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Holder of Legal Title to Mortgage Can Foreclose Even If It Does Not Possess the Promissory Note

In a non-bankruptcy case, *Stein v. Chase Home Finance, LLC*, 662 F.3d 976 (8th Cir. 2011), a homeowner challenged the propriety of a foreclosure by advertisement by alleging that the foreclosing creditor did not possess the mortgage loan's promissory note. On appeal to the Eighth Circuit, the court concluded that the mortgagee could foreclose even if it did not possess the promissory note.

The Eighth Circuit analyzed the Minnesota Supreme Court case of *Jackson v. Mortgage Electronic Registration Systems, Inc.*, 770 N.W.2d 487 (Minn. 2009) and concluded that the right to enforce a mortgage through foreclosure by advertisement lies with the legal holder of the mortgage. An assignment of a promissory note serves as an equitable assignment of the underlying mortgage; but legal title of the mortgage passes only through assignment of the mortgage. The court also noted that the foreclosing mortgagee in this case did, indeed, hold the promissory note. Because this was originally a district court action, the Eighth Circuit did not opine on what extent, if any, this decision has on the rights of creditors and debtors in bankruptcy.

Circumstantial Evidence of a Reckless Indifference to the Truth Equals Fraudulent Intent

In *Lincoln Savings Bank v. Freese (In re Freese)*, No. 11-6055, (B.A.P. 8th Cir. 2011), the BAP affirmed the bankruptcy court's denial of the debtor's discharge because the debtor made material and intentional false statements on his statement of financial affairs.

The debtor made a series of inaccurate statements on his Chapter 7 schedules and statements and failed to disclose material facts. Specifically, the debtor failed to disclose the existence of his livestock business and the approximately $500,000 of income he earned from that business. The debtor argued that the income was not disclosed because he had a net loss for that business and he was unaware he had to report the gross income before accounting for expenses. The bankruptcy court was unconvinced by this argument because it was clear that the debtor correctly reported gross income in other forums. Additionally, the debtor failed to report certain income from 2007 related to his hog business, which he claimed he simply forgot to disclose.

In addition to the misstatements made about income, the debtor also failed to report transfers of certain business assets prior to his filing, even though these assets were collateral for a loan from Lincoln Savings Bank, the plaintiff that filed the nondischargeability action. The debtor incorrectly believed that these transfers did not need to be reported because they were made in the ordinary course of his business. Furthermore, the debtor failed to report his ownership of a car that he jointly owned with his wife. The court noted that the debtor held the title for the vehicle and was in possession of all his books and records so he had the information to correctly disclose ownership of the vehicle.

Upon review of the debtor's schedules, Lincoln Savings Bank noticed the discrepancies between the debtor's disclosures and the information provided to it for its loan to the debtor, so it filed a nondischargeability action under 11 U.S.C. § 727(a)(4)(A). In order to prevail, the bank had to prove that the debtor made a materially false statement under oath with fraudulent intent. The debtor argued that all the errors and omissions on his schedules and statements were unintentional or due to a misunderstanding of the question or the law. The bankruptcy court, however, determined that the debtor had the requisite knowledge to correctly disclose his financial situation, but made false statements under oath nonetheless. So, the main issue was whether the false statements were material and intentionally made. The court noted that proof of fraudulent intent can be found by circumstantial evidence and that a debtor's reckless indifference to the truth is treated as the required intent. In this case, the bankruptcy court analyzed the debtor's knowledge and credibility and determined that the debtor's explanations were "not compelling in establishing innocent intent." Additionally, the court held that the misstatements were material even though some of the items that were not disclosed had a minimal dollar value. The court noted that omissions in a statement made under oath about the discovery of assets, business dealings, or the existence and disposition of property is always material in a bankruptcy. On appeal, the BAP agreed with the bankruptcy court's interpretation of the facts and affirmed the denial of debtor's discharge.

Homestead Size in Lien-Avoidance Motion is Determined on Filing Date, Not Date Lien Originally Encumbers Property

In *White v. Commercial Bank and Trust Co.,* (*In re White*), 460 B.R. 744 (B.A.P. 8th Cir. 2011), divorced Arkansas debtors each filed separately for Chapter 7 bankruptcy. In the divorce, the debtors had split a 160 acre property, each receiving an undivided interest in one-half of the property. The debtors each claimed a homestead exemption of 80 acres in their respective halves of the property. The properties were encumbered by a $161,000 judgment lien obtained by creditor Commercial Bank prior to the property split.

Both debtors moved to avoid the lien under 11 U.S.C. 522(f)(1)(A), which provides that a debtor may avoid a judicial lien on property to the extent that lien impairs an exemption to which the debtor would have been entitled. Under Arkansas law, if a rural homestead exceeds $2,500 in value, the debtor may claim a homestead exemption if the property does not exceed 80 acres in size.

The BAP held that each debtor may avoid the lien on his or her respective homestead. Despite the fact that the property was 160 acres in size when the lien was fixed to the property, at the time each debtor filed their bankruptcy petition, each debtor held an 80 acre homestead encumbered by the lien. Because 11 U.S.C. 522(b)(2)(a) provides that exempt property is determined "on the date of the filing of the petition," each debtor was entitled to a homestead exemption of 80 acres. Therefore, each debtor was entitled to avoid the lien.

Untraceable Trust Funds in a Commingled Account Are the Property of Debtor

In *Stoebner v. Consumers Energy Company, et al. (In re LGI Energy Solutions, Inc.)* (B.A.P. 8th Cir. 2011), the BAP reversed the bankruptcy court and held that the preference avoidance defendant had to trace its funds in the debtor's comingled account in order to prevail.

In these consolidated preference avoidance cases, the utility company defendants received payments for services they provided to the debtor's customers. The debtor collected funds from their customers to pay those customers' utility bills. All the funds collected from the debtor's customers were deposited into a bank account held in the debtor's name, and then the utility companies were typically paid from that bank account within hours or up to a few days after receipt of the funds from the customers. The bankruptcy trustee argued as the debtor neared bankruptcy, there were times when the bank account had no money or was overdrawn after a customer paid the debtor but before the utility bill was paid, so a customer's funds were not used to pay that customer's utility bill.

In order for the trustee to avoid the payments made by the debtor to the utility company defendants, it has to prove that the funds were property of the debtor. The defendants argued that the debtor had agreements with its customers that created a trust-like relationship, and therefore the funds held by the debtor to pay the utility companies were held pursuant to a trust and not ever the property of the debtor. Even though the defendants conceded that the debtor commingled is customers' funds and they could not trace the exact funds from the customer to the payment of that customer's utility bill, they argued that tracing was not required since the debtor did pay all the utility bills the funds were meant to pay. The bankruptcy court agreed and granted summary judgment for defendants.

The BAP, however, held that Minnesota law requires tracing of specific funds in this circumstance. In support of its holding, the BAP discussed the Supreme Court's ruling in *Begier v. Internal Revenue Service*, 496 U.S. 53 (1990), which differentiated funds held in trust pursuant to statute and funds held pursuant to a common-law trust. A statutory trust for taxes requires a certain amount to be held in trust for an employee's taxes, but in a common-law trust particular funds are set aside and held in trust. Id. at 62-63. Since the trust-like relationship between the debtor and its customers is a common-law trust, the particular funds, and not just an amount enough to cover the utility bills, must be held in trust for a customer's utility bills, and therefore if the particular funds are not traceable they are not funds held in trust but instead are property of the debtor.

The BAP's holding is also supported by Minnesota law which requires tracing particular trust *res* for both an express trust and constructive trust. Additionally, in its analysis of the agreement the debtor had with its customers, the BAP noted that funds held under such an agreement could be held by the debtor as an agent and the funds would not be a part of the debtor's estate. However, the debtor's actions with those funds, such as commingling funds, having negative balance in the account, inability to trace funds, and exercising control over the funds, could recharacterize the relationship and prove a debtor's ownership of the those funds.

Failure to Receive Money or Property Concurrent With Alleged Misrepresentations is Fatal to Dischargeability Complaint Brought Pursuant to 11 U.S.C. §§ 523(A)(2)(B)

In *The Samuel J. Temperato Revocable Trust v. Unterreiner* (*In re Jeffrey Scott Unterreiner and Lisa Marie Unterreiner*), No. 11-6039 (B.A.P. 8th Cir. 2011), the debtor and another individual were the sole shareholders of the franchisee, a corporation that owned and operated at least three Dairy Queen restaurants pursuant to a franchise agreement with the franchisor, a separate corporation wholly owned by the trust.

By December 2005, the franchisee was experiencing extreme financial difficulties and was unable to make payroll, supply its restaurants, or make its royalty payments to the franchisor. As a result, the bank made a loan of $235,000 to the franchisee as borrower, which loan was arranged by the franchisor. The shareholders of the franchisee and their wives personally guaranteed the loan. The loan documents included a security agreement executed by the franchisee and the guarantors, which granted the bank a security interest in all business assets located at two of the restaurants.

Prior to the loan, the debtor did not submit any documents to the bank, to the franchisor, or to the trust with respect to the loan. Prior to granting the loan, no bank representative spoke with the debtor or inspected the collateral identified in the security agreement. In fact, the debtor had never heard of the bank and the franchisee had not ever done business with the bank.

Although the debtor was unaware of it at the time, the bank also required the franchisor to guaranty the franchisee's obligations under the loan. The bank held a pre-existing blanket guaranty from the trust under the terms of which the trust guaranteed all obligations of franchisor to the bank. The debtor had never heard of the trust and had no knowledge of any liability the trust had to the bank.

About a year after making the loan, the bank learned from the debtor that at the time the security agreement was executed, the vast majority of the franchisee's business assets were owned by a separate entity, not the franchisee or the debtor. Ultimately, the franchisee was unable to repay the loan and the bank pursued the guarantors, who settled their differences for $20,000 and a release. The bank subsequently made a demand upon the trust for payment of the outstanding balance due on the note. The trust and the franchisor settled all obligations for a payment from a related entity in the amount of $185,000.

After the debtor and his spouse filed for bankruptcy, the trust brought an adversary proceeding against them, asserting that they knowingly misrepresented which entity owned the assets pledged as collateral for the loan in the security agreement and that this misrepresentation was material to the franchisor's decision to guarantee the loan. The trust sought to have the amount it paid to the bank deemed nondischargeable pursuant to 11 U.S.C. §§ 523(a)(2)(B). The bankruptcy court granted the trust's motion for summary judgment on its complaint and the debtor and his spouse appealed.

The BAP reversed and remanded with instructions to enter judgment for the debtor and his spouse, holding that the trust failed to show that it was entitled to judgment as a matter of law pursuant to the plain language of the statute as the alleged misrepresentations contained in the security agreement were made to the bank, not the trust, and the debtor and his spouse did not receive any money or property from the trust concurrent with the misrepresentations.

With respect to the trust's argument that value was received concurrent with the misrepresentations in that the trust guaranteed the loan, the BAP held that the trust could not have relied on the misrepresentations as it was undisputed that the trust's liability to the bank stemmed from its own guaranty of all obligations of the franchisor, which guaranty was dated years prior to the security agreement executed by debtor and his spouse. Accordingly, the trust could not have reasonably relied on the misrepresentations as its obligation to the bank predated the security agreement.

Alternative Theory for Measure of Damages in Fraud Claims

In *Bauer v. Gilmartin* (*In re James Joseph Gilmartin and Nawana Maria Gilmartin*), No. 11-6014 (B.A.P. 8th Cir. 2011), the debtors and the creditors were close personal friends. In 2006, the debtors and the creditors formed a limited liability company for the purpose of acquiring and developing real property. Although there were no written operating agreements or contracts between them, according to the creditors, the parties orally agreed that the two families would make equal cash contributions and would share profits and losses equally. The creditors and the debtors made initial capital investments of $20,000 and $16,800, respectively.

Shortly thereafter, the LLC purchased an existing apartment building, which the parties planned to replace with a new four-unit condominium. About a year later, the LLC purchased a single-family residential property, which they planned to tear down and rebuild. The LLC obtained two bank loans to finance these projects: the first in the amount of $1.36 million, and a second in the amount of $465,000. Both loans were personally guaranteed by the debtors and the creditors.

The creditors were not involved in the day-to-day management of the LLC. Instead, the debtors handled supervision of the construction projects and maintaining the LLC's records and finances. In exchange for these services, the debtors were to receive monthly compensation, although the parties disagreed as to whether such compensation was to extend for more than a year if the projects had not been completed.

While the projects were under construction, the debtors experienced financial problems, and the creditors loaned money both to the debtors and to the LLC on several occasions. In 2008, creditors took out a $330,000 second mortgage on their home and turned it over to the LLC, alleging debtors advised them of cost overruns on the projects. Debtors did not infuse any additional capital into the LLC other than their initial investment.

When the bank phoned the creditors in late 2008 to advise that the loan payments were delinquent, the creditors obtained bank records and allegedly determined that the debtors withdrew more than $200,000 in unauthorized funds from the LLC's bank account between 2007 and 2008. Ultimately, one of the real estate projects owned by the LLC was sold at a loss and the other was foreclosed by the bank.

The debtors then filed a Chapter 7 bankruptcy petition. The creditors commenced an adversary proceeding against them, seeking a determination that the debt they owed was nondischargeable pursuant to 11 U.S.C. §§ 523(a)(2)(A) and (a)(4). At the conclusion of the trial, the bankruptcy court concluded that the creditors failed to meet their burden under the statute and prove they were damaged as a result of the debtor's alleged fraud.

The BAP reversed and remanded, holding the bankruptcy court failed to consider evidence introduced by the creditors that they neither would have invested money initially nor continued to invest funds had they known about the debtors' unauthorized and fraudulent withdrawals. The BAP recognized that alternate measures for proving fraud damages are available when the standard benefit of the bargain theory does not accurately measure the loss sustained. The BAP instructed the bankruptcy court to consider whether the creditors' "out of pocket" measure of damages was applicable.

Once Social Security Income is Included in a Chapter 13 Plan, Any Modification May Have to Include Social Security Income As Well

In *Johnson, et al. v. Fink* (*In re Johnson*), 11-6037 (B.A.P. 8th Cir. 2011), husband and wife co-debtors sought to modify their original, confirmed plan based on a change in financial circumstances. The co-debtors' social security income, among other things, had been included in the calculation of disposable income that resulted in their monthly payment under the initial plan. After their plan was confirmed, one of the co-debtors lost a second job that resulted in a substantial reduction of their collective monthly income and the co-debtors sought to modify their plan accordingly. In the course of this effort, the co-debtors also sought to remove their social security income from the calculation of their disposable income despite the fact that there had been no change in the amount of their social security income.

The bankruptcy court sustained an objection by the trustee to the first modified plan proposed by the co-debtors based on the fact that the modified plan did not take account of social security income. The co-debtors then proposed a plan incorporating terms that the bankruptcy court indicated it would confirm, and filed an objection to their own plan. The bankruptcy court overruled the co-debtors' objection and the co-debtors appealed.

On appeal, the co-debtors took the position that, given the material change in their circumstances, their entire plan should be deemed open for modification. In response, the trustee argued that the co-debtors' modification should reflect only the relevant change in their circumstances. The BAP agreed with the trustee holding that any modification of a confirmed plan must correlate to the change in circumstances justifying modification. The BAP therefore affirmed the bankruptcy court's decision and further determined that the reduction in plan payments proposed by the co-debtors was not reflective of their loss of income.

Order Granting Use of Cash Collateral Affirmed Where the Factual Record Was Sufficient to Support the Bankruptcy Court's Decision

In *TLP Services, LLC v. Stoebner* (*In re Polaroid, et al.*), 11-6058 (B.A.P. 8th Cir. 2011) TLP Services, LLC, appealed an order of the bankruptcy court authorizing the Chapter 7 trustee to use cash collateral. The trustee filed a motion with the bankruptcy court seeking authority to use cash collateral to fund more than 80 adversary proceedings. As adequate protection to secured creditors with an interest in such cash collateral, among other things, the trustee offered to provide replacement liens. TLP objected to the trustee's motion arguing that the trustee failed to provide sufficient evidence that the replacement liens would adequately protect their secured interest. The bankruptcy court overruled TLP's objection and TLP appealed.

The BAP affirmed the bankruptcy court's decision on appeal. Applying a "clear error" standard, the BAP determined that the bankruptcy court's decision had sufficient support in the evidentiary record to satisfy the three-prong standard articulated in *In re Martin*, 761 F.2d 472 (8th Cir. 1985). Specifically, the BAP noted that the bankruptcy court (i) accepted TLP's valuation of its secured interest; (ii) considered the potential risks to TLP's interest; and (iii) heard detailed arguments regarding the sufficiency of the proposed replacement liens to protect TLP's secured claim against the risks identified.

In Denying Dischargeability of Student Loans, District Court Refuses to Rely on Speculation in the Face of Insufficient Financial Data

In *Jacobs v. Educational Credit Management Corporation (In re Jacobs)*, No. 11-1331 (D. Minn. 2011), the district court upheld a decision of the bankruptcy court, which held, *inter alia*, that the debtor failed to adequately show "undue hardship" required to discharge student loan debt. Therefore, the debtor's student loans were excepted from discharge pursuant to 11 U.S.C. § 523(a)(8).

While pursuing higher education in the early to mid-1990s, the debtor became indebted to the Respondent, ECMC, in the amount of $110,658.06. In 2008, the debtor was forced into retirement, and subsequently undertook the position of part-time substitute teacher earning $110 for each day of work and $60 for each half day. Additionally, when the debtor was unable to find work as a substitute teacher, he received unemployment benefits of $120 per week. Later that year, the debtor filed for Chapter 7 protection and received a discharge. In early 2010, the debtor filed a complaint against Sallie Mae seeking the discharge of his considerable student loan debt. After a bench trial on the matter, the bankruptcy court entered an order rejecting the debtor's efforts to have the debt discharged, and the instant appeal followed.

After dispensing with the debtor's assertions that the bankruptcy court mismanaged certain procedural aspects of the case, the district court set out to analyze the issue of "undue hardship" and the dischargeability of student loan debt. Courts in the Eighth Circuit determine the existence of "undue hardship" by analyzing the totality of the circumstances, and consider a debtor's past, present and future economic outlook, reasonable and necessary living expenses, and any other relevant information.

According to the district court, the debtor failed to prove such hardship by a preponderance of the evidence, as is the required standard. Primarily, the debtor provided only a partial picture of his finances, with no indication of future resources or expenses. As such, the debtor failed to equip the bankruptcy court with sufficient information to draw the clear conclusion as to whether the debtor could repay his student loan obligations while maintaining a minimal standard of living. Specifically, the debtor failed to provide detailed information as to current or expected earnings, or about current or future levels of social security benefits. Additionally, the debtor failed to provide the bankruptcy court with enough information to analyze other factors such as applicable taxes. By merely providing vague, general, and cursory statements, the bankruptcy court was unable to determine the existence of "undue hardship" without engaging in prohibited conjecture or speculation. Therefore, the debtor was not entitled to the discharge of his student loan debt and must pursue such other relief as may be appropriate when considering his deteriorating financial situation.

Constitutional Considerations Prevent Debtor From Making Exemption-Based Objection to Proposed Settlement

In *Hecker v. Seaver (In re Hecker)*, No. 11-02083 (D. Minn. 2011), the district court examined the intersection of bankruptcy and black-letter Constitutional law.

In 2005, GELCO Corporation entered into a Sales Commission Agreement ("SCA") with the debtor and two of his wholly owned automobile leasing subsidiaries. Under the SCA, GELCO would make an advance of $7,500,000 and make subsequent formulaic based incentive payments based on differing factors. Pursuant to the SCA, the debtor agreed to be classified as an independent contractor, and agreed that he would not be deemed an employee of GELCO for any reason. As a result, GELCO never filed a W-2 or 1099 for the debtor, and the debtor never claimed any amount under the SCA on his state or federal tax returns. In 2009, the debtor filed for Chapter 7 protection. The debtor never claimed an exemption based on any amount received under the SCA, despite twice amending his Schedule C, and listed himself as "self-employed" in his Schedule I. In 2011, the respondent, the Chapter 7 trustee, moved the bankruptcy court for an order approving a settlement with GELCO under which GELCO would pay $4.1 million to resolve outstanding amounts owed under the SCA. The debtor objected to the settlement, claiming that a portion of the SCA proceeds may be exempt under Minn. Stat. § 550.37, subds. 1 and 13 and § 571.922(a) as earnings, and, as such, belonged to the debtor rather than the estate. The bankruptcy court denied the debtor's objection, holding that the debtor lacked standing to object, and subsequently approved the settlement. The instant appeal followed.

Primarily, the debtor's claim was not ripe. Rather, the district court found that the debtor was merely seeking a prohibited advisory opinion, as he was seeking an opinion advising of what the law would be upon a hypothetical state of facts. Though a debtor is generally able to liberally amend its financial schedules, such ability is not absolute. The debtor only raised the exemption argument upon his objection to the settlement, and as the agreement was already negotiated based on information contained in the (twice) amended financial schedules, the debtor's objection was indicative of bad faith. Additionally, any further amendment would result in undue prejudice to the parties to the agreement. In sum, the debtor was making a claim based on events that had not happened (specifically, the *proposed* exemption claim), and was requesting a constitutionally prohibited advisory opinion based entirely on hypothetical facts.

Additionally, the debtor lacked the standing required to bring such a claim. Constitutional standing requires an injury that is causally connected to the challenged action by the other party. Additionally, it must be likely that the injury will be redressed by a favorable decision. However, in the current instance the debtor was not directly or adversely affected pecuniarily by the order approving the settlement. No matter how the estate's assets were to be distributed, no assets would revert back to the debtor's possession. As the debtor never listed any SCA related payments on his twice-amended schedule C, the amounts owed under the SCA belonged to the estate, and the debtor had no right to payment. Therefore, the debtor had no injury and, thus, no standing to assert his objection.

Debt Non-Dischargeable for Embezzlement But Court Declines Double Damages Award Under Minnesota Civil Theft Act

The bankruptcy court in *Town Centre Self Storage, LLC v. Conoryea (In re Conoryea)*, Adv. No. 09-3169, (Bankr. D. Minn. 2011) found a debtor's debt to his former employer non-dischargeable under section 523(a)(4) for embezzlement. The debtor was a manager for a self-storage operation owned by the plaintiff. During the three years of his employment, the debtor irregularly booked rental payments made in cash to the electronic accounting system, and his employer alleged that the debtor embezzled the cash for his own benefit.

The court engaged in an extensive inquiry into the external credibility of the debtor's explanation for irregular entries for cash payments. The debtor stated that the system routinely crashed when entering cash payments, causing customer dissatisfaction in delaying processing of a receipt. The debtor began processing the payments manually, provided a hand written receipt, and electronically processed the transactions as a deferral, meaning the system would not flag the unpaid rent until the future deferred date. The preceding and subsequent managers reported no similar defects about the system's inability to process cash payments.

The debtor also testified he remitted all cash payments to the owner with a copy of the manual receipt, and implied that the owner must have embezzled the funds or otherwise made a false accusation. While the plaintiff did not establish actual proof of debtor's subsequent use of converted funds, the court found that the owner's fervent pursuit of the debtor, including filing a report with the police, belied any claim that the owner himself committed a wrong.

On the balance, the court found the defendant's story unpersuasive and that sufficient circumstantial evidence established the elements of a non-dischargeable embezzlement under *In re Phillips*, 882 F.2d 302, 304 (8th Cir. 1989). First, as a manager employed by the plaintiff, the defendant lawfully collected the cash payments from plaintiff's renters. Second, the balance of the credible evidence showed the defendant misappropriated those funds for his own use. Third, the more credible evidence showed defendant concealed the appropriation through the use of misleading entries on the electronic accounting system and therefore his misappropriation was fraudulent.

The court entered a non-dischargeable judgment in the amount of $25,915.00, the amount stipulated as the cash payments received by defendant from customers. The court did not award double damages that are available under Minnesota's Civil Theft Statute found at MINN. STAT. § 604.14. Citing *One Point Solutions, LLC v. Borchert*, 486 F.3d 342, 348 (8th Cir. 2007), the court held that the statute's doubling provision sets the ceiling on the potential punitive damages necessary to punish a civil theft. Nonetheless, the plaintiff must offer a record warranting imposition of punitive damages and plaintiff in this case failed to do so.

Debtor Denied Discharge Due to Numerous False Oaths on Bankruptcy Schedules

In *Ries v. Stephanie (In re Stephanie)*, Adv. No. 10-3235, (Bankr. D. Minn. 2011) the bankruptcy court denied a debtor's discharge on account of several omissions from his bankruptcy schedules including hidden assets and several transactions undertaken during a failed romantic relationship. During the relationship, the debtor and his girlfriend purchased a 2004 Chevrolet Silverado with a plow for the purpose of starting a snow plow business. The vehicle was titled jointly, and the debtor scheduled a 50% ownership interest. During trial, however, the debtor asserted he owned 100% of the truck and that he planned to start the snow plow business with his grandson. The court therefore found he failed to disclose his full interest in the truck on his schedules and gave a false oath.

The debtor also transferred a 2002 Ford F-250 pickup truck to his girlfriend for the purpose of keeping the truck out of his bankruptcy estate. He disclosed the transfer as a sale, said he only intended the transfer to secure a $3,000 loan she gave him, which he claimed he paid back prior to the bankruptcy, and further testified that he wants the truck back. His failure to schedule the truck as an asset of his estate is another false oath.

The debtor showed a number of guns and a bow to his girlfriend. He told the bankruptcy court he did not own the items and neither identified an owner nor expressly disclaimed ownership of the bow. The debtor also claimed he sold a 2005 Chevrolet Silverado before the petition date at an auction for $18,265, notwithstanding the fact the title to the vehicle remained in his name. The court found that evidence of a document from a potential purchaser at an auction, which was not a receipt, did not overcome the presumption of ownership arising from the certificate of title. Further, the certificate demonstrated a security interest and it was not reasonable that a purchaser would have purchased the vehicle without obtaining a new title or removing the security interest. The court found that the debtor continued to own the truck and his omission of the asset constituted another false oath.

Finally, the debtor obtained $30,000 from his girlfriend to satisfy the second mortgage on his homestead. The debtor claimed it was a gift, but his girlfriend claimed it was a loan. The court found that the girlfriend's lack of assets and recently deceased spouse suggested she would not dispose of a substantial amount of her assets as a gift. Thus, the court deemed the transaction a loan, and found that the debtor's failure to schedule her as a creditor appeared to be "out of spite," and was a false oath.

The debtor also failed to comply with the bankruptcy trustee's request to turnover bank records, which the court concluded were further grounds to deny his discharge under Sections 727(a)(3) and (a)(4), for withholding financial information for which the trustee is entitled and obstructing the administration of the bankruptcy estate.

Debt Excepted From Discharge Where Debtor, As Manager of Plaintiff's Rental Properties, Failed to Properly Allocate, Segregate and Account for Monies He Received in the Course of His Duties

In the case of *Evans v. Walters* (*In re Walters*), 10-3158, (Bankr. D. Minn. 2011), the plaintiff brought a nondischargeability action against the debtor, Neil Evans, alleging a breach of fiduciary duty for his failure to properly segregate and allocate rent monies he collected on behalf of the plaintiff in accordance with the written agreement between the parties.

The debtor was a real estate broker at all times relevant to the adversary action. The plaintiff owned rental properties that were managed by the debtor through his companies E and W Properties or Walter's Real Estate and Investment, LLC. The agreement between the parties required the debtor's management company to: (i) collect rents for tenants; (ii) hold damage deposits; (iii) pay utilities; (iv) send monthly statements to the plaintiff showing gross receipts, rents received and itemization of deductions from gross rents received, such as utility bills; and (v) send a net check to the plaintiff. Ultimately, the debtor ended up with a $33,000 shortfall and explained that it was the result of having followed procedures, which consisted of shuffling funds around to meet cash flow obligations, that he had been taught to use by the plaintiff when they had been partners in E and W Properties.

The plaintiff's dischargeability claim stemmed from 11 U.S.C. § 523(a)(4), which provides that a discharge does not discharge a debtor from any debt "…(4) for fraud or defalcation while acting in a fiduciary capacity; embezzlement, or larceny[.]" The court first looked to federal law to determine whether the debtor owed a fiduciary duty to the plaintiff. Federal law essentially directed that a fiduciary duty exists between the debtor and a creditor where there is an express or technical trust, with the latter of the two being imposed by statute or common law. *Reshetar Systems, Inc. vs Tohompson*, ___ B.R. ___, 2011 WL 4552298 (B.A.P. 8th Cir. 2011). Next the court looked to Minnesota common law and Minnesota statues, which provided that a real estate broker is a fiduciary and that the duties being performed by the debtor, in his capacity as the manager of plaintiff's rental properties, were such that he was acting as a real estate broker within the definition of the M.S.A. § 82.55, which outlines the definition of a "real estate broker".

Furthermore, the court found that the written agreements between the parties created both a technical trust and an express trust, thereby making the debtor a fiduciary to the plaintiff within the meaning of 11 U.S.C. § 523(a)(4). Pursuant to the agreement, the debtor was required to segregate the plaintiff's managed funds from his business accounts and to deposit all receipts collected. Since he did not do so, he was acting contrary to his fiduciary duties to the plaintiff which arose under the applicable technical and express trusts which governed the parties' relationship.

Lastly, the court noted that defalcation under § 523(a)(4) does not require that the fraud or wrongdoing on the part of the defendant is intentional. Instead, an innocent default of a fiduciary who fails to account fully for money received rises to the level of defalcation, the definition of which includes misappropriation of trust funds or money held in a fiduciary capacity. Since the court found that the debtor had a fiduciary duty to plaintiff and his actions as fiduciary were enough in this context to rise to the level of defalcation, the court held that the $33,000 debt to plaintiff should be excepted from discharge.

Court Disallows Bonus Plan for Management of Chapter 11 Debtor

The bankruptcy court in *In re Lyman Holding Company*, Case No. 11-45190, (Bankr. D. Minn. Jan. 3, 2012) rejected a Chapter 11 debtor's motion to approve an incentive plan which provided $50,000 bonuses for two key employees who were also insiders. Section 503(c)(1) of the Code generally forbids payments to insiders merely as an inducement to retain such insiders during the Chapter 11 case and provides that incentive payments cannot be made outside of the ordinary course when not justified by the facts and circumstances. Retention bonuses can be made where an employee is essential to the survival of the business, the employee has a bona fide job offer paying equal or greater compensation, and the overall retention bonus is not greater than ten times the average of similar types of payments to non-management employees. The court has substantial discretion in assessing the justification for the proposed incentive compensation.

The court here found that the proposed incentive payments were retention payments in substance. The debtor created the incentive plan shortly before the petition. The primary condition for payment was that the officers had to remain employed by the debtor and the proceeds from the anticipated sale of assets during the bankruptcy had to satisfy the claims of the secured lenders. The court noted that the plan did not specify the exact nature of additional services required by the key employees to earn the bonuses. The condition that the proceeds simply pay the secured claims was insufficient because it did not seek to benefit the unsecured creditors. Based on these factors, the court found the plan sought to pay the employees simply to remain employed, and without meeting additional conditions for payment of a retention bonus, the court denied the proposed bonus plan.