UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF MICHIGAN
SOUTHERN DIVISION

In re:

JESSIE R. JEFFERSON, SR.

Debtor.

Case No. 04-49126
Chapter 7
Hon. Marci B. McIvor

_____/

ARTHUR J. BOTT, SR., and
ARTHUR J. BOTT, SR., TRUST,

Plaintiffs,

v.

JESSIE R. JEFFERSON, SR.,

Defendant.
_____/

Adv. Proc. 04-4626

OPINION GRANTING DEFENDANT'S MOTION FOR SUMMARY JUDGMENT WITH RESPECT TO § 523(A)(4) AND DENYING DEFENDANT'S MOTION FOR SUMMARY JUDGMENT WITH RESPECT TO § 727(A)(2)

Plaintiffs filed an adversary complaint alleging two counts: (1) that certain of Defendant's debts are non-dischargeable pursuant to § 523(a)(4); and (2) that Defendant should be denied his discharge pursuant to § 727(a)(2). Defendant filed this motion for summary judgment on both counts, alleging that the subject debts are *not* non-dischargeable pursuant to § 523(a)(4) and that Defendant is entitled to his discharge because he did not violate § 727(a)(2). For the reasons set forth below, this Court GRANTS summary judgment with respect to § 523(a)(4) and DENIES summary judgment

with respect to § 727(a)(2).

I.

FACTUAL BACKGROUND

Grand Rapids Plastics, Inc. ("GRP") was in business for several decades as a mid-sized plastics molder. It supplied a variety of industries, including the automotive industry.

On or about November 13, 2000, GRP and GMAC Business Credit, LLC ("GMAC") entered into a Loan Security Agreement (the "Loan Agreement") under which GMAC provided secured financing to GRP, including a revolving line of credit. At the time GMAC entered into the Loan Agreement, the stock of GRP was owned by the Bott Trust. Under the Loan Agreement, GRP granted GMAC a security interest in substantially all of its assets, including all existing and after acquired accounts receivable, general intangibles and all proceeds thereof. The Loan Agreement strictly forbade the Trust from pledging, hypothecating, selling, transferring or otherwise encumbering GRP's stock.

Nonetheless, on or about September 13, 2001, the Trust sold the stock of GRP to Defendant, who immediately became the president and sole shareholder. In connection with this sale, Defendant granted Plaintiffs a security interest in certain of GRP's assets (the "Trust Equipment"). However, because the Loan Agreement strictly forbade the Trust from selling GRP's stock, on September 25, 2001, Defendant, GMAC and Plaintiffs entered into an Intercreditor and Subordination Agreement (the "Subordination Agreement") under which all amounts owed to Plaintiffs from GRP and/or Defendant were subordinated to payment of GMAC's indebtedness. At the same time that GRP and Plaintiffs entered into the sale, Defendant also purchased certain equipment ("Equipment")

from Plaintiffs that he subsequently leased to GRP. Prior to Defendant acquiring the Equipment and leasing it to GRP, Bott also leased the same Equipment to GRP under the same terms.

As soon as Defendant acquired the stock of GRP, GMAC began to claim that GRP was in breach of the Loan Agreement. Because of these claims, GRP and GMAC entered into a series of forbearance agreements, each of which reaffirmed and ratified all obligations under the Loan Agreement. At all relevant times, General Motors was GRP's largest customer.

At some time subsequent to the sale, Defendant defaulted under the terms of the sale. On October 9, 2002, Plaintiffs initiated an action in the Kent County Circuit Court to recover amounts allegedly owed from GRP's default under the terms of the sale. On November 6, 2002, the Trust initiated a separate action in the 62-A Judicial District Court, State of Michigan to obtain a judgment of possession of the premises occupied by GRP ("District Court Litigation").

In late spring of 2003, General Motors announced that it would withdraw its longstanding business from GRP. On or about June 30, 2003, days before GRP's lender foreclosed on GRP's loans and essentially put GRP out of business, $398,000 was transferred out of the corporate accounts of GRP to the personal account of Jefferson and/or the accounts of his legal and other advisors, including:

(1) $175,000 to Mr. Melvin Resnick, an attorney; and

(2) $98,000 to the personal account of Defendant; and

(3) $10,000 to Malcolm Hitchcock in Grand Rapids, Michigan;

(4) $60,000 to Kirby Albright in Lansing, Michigan;

(5) $55,000 to Doreen Mayhew in Detroit, Michigan.

GRP also made the following transfers:

(1) $180,000 during 2003 to Defendant as income; and

(2) $400,000 during 2002 to Defendant as income;

Defendant made the following transfers:

(1) $12,000 to Whittenberg University on behalf of Defendant's daughter for fall 2003 tuition and for winter 2004 tuition; and

(2) a 1994 Mercedes Benz to Defendant's son for $4,500 four days prior to the bankruptcy filing.

On or about July 1, 2003, GMAC Commercial Finance foreclosed on all of the assets of GRP. On August 11, 2003, the District Court Litigation resulted in a judgment of possession being entered in favor of the Trust. On October 24, 2003, the Kent County court entered a judgment in favor of the Trust and Bott against Defendant and/or GRP from breach of contract, breach of lease guarantee and breach of consulting guarantee in a principal amount exceeding 1.3 million.

On March 30, 2004, Defendant filed for bankruptcy under chapter 7.

On June 29, 2004, Plaintiffs filed their adversary complaint, alleging that the $398,000 transferred on June 30, 2003 is non-dischargeable under § 523(a)(4) because, when made, these disbursements breached Defendant's fiduciary duty as Director of GRP, violated Michigan law, and were designed to solely benefit Defendant, his personal advisor, and his family. Additionally, Plaintiffs allege that Defendant should be denied his discharge pursuant to 11 U.S.C. § 727(a)(2) because the sole purpose of the

disbursements was to benefit Defendant and his family to the detriment of Defendant's creditors.

On April 15, 2005, Defendant moved for summary judgment claiming that, as a matter of law, Defendant debts are *not* non-dischargeable under § 523(a)(4) and that Defendant should receive his discharge because he did not violate § 727(a)(2).

The Plaintiffs contend that the admitted facts and the law cited preclude the entry of summary judgment. Alternatively, Plaintiffs contend that the Court should deny summary judgment to Defendant as a matter of law pending the completion of discovery that Defendant has refused to answer in this case.

II.

STANDARD FOR SUMMARY JUDGMENT

Summary judgment is appropriate only when there is no genuine issue as to any material fact and the moving party is entitled to judgment as a matter of law. Fed. R. Civ. P. 56(c); Fed. R. Bankr. P. 7056 (Rule 56 applies in adversary proceedings). The central inquiry is "whether the evidence presents a sufficient disagreement to require submission to a jury or whether it is so one-sided that one party must prevail as a matter of law." *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 251-52 (1986). After adequate time for discovery and upon motion, Rule 56(c) mandates summary judgment against a party who fails to establish the existence of an element essential to that party's case and on which that party bears the burden of proof at trial. *Celotex Corp. v. Catrett*, 477 U.S. 317, 322 (1986).

The movant has an initial burden of showing "the absence of a genuine issue of material fact." *Celotex*, 477 U.S. 317, 323. Once the movant meets this burden, the non-movant must come forward with specific facts showing that there is a genuine issue for trial. *Matsushita Electric Industrial Co., Ltd. v. Zenith Radio Corp.*, 475 U.S. 574, 587 (1986). To demonstrate a genuine issue, the non-movant must present sufficient evidence upon which a jury could reasonably find for the non-movant; a "scintilla of evidence" is insufficient. *Liberty Lobby*, 477 U.S. at 252. The court must believe the non-movant's evidence and draw "all justifiable inferences" in the non-movant's favor. *Liberty Lobby*, 477 U.S. at 255.

III.

JURISDICTION

Bankruptcy courts have jurisdiction over all cases under title 11 and all core proceedings arising under title 11, or arising in a case under title 11. 28 U.S.C. §§ 1334 & 157. Core proceedings include proceedings to determine dischargeability. *Id.* § 157(b)(2)(I). As this is a proceeding to determine dischargeability, this is a core proceeding under 28 U.S.C. § 157(b). Thus, this Court has jurisdiction over this matter.

IV.

ANALYSIS

A. The Transfers Made on June 30, 2003 Are **Not** Non-dischargeable under §

523(a)(4) and, Therefore, Defendant's Motion for Summary Judgment Is Granted with Respect to § 523(a)(4).

Section 523(a)(4) provides:

> (a) A discharge under section 727,1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt –
>
> > (4) for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny.

11 U.S.C. § 523(a)(4). To establish that a debt is non-dischargeable under § 523(a)(4), a creditor must establish: (1) debtor was acting as a fiduciary to the creditor at the time the debt was created; (2) the existence of an express or technical trust; and (3) a breach of the fiduciary relationship (fraud or defalcation). *Technical Aid Corp. v. Krizanic (In re Krizanic)*, 255 B.R. 688, 690 (Bankr. E.D. Mich. 2000).

This Court finds that, as a matter of law, Defendant was not acting as a fiduciary to Plaintiffs at the time the debt was created, an express or technical trust did not exist, and Defendant could not have committed defalcation.

1. Defendant Was Not Acting in a Fiduciary Capacity with Respect to Plaintiffs.

Under Michigan law, a corporate officer or director is not a fiduciary of the corporation for which he is an officer or director, although he has a duty to serve the corporation in good faith. *Digital Commerce, Ltd. v. Sullivan (In re Sullivan)*, 305 B.R. 809, 825 (Bankr. W.D. Mich. 2004); Mich. Comp. Laws Ann. § 440.1541a. This Court summarized its view in *Michigan Web Press, Inc. v. Wilcox (In re Wilcox)*, 310 B.R. 689, 696-7 (Bankr. E.D. Mich. 2004), in which it stated:

> The Sixth Circuit has defined the term "fiduciary capacity" as used in section 523(a)(4) narrowly, holding that the term applies only to express or technical trust relationships where a specific property is placed in the hands of the debtor as trustee. *In re Garver*, 116 F.3d 176, 179 (6th Cir. 1997). The term "fiduciary" as used in section 523(a)(4) does not apply to implied trusts. *In re Brady*, 101 F.3d 1165, 1173 (6th Cir. 1996). Although Michigan law imposes a fiduciary duty of good faith on corporate officers, Mich. Comp. Laws Ann. § 440.1541a, Michigan law does not provide that corporate assets are placed in trust with corporate officers or that corporate officers act as trustees. Thus, a corporate director or officer is not a fiduciary under section 523(a)(4). *Sullivan*, 305 B.R. at 825.

The Plaintiffs argue that Defendant, as a corporate officer of GRP, owes a fiduciary duty to creditors, including Plaintiffs because such a duty is imposed on a corporate officer of an insolvent corporation or a corporation in the "vicinity of insolvency." *Credit Lyonnais of Nederland, ND v. Pathe Communications Corp.*, 1991 WL 277613 (Del. 1991); *In re Schultz*, 28 B.R. 723 (M.D. Fla. 1997). Plaintiffs further argue that it is appropriate to follow the holdings in *Credit Lyonnais* and *Schultz* because the determination of whether a party is acting in a fiduciary capacity under § 523(a)(4) is a matter of federal law, not state law. *In re Johnson*, 691 F.2d 249, 251 (6th Cir. 1992).

This Court finds that the term "fiduciary relationship," for purposes of § 523(a)(4) is determined by federal, and not state, law. However, state law is important in determining when a trust relationship exists. *Johnson*, 691 F.2d at 251. Additionally, "[i]n determining whether as a matter of federal law, a debtor was acting as a fiduciary, courts have considered substantive state law as a central factor in the analysis." *In re Bloomberg*, 112 B.R. 236, 240 (N.D. Ill. 1990). Although sometimes misused, the term "fiduciary" has a special and unique meaning under Michigan law. The word "fiduciary" implies a

relationship that exists only when there is a reposing of faith, confidence and trust, and the placing of reliance by one upon the judgment and advice of another. *Potter v. Chamberlain*, 783 N.W.2d 844 (Mich. 1955). Under Michigan law, if state law does not clearly and expressly impose trust-like obligations on a party, the court will not assume that such obligations exist and will not find that there was a fiduciary relationship. *Johnson v. Woldman*, 158 B.R. 992 (Bankr. N.D. Ill. 1993). Therefore, because Michigan law does not provide that corporate assets are placed in trust with corporate officers or that corporate officers act as trustees, a corporate director or officer is not a fiduciary under § 523(a)(4). *Sullivan*, 305 B.R. at 825.

Plaintiffs also argue that Defendant violated Michigan law, specifically, M.C.L. 450.1345, when he made the disbursements because GRP was a near insolvent corporation and the disbursements essentially made the corporation insolvent. This Court finds that M.C.L. 450.1345 is inapplicable in this case. M.C.L. 450.1345 concerns distributions to shareholders and states that such distributions cannot be made if the distribution to shareholders would render the corporation unable to pay its debts. In this case, there has not been any distributions to shareholders. Although Defendant was the sole shareholder, the disbursements he received were in the form of salary. Therefore, M.C.L. 450.1345 does not apply.

2. Defendant Is Not the Trustee of an Express or Technical Trust.

Four requirements are necessary to establish the existence of an express or

technical trust: (1) an intent to create a trust; (2) a trustee; (3) a trust res; and (4) a definite beneficiary. *Commonwealth Land Title Co. v. Blaszak (In re Blaszak)*, 397 F.3d 386, 391 (6th Cir. 2005). In this case, there does not exist an express or technical trust. First, the Court finds that Plaintiffs and Defendant did not intend to create a trust; they entered into a contractual agreement whereby Plaintiffs sold the business to Defendant in exchange for payment by the corporation and a personal guarantee by Defendant on that payment. Second, Defendant was not a trustee for the payment of GRP's debt to Plaintiffs. Defendant was merely the president of GRP. Third, no specific trust res existed; certain specific monies were not being set aside for the payment to Plaintiffs. Instead, GRP was to make payments to Plaintiffs from any available funds. Fourth, Plaintiffs were not a definite beneficiary. Defendant was running GRP for the purpose of making enough money to pay all of GRP's creditors, including himself. Because none of the requirements necessary to establish the existence of an express or technical trust exist in this case, this Court finds that no such trust exists.

3. Defendant Did Not Commit Defalcation.

Defalcation is defined as "misappropriation of trust fund money held in any fiduciary capacity, and the failure to properly account for such funds." Black's Law Dictionary. Plaintiffs argue that, at a minimum, Defendant committed defalcation in this matter because he misused his position with the corporation to gain a personal benefit at the expense of the corporate creditors, thereby breaching his fiduciary duty. Because this Court has already found that the Defendant did not owe a fiduciary duty to the corporation

and that Defendant did not hold corporate monies in trust, this Court also finds that Defendant did not commit defalcation.

In summary, this Court finds that Defendant's debt to Plaintiffs is *not* non-dischargeable pursuant to § 523(a)(4) because: (1) Defendant was not acting in a fiduciary capacity with respect to Plaintiffs; (2) Defendant was not the trustee of an express or technical trust; and (3) Defendant did not commit defalcation. Therefore, this Court GRANTS Defendant's Motion for Summary Judgment with respect to § 523(a)(4).

B. <u>There Are Issues of Fact Concerning Whether Defendant Should Be Denied His Discharge Pursuant to § 727(a)(2).</u>

11 U.S.C. 727(a)(2) states:

> (a) The court shall grant the debtor a discharge, unless –
>
> > (2) the debtor, with intent to hinder, delay, or defraud a creditor or an officer of the estate charged with custody of property under this title, has transferred, removed, destroyed, mutilated, or concealed, or has permitted to be transferred, removed, destroyed, mutilated, or concealed –
> >
> > > (A) property of the debtor, within one year before the date of the filing of the petition; or
> > >
> > > (B) property of the estate, after the date of the filing of the petition.

In order to deny a debtor his discharge, § 727(a)(2) requires that four elements be proven: (1) transfer of property; (2) belonging to the debtor; (3) within one year of filing the bankruptcy petition; and (4) with actual intent to hinder, delay, or defraud creditors or an

officer of the estate. *See, e.g., In re Halperin*, 215 B.R. 321 (Bankr. E.D.N.Y. 1997).

Because a debtor rarely admits to acting "with actual intent to hinder, delay, or defraud creditors or an officer of the estate", courts have considered the following factors as indicators of fraudulent intent:

(1) the transfer was to an insider;

(2) the debtor retained possession or control of the property transferred after the transfer;

(3) the transfer was disclosed or concealed;

(4) before the transfer was made, the debtor had been sued or threatened with suit;

(5) the transfer was of substantially all of the debtor's assets;

(6) the debtor absconded;

(7) the debtor removed or concealed assets;

(8) the value of the consideration received by the debtor was reasonably equivalent to the value of the asset transferred;

(9) the debtor was insolvent or became insolvent shortly after the transfer was made;

(10) the transfer occurred shortly before or shortly after a substantial debt was incurred; and

(11) the debtor transferred the essential assets of the business to a lienor who transferred the assets to an insider of the debtor.

Taunt v. Wojtala (In re Wojtala), 113 B.R. 332, 336 (Bankr. E.D. Mich. 1990) citing *In re Peters*, 106 B.R. 1 (Bankr. D. Mass. 1989); *Matter of Brooks*, 58 B.R. 462 (Bankr. W.D. Pa. 1986).

Courts also look to a number of factors to determine if a debtor's transfer was

intended to hinder or delay creditors, including:

> (1) whether the transaction is conducted at arms-length; (2) whether the debtor is aware of the existence of a significant judgment or over-due debt; (3) whether a creditor is in hot pursuit of its judgment/claim and whether debtor knows this; and (4) the timing of the transfer relative to the filing of the petition. Thus while a court may, after viewing all of the relevant factors, determine that the debtor did not intend to defraud any creditor it may still reach the conclusion that the debtor did intend to hinder or delay a creditor.

Wojtala, 113 B.R. at 336-337.

Plaintiffs' allege that Defendant should be denied his discharge under § 727(a)(2) because Defendant made the following transfers:

1. The transfer on June 30, 2004 of $398,000 out of a corporate account of GRP to a personal account of Defendant's and the accounts of his legal and other business advisors.

2. The transfer by GRP of $180,000 to Defendantfor his 2003 income.

3. The transfer by GRP of $400,000 to Defendant for his 2002 income.

4. Defendant's payment of $12,000 to Wittenberg University on behalf of his daughter in 2003 and 2004.

5. Defendant's sale of a 1994 Mercedes Benz 400 to Jefferson's son for $4,500 four days before filing for bankruptcy.

Plaintiffs' Complaint, p 27.

These transfers can be broken down into two categories: (1) transfers made by GRP (which Plaintiffs' allege is the alter ego of Defendant); and (2) transfers made by Defendant himself. With respect to the three transfers made by GRP, those being: (1) the transfer of $398,000 on June 30, 2004; (2) the transfer of $180,000 in 2003; and (3) the transfer of $400,000 in 2002, the Court finds that there are material questions of fact regarding two issues: (1) whether a transfer by GRP could be considered a transfer by the

Defendant/Debtor (i.e. can Plaintiff pierce the corporate veil); and (2) whether the transfers were made with actual intent to hinder, delay, or defraud creditors. The parties appear to argue that the other elements of § 727(a)(2) have been met, those being that there was, in fact, a transfer of property within one year of the filing of the bankruptcy petition.

With respect to Defendant's transfer of money to Whittenberg University to pay for his daughter's tuition, the Court finds that there is a material question of fact as to whether Defendant, in paying his daughter's tuition, intended to hinder, delay or defraud creditors of the estate.

With respect to Defendant's transfer of the Mercedes to his son, the Court finds that there is a question of fact as to whether Defendant, in selling the car to his son for $4,500, intended to hinder, delay or defraud creditors of the estate. There appear to be issues concerning the market value of the vehicle and whether the vehicle was transferred for less than the market value.

V.

CONCLUSION

For the above-stated reasons, this Court GRANTS summary judgment with respect to § 523(a)(4) and DENIES summary judgment with respect to § 727(a)(2). This case will proceed to trial on the § 727(a)(2) issue.

Dated: June 10, 2005
Detroit, Michigan

/s/
Marci B. McIvor
United States Bankruptcy Judge

cc: Frederick Berg, Deborah Rubin