this memorandum decision, which will constitute its findings of fact and conclusions of law.

FINDINGS OF FACT

Plaintiffs engaged in a joint venture to develop a condominium project. Plaintiff Andersen heard that an entity known as Standard Escrow had access to large sums of money from an offshore source. Andersen and Hale needed funding for their project and contacted an employee of Standard Escrow named Montier, who told them that he had offshore contacts, that he was very excited, and that the funds available for loans were "very real."

Over a one month period, plaintiffs had three meetings with Montier. Montier helped them draft a loan application. When the application was ready, plaintiffs met defendant, who was introduced to them as the president of Standard Escrow.

In this first meeting, Haycock said that he had an offshore source of funding for long term loans but that he couldn't say who the lender was. He said that he was submitting other applications and that plaintiffs' application would be considered along with the others. Plaintiffs gave Haycock $37,000 as a commitment fee for their 3.7 million dollar loan. Haycock told plaintiffs that they would receive letters of commitment regarding funding for their loan and that he definitely had a good

lender and source of money.

Plaintiffs met with Haycock four or five days later. Plaintiffs brought with them Phil Mitchell, their construction foreman. Haycock told plaintiffs that the people he was working with were "for real," that the money looked good, that he was working with a mortgage company in Oregon to present the packages, and that the Oregon company was also working with an offshore entity.

To a third meeting with Haycock, plaintiffs brought Reese Howell, an attorney and vice president of a title insurance company, in order to assure that the documents and the transaction were proper. Howell told them the form shown to him at Standard Escrow was a standard form. Howell also advised plaintiffs to obtain security for their $37,000 commitment fee.

Next, plaintiffs completed the loan application and submitted it to Haycock, who gave them a typed escrow agreement, exhibit 1. Plaintiffs retained the escrow agreement for several days. Then, plaintiffs met with Haycock to sign the escrow agreement, which is dated March 7, 1980. They required two changes in the agreement: the addition of a provision that the loan was to be "amortized on a thirty (30) year basis" and a provision that "in the event the lender issues a letter of commitment but fails to complete the transaction, the escrow

company will pledge accounts receivable of approximately $92,000.00 as security for the borrower."

Plaintiffs insisted on a pledge of accounts receivable because they doubted the reality of the loan funding. Hale had lost money in a bad investment before and in his words didn't want to be "burned" again. Plaintiffs' demand for security angered Haycock, who questioned why only plaintiffs, of all the loan applicants, had required security. Haycock reached in his desk drawer and pulled out exhibit 2, a handwritten list of promissory notes receivable Haycock had prepared in anticipation of factoring some of the notes.

Haycock showed the list to plaintiffs. Andersen testified that Haycock then said, "I will pledge these assets to you as collateral because I'm so sure." Hale testified that Haycock said, "I'll guarantee that your money will be safe by these assets . . . these will be your protection." On cross-examination Hale said Haycock told them "some of these are my personal things and I'll make sure you guys are protected" and promised them "these were ours" and "would be kept for us." Haycock testified he showed exhibit 2 to plaintiffs in order to show them that if the deal went sour, Standard Escrow was in a sufficiently solid financial position to pay them $37,000. Haycock denied telling plaintiffs that the assets would be available to protect them or that they could rely on the list. He said he didn't know plaintiff's thought that the assets were supposed to protect

them. According to Haycock, he told them "this is what the company owned and that if they got into trouble this is what the company would pledge."

The only other testimony about this conversation was the hearsay testimony of plaintiffs' attorney Mr. Bird. Plaintiffs told him they had obtained $92,000 worth of assets and that Haycock assured them that those assets were available and would protect his clients if the transaction failed.

FRAUD

Based on this evidence, the Court finds that Haycock did not represent to the plaintiffs that he was presently either granting them a security interest in the receivables or conveying the receivables to them. Haycock, however, did represent to the plaintiffs that if the loan was not funded, he would pay them $37,000. How this payment was to be made is best evidenced by the escrow agreement. If the loan was not funded, Haycock[1] would "pledge accounts receivable of approximately $92,000.00 as security" for the $37,000. The parties did agree on how the pledge was to take place. In a letter to plaintiffs' attorney

---

1 The parties disputed whether Haycock made the representations as an individual and whether Haycock owned the assets personally. These distinctions are irrelevant. Even if Haycock was acting as an agent, he is liable for any fraud he committed. And even if the assets belonged to a corporation, if Haycock lied to plaintiffs, he is liable personally.

dated September 2, 1980, exhibit 13, Haycock said "we had no agreement to put them [the notes receivable] into escrow and I had no intention of giving your clients involved the entire sum, but only enough to cover their up front fees. I am sure that is understood by them, and is only fair. $92,000 to cover $37,000 would be grossly unfair, as a matter of equity . . . . As soon as I ascertain the value of the remaining notes, I will contact them and will make arrangements to have $37,000 worth, of their choice, transferred to them." Although plaintiffs argue that this statement is evidence Haycock never intended to comply with his promise to "pledge accounts receivable of approximately $92,000," the Court finds that the statement meant only that Haycock then intended to pledge to plaintiffs $37,000, not $92,000.

In summary, Haycock represented that if the loan was not funded, he would pay plaintiffs their $37,000 and that to do this he would "pledge accounts receivable of approximately $92,000.00 as security." Whether Haycock made these representations with fraudulent intent depends on whether at the time he made them he intended not to pay or pledge. Plaintiffs have failed to show by clear and convincing evidence that when Haycock said he would pay plaintiffs their $37,000 if the loan was not funded he did not intend to do so. Plaintiffs also have failed to show by clear and convincing evidence that Haycock, when he said he would pledge receivables, did not intend to pledge them.

When Haycock made these representations, all of the parties, including Haycock, actually believed that the loan would be funded soon enough to make a present escrow or a present transfer of the receivables unnecessary. Later, when circumstances changed and the loan was not funded, Haycock should have kept his promise to make the receivables available to plaintiffs. His failure to do so was a breach of contract. But this does not prove his original representations were made with fraudulent intent.

Plaintiffs also allege that Haycock defrauded them by falsely representing that the assets were his personal assets and that the assets were valuable. There is no evidence that the assets were not valuable. Whether the assets were Haycock's assets or the assets of Standard Escrow is irrelevant.

Because plaintiffs have failed to prove by clear and convincing evidence an intent to deceive on Haycock's part, their cause of action under Section 523(a)(2)(A) must be dismissed.

FIDUCIARY CAPACITY

Plaintiffs' second theory is that Haycock is guilty of fiduciary defalcation within the meaning of Section 523(a)(4). In addition to the evidence described above, the evidence shows that after plaintiffs gave Haycock a check for $37,000, Haycock deposited it in Standard Escrow's bank account with commitment

fees received from other loan applicants, had one check drawn to cover all the commitment fees, and then traveled to the Netherlands Antilles to meet with M. A. Flores, a principal of the offshore lender, Camari Corporation. Haycock met with Flores. Flores gave him exhibit 3 in exchange for the check, which included plaintiffs' $37,000.

Exhibit 3 is a letter to Standard Escrow from Camari Corporation dated March 14, 1980. It is entitled "Letter of Receipt and Acceptance" and reads in full as follows: "The following project, comprised in the package as presented to you, has been accepted for funding by CAMARI CORPORATION N.V. on or before Twenty-one (21) days from the date of this letter of acceptance. Name of project: COPPERVIEW VILLAGE, also known as escrow file #M-812 with Standard Escrow of Utah. Amount: Three Million Seven Hundred Thousand Dollars ($3,700,000.00). Particulars: 10 year loan at 9.5% interest APR amortized on a 30 year basis. (See enclosed Escrow Instructions)."

Plaintiffs argue that Haycock was acting in a fiduciary capacity with respect to the $37,000 and with respect to the receivables.

The phrase "acting in a fiduciary capacity" as used in Section 523(a)(4) has its origin in the Bankruptcy Act of 1841, which provided that "all persons whatsoever, residing in any State, territory, or district of the United States, owing debts

which shall not have been created in consequence of the defalcation as a public officer, or as executor, administrator, guardian, or trustee, or while acting in any other fiduciary capacity" could, on compliance with the requirements of the Act, receive a discharge.

In 1844, the meaning of "fiduciary capacity" under the 1841 Act came before the Supreme Court in Chapman v. Forsyth, 2 U.S. (How.) 202 (1844). In Chapman, the Court held that a factor, who had been entrusted with selling cotton for another, and who then sold the cotton but failed to give the sales proceeds to his principal, was not a fiduciary within the meaning of the bankruptcy law. The Court gave the term "fiduciary capacity" a narrow construction, explaining that

> If the act embrace such a debt [that of a factor who retains the money of his principal], it will be difficult to limit its application. It must include all debts arising from agencies; and indeed all cases where the law implies an obligation from the trust reposed in the debtor. Such a construction would have left but few debts on which the law could operate. In almost all the commercial transactions of the country, confidence is reposed in the punctuality and integrity of the debtor, and a violation of these is, in a commercial sense, a disregard of a trust. But this is not the relation spoken of in the first section of the act.
>
> The cases enumerated, "the defalcation of a public officer," "executor," "administrator," "guardian," or "trustee," are not cases of implied, but special trusts, and the "other fiduciary capacity" mentioned, must mean the same class of trusts. The act speaks of technical trusts, and not those which the law

> implies from the contract. A factor is not, therefore, within the act.

2 U.S. (How.) at 207.

The Bankruptcy Act of 1867 provided that "No debt created by the fraud or embezzlement of the bankrupt, or by defalcation as a public officer, or while acting in a fiduciary capacity, shall be discharged under this Act." Under this provision, two lines of cases developed, one holding that agents, factors, and commission merchants act in a fiduciary capacity "on the view that the act [of 1867] was conceived in broader and more general terms than the act of 1841;" the other line of cases holding that the act of 1867 used the phrase 'acting in a fiduciary capacity' in the "sense which it had received by construction in the act of 1841." Hennequin vs. Clews, 111 U.S. 676, 680 (1884). But in 1884, the Supreme Court rejected the first line and followed the second, holding that the Chapman limitation of "fiduciary capacity" to technical trustees required a finding that a debt arising from the conversion of collateral was dischargeable. A party holding collateral securing a debt was no more a technical trustee than a party who receives money from the sale of his principal's property. His duties are defined by contract: "The creditor who holds a collateral, holds it for his own benefit under the contract. He is in no sense a trustee. His contract binds him to return it when its purpose as security is fulfilled; but if he

fails to do so it is only a breach of contract, and not a breach of trust." Hennequin, supra, at 682.

By 1889, this interpretation of the term "fiduciary capacity" was held to be "fully settled." Noble v. Hammond, 129 U.S. 65, 68 (1889). In 1891, the Court limited the "fiduciary capacity" exception to discharge even further, holding that not only is a debt not created by a person while acting in a fiduciary capacity "merely because it is created under circumstances in which trust or confidence is reposed in the debtor, in the popular sense of those terms," but that in addition, only debts "created by a person who was already a fiduciary when the debt was created" were excepted from discharge. Upshur v. Briscoe, 138 U.S. 365, 375-78 (1891).

Under the Bankruptcy Act of 1898, Section 17(a)(4) excepted from the discharge all debts of a bankrupt "created by his fraud, embezzlement, misappropriation or defalcation while acting as an officer in any fiduciary capacity." In 1934, the Supreme Court held that a car dealer who sold cars he held under a trust receipt without first securing the financer's consent was not acting in a fiduciary capacity. The Court said that the Chapman rule, that the statute "speaks of technical trusts, and not those which the law implies from the contract," 2 U.S. (How.) at 208, "has been applied by this court in varied situations with unbroken continuity." Davis v. Aetna Acceptance Co., 293 U.S. 328, 333 (1934). The Court reiterated Upshur's holding: "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." Id. Further, the Court ruled that a debt "is not turned into one arising from a trust because the parties to one of the documents have chosen to speak of it as a trust." Id. at 334. The Court held that "a mortgagor in possession before condition broken is not a trustee for the mortgagee within the meaning of this statute, though he has charged himself with a duty to keep the security intact." Id.

Although the Tenth Circuit Court of Appeals in In re Romero, 535 F. 2d 618, 621 (10th Cir. 1976) said that "'fiduciary capacity' as used in § 17(a)(4) . . . has been held to connote the idea of trust or confidence, which relationship arises whenever one's property is placed in the custody of another," the court also recognized that "the exception under § 17(a)(4) applies only to technical trusts and not those which the law implies from a contract," and that "the fiduciary relationship must be shown to exist prior to the creation of the debt in controversy." Id. (citing Davis v. Aetna Acceptance Co., supra). Thus, "the traditional definition of a 'fiduciary' is not applicable in bankruptcy law. The general meaning -- a relationship involving confidence, trust and good faith -- is far too broad." Rhode Island Lottery Commission v. Cairone (In re Cairone), 12 B.R. 60, 62 (Bkrtcy. D.R.I. 1981).

The consensus of opinion is that the term "fiduciary capacity" in Section 523(a)(4) should receive the same construction it received under former law. See, e.g., Joseph Lorenz, Inc. v. Thomas (In re Thomas), 21 B.R. 553 (Bkrtcy. E.D. Wis. 1982); Kannon v. Blalock (In re Blalock), 15 B.R. 33 (Bkrtcy. E.D. Tenn. 1981); Witt Building Material Co. v. Barker (In re Barker), 14 B.R. 852 (Bkrtcy. E.D. Tenn. 1981); Jarel Building Products Corp. v. Polidoro (In re Polidoro), 12 B.R. 867 (Bkrtcy. E.D. N.Y. 1981); Rhode Island Lottery Commission v. Cairone (In re Cairone), 12 B.R. 60 (Bkrtcy. D. R.I. 1981); Baugh v. Matheson (In re Matheson), 10 B.R. 652 (Bkrtcy. S.D. Ala. 1981). 3 COLLIER ON BANKRUPTCY ¶523.14[1][c], at 523-99 (15th ed. 1982). Thus, in this case the inquiry must be directed to whether Haycock was an express or technical trustee.

Bogert's work on trusts notes that "A question may arise as to whether a depositary in escrow is an agent or bailee with contract duties as to the property or instrument deposited, or is intended to be a trustee thereof . . . . [When a deposit in escrow is made,] the depositary is admittedly a fiduciary. If he is at liberty to use the thing deposited as his own (as in the case of cash), in return for a promise to supply cash from other sources at the maturity of the escrow, debt and not agency or trust is indicated. If title to the property or instrument deposited is to pass to the depositary but he is to hold it apart until completion of the escrow transaction, he is often declared

to be a trustee, but it would seem that he might reasonably be adjudged to be an agent with merely contractual duties. There are many cases holding the escrow depositary to be a trustee for the depositor or for the party to whom the deposit was to be paid. This seems an unsound result unless a specific res was to be held." BOGERT, THE LAW OF TRUSTS AND TRUSTEES § 15, at 77-80 (2d ed. 1965).

An important factor, therefore, in determining whether a depositary in escrow is a trustee, is whether the depositary is free to use the money deposited or whether the depositary must hold the depositor's money without liberty to use it as his own.[2]

---

2 The "free use of funds" or "segregation" test has been applied in analogous circumstances. First, in cases involving agents who collect money for their principals, a test has been stated in bankruptcy cases for determining whether the agent is a trustee or merely a debtor to his principal: "An agent is a debtor if he is intended to have unrestricted use of the money he receives, with the duty to pay a similar amount later to his principal. He is a trustee if he is intended to hold the money as a separate fund for the benefit of the principal. It may be proper for the agent who is a trustee to mingle the funds of different principals in a common bank account, if he keeps adequate records to show the interest of each. But it is generally improper for the agent who is a trustee to mingle the funds of a principal with his own." In re Herring, 4 B.C.D. 104, 105 (Bkrtcy. N.D. Ga. 1978). Second, in a case involving an agent appointed to secure a loan commitment under an agreement whereby the agent received $5,000 as "an initial good faith deposit" which the agent would earn "upon issuance of a commitment for the loan," it was held that the agent was not the trustee of an express or technical trust because "the agreement in no way restricted [the agent's] use of the $5,000 good faith deposit. The agreement did not call for segregation of the $5,000 deposit from [the agent's] funds. [citation omitted] The agreement only required [the agent] to return the $5,000 deposit in the event he was unable to obtain a firm commitment in writing from a lender." In re Wiedman, 18 B.R. 249, 251 (Bkrtcy. E.D. Va. 1982).

In this case, although the escrow agreement permitted Haycock to deposit plaintiffs' $37,000 in a bank account along with "other escrow funds," exhibit 1, ¶1, and thus did not require that plaintiffs' money be earmarked, the money was to be held in an account with other escrow funds, not Haycock's funds, and the money was to be used only "when the lender gives the escrow agent an irrevocable letter of commitment to fund the . . . loan." Exhibit 1. Haycock was not free to use plaintiffs' money as his own. Instead, he was to keep the money in a bank account separate from his own funds and was not to use it other than as specified in the agreement. It therefore appears that with respect to the $37,000 deposited with him, Haycock was the trustee of an express or technical trust.

Haycock was a trustee of the $37,000 because of the terms of the escrow agreement, which specifically restricted his use of the $37,000. It may be argued that Haycock, once he is found to be a fiduciary with respect to one aspect of his financial dealings with plantiffs, should be found to be a fiduciary in all aspects, especially when those financial dealings revolve around obligations fixed by a single contract. Thus, it may be argued

---

"A person who is intended to have unrestricted use of another's money or property, although under an obligation to make designated payments, is a debtor-agent and not a fiduciary. In contrast, if it is intended that the funds be held in a segregated account for the other's benefit, the holder is a fiduciary." 1 NORTON BANKRUPTCY LAW AND PRACTICE § 27.45 (1982).

that because Haycock was a fiduciary as to the $37,000, he was a fiduciary as to the receivables.

A debtor who is a party to a contract governing multiple obligations, however, may be a fiduciary only as to one of those obligations. This conclusion is consistent with the narrow construction which has been given to the fiduciary defalcation exception to discharge. The two obligations of Haycock's contract with plaintiffs are different because the property to which they relate was owned by different parties. The $37,000 was owned by plaintiffs and placed in Haycock's custody. The receivables were owned by Haycock, or his company. In dealing with plaintiffs' property entrusted to his care, Haycock had a fiduciary obligation. In this regard, the definition given by the Tenth Circuit Court of Appeals in In re Romero, supra, is helpful: "[F]iduciary capacity . . . has been held to connote the idea of trust or confidence, which relationship arises whenever one's property is placed in the custody of another." 535 F. 2d at 621. In dealing with his own, or his company's property, Haycock's obligation was contractual only.

Because the Supreme Court has consistently held that conversion of pledged collateral does not create a fiduciary debt, see Hennequin v. Clews, supra; Crawford v. Burke, 195 U.S. 176 (1904), it follows that conversion of collateral not yet pledged but promised to be pledged does not create a fiduciary debt. Haycock's obligation to pledge receivables, if it had been

his only obligation to plaintiffs, would not have made him a fiduciary within the meaning of the bankruptcy law. That obligation should not be transformed into a fiduciary obligation simply because it is found in the same contract as a fiduciary obligation relating to plaintiffs' property. To rule otherwise would make every breach of contract by a fiduciary with its principal nondischargeble even though a particular breach with respect to that principal might relate only to the fiduciary's dealings with his own property.

DEFALCATION

Plaintiffs argue that Haycock is guilty of two defalcations. First, plaintiffs contend that Haycock's delivery of their $37,000 to Flores was a defalcation because in their view exhibit 3 is not the irrevocable letter of commitment contemplated by the escrow agreement. Second, plaintiffs assert that Haycock's use of funds produced by receivables he had promised to pledge was a defalcation. Because Haycock was not in a fiduciary capacity with respect to the receivables to be pledged as security, only the alleged defalcation involving the $37,000 need be addressed.

The escrow agreement provided that the $37,000 was to be used as a commitment fee when Camari Corporation gave the escrow agent an irrevocable letter of commitment to fund the $3,700,000

loan. The agreement does not define the term "irrevocable letter of commitment." Although the parties, at trial and in their post-trial memoranda, have struggled to establish some meaning for this term, it is clear that when the parties made their agreement, they did not agree on what sort of letter would suffice. Plaintiffs now say that exhibit 3, the letter from Camari, was not an irrevocable letter. Haycock testified that when he received the letter from Flores, he thought that it was an irrevocable letter. Plaintiffs' witness Howell, an attorney in the title insurance business, testified that he could attach no definite meaning to the term "irrevocable letter of commitment."

Of particular significance in clothing the term "irrevocable letter of commitment" with meaning is plaintiffs' conduct after receiving exhibit 3. After receiving this letter from Camari Corporation shortly after its March 14, 1980 date, plaintiffs did not object that the letter was not the "irrevocable letter of commitment" contemplated by the escrow agreement. When presented with exhibit 4, page 2, a letter from Camari dated April 2, 1980 extending the "previous letter of commitment," plaintiffs did not object, even though Haycock's cover letter, exhibit 4, page 1, imposed two new requirements, a phasing plan and a non-disclosure, non-competition agreement. Mr. Andersen testified that he made no demand on Haycock for the return of the $37,000 until July, 1980, when Mr. Bird first wrote Haycock. Exhibit 9.

Plaintiffs' conduct shows that for approximately three months, they were satisfied that Haycock had properly disbursed the $37,000.

It therefore appears that Haycock did what plaintiffs wanted him to do: deliver the $37,000 to Camari in exchange for the letter, exhibit 3. This is not a case where a defendant has applied funds to a purpose other than that for which the funds were intended. Here, Haycock was expected to deliver the funds to Camari and did so according to the agreement. Given the ambiguity of the term "irrevocable letter of commitment," the conduct of the parties after Haycock received exhibit 3, and the absence of proven fraudulent conduct on Haycock's part, the Court finds that Haycock did all he was required to do by the escrow agreement with respect to disbursing the $37,000. No defalcation occurred. Plaintiffs argued that Haycock was obligated to verify Camari's reliability before releasing the $37,000. Haycock's uncontradicted testimony was that while he was in the Netherlands Antilles, he in fact investigated Camari when he contacted both an official of the local government and Camari's banker. Plaintiffs have not shown that Haycock failed to exercise requisite care.

Mr. Bird testified he told plaintiffs that their plan to obtain this loan was a "hairbrained idea." It is unfortunate that plaintiffs' money was lost. Camari Corporation, from the evidence received at trial, may be the wrongdoer responsible for

the loss of plaintiffs' $37,000. That plaintiffs acted imprudently is admitted. That defendant breached his promise to them is evident. But neither fraud nor defalcation has been proven.

Defendant's counsel shall submit an appropriate order.

DATED this 11 day of May, 1983.

BY THE COURT:

GLEN E. CLARK
UNITED STATES BANKRUPTCY JUDGE