IT IS ORDERED as set forth below:

Date: April 28, 2009

Mary Grace Diehl

Mary Grace Diehl
U.S. Bankruptcy Court Judge

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF GEORGIA
ROME DIVISION

In re:	:	
	:	BANKRUPTCY CASE NUMBER
ROBERT K. NAGUSZEWSKI,	:	**07-40860-MGD**
	:	
Debtor.	:	
	:	
NEIL SANDERS,	:	ADVERSARY CASE NUMBER
	:	**07-04050-MGD**
Plaintiff,	:	
v.	:	CHAPTER 7
	:	
ROBERT K. NAGUSZEWSKI,	:	
	:	
Defendant.	:	

ORDER

The trial in the above-styled adversary proceeding was held before the Court on March 10, 2009. Present at the trial were Neil Sanders ("Plaintiff"), Edward Hine, counsel for Plaintiff, Robert K. Naguszewski ("Defendant"), and James McKay, counsel for Defendant. In Plaintiff's Complaint, Plaintiff seeks a determination that Defendant's debt to Plaintiff is nondischargeable

under 11 U.S.C. § 523(a)(2)(A), (a)(2)(B), (a)(6), and (a)(4). (Docket No. 1) At trial, Plaintiff stated that he was proceeding solely under Count IV of his complaint, which is whether Defendant's debt is nondischargeable pursuant to 11 U.S.C. § 523 (a)(4) based on an act of defalcation by Defendant. All other counts of the Complaint were abandoned by Plaintiff. The Court heard testimony of witnesses and argument of counsel and admitted documents into evidence. Following the trial, Plaintiff and Defendant each submitted letter briefs to the Court and Plaintiff submitted a response to Defendant's letter brief. For the reasons set forth herein, Defendant's debts to Plaintiff are determined to be dischargeable. Plaintiff failed to meet his burden of demonstrating that Defendant's debts to Plaintiff are the results of Defendant's acts of defalcation.

I. FACTS

The evidence presented at trial showed the following: Defendant owns fifty percent of the stock in N&A Properties, Inc. ("N&A"), which is a privately owned real estate holding company. The remaining fifty percent of the stock is owned by Mario Armas, who is not a party to this adversary proceeding. Defendant was also an officer of N&A. Defendant invested heavily in N&A and personally guaranteed some of N&A's debts. On April 10, 2007, Defendant filed a personal Chapter 7 bankruptcy. N&A is not a debtor in any bankruptcy case at the time of this proceeding.

Defendant's dealings with Plaintiff began in 2006. In the months of June and July of 2006, Plaintiff entered into two agreements with N&A. On June 20, 2006, Defendant and Armas, as president and secretary of N&A respectively, signed a promissory note ("First Note") for $60,000 payable to Plaintiff. (Plaintiff's Exh. 1). On July 14, 2006, the same parties entered

into a second agreement ("Second Note") in which Plaintiff loaned N&A $100,000. (Plaintiff's Exhibit 2). The Second Note was intended to be secured by $100,000 of equity in a property identified as Treasure Island Condo #305 ("Treasure Island Property") and was guaranteed by both Defendant and Armas personally. (Plaintiff's Exh. 2). When the parties signed the Second Note, N&A did not have title to the Treasure Island Property. While Defendant, as the representative of N&A, signed a Letter of Intent on June 9, 2006, to purchase the Treasure Island Property, the sale was never completed as planned. (Defendant's Exh. 1). When N&A had the property appraised for purposes of getting financing for the purchase, the property was assessed for less value than N&A anticipated. To secure the necessary financing, Defendant and Armas took out loans personally and, on July 18, 2009, each personally received a one-half interest in the Treasure Island Property by quit claim deed. (Defendant's Exh. 3). As a result, Plaintiff holds two unsecured notes for a total of $160,000 that are personally guaranteed by Defendant. It is for these debts that Plaintiff seeks a determination of nondischargeability.

N&A began experiencing financial difficulties sometime in 2006. Plaintiff claimed that N&A's 2006 tax returns indicate that N&A was insolvent in January 2006, before Plaintiff made loans to N&A. Specifically, the 2006 tax returns suggest that N&A's assets exceeded its liabilities in January of 2006. (Plaintiff's Exh. 3). David Brian Land, the certified public accountant who prepared N&A's tax returns, testified that the tax returns did not prove that N&A was insolvent at that time. The tax returns did not indicate the fair market value of all the properties held by N&A, but merely the cost of the properties minus depreciation, and therefore were not an accurate representation of the value of N&A's assets.

Defendant testified that N&A's financial difficulties actually began in late 2006, when

Armas was arrested by federal authorities and the federal government "locked down" N&A properties. N&A's income from rental properties deteriorated after Armas' arrest. Defendant tried to continue running N&A in Armas' absence. Despite Defendant's efforts, N&A was unable to pay fully all debts as they came due in November of 2006. Accordingly, in November of 2006, N&A was insolvent.

Defendant has not always clearly distinguished Defendant's personal liabilities from N&A's corporate liabilities. The Treasure Island Property is an example of a common practice by Defendant and Armas with respect to N&A real estate. Defendant and Armas held several properties, and the corresponding debt, in their personal names with the intent to treat the properties as N&A assets. As a result, the funds related to properties titled in N&A and properties titled in Defendant's name were commingled. Among the deposits Defendant made to the N&A account were rental payments for properties that were titled in Defendant's and Armas' names individually. Likewise, among the payments Defendant made from the N&A account were payments on loans owed by Defendant individually and secured by the properties titled in Defendant's and Armas' names individually. Defendant also made payments to other personal creditors of Defendant. Specifically, Defendant testified at trial about payments made from the Citizens First account that Defendant opened in October of 2006. Defendant identified payments made to AmSouth on a property titled in Defendant's name individually, payments made on Armas' wife's Visa account, for which Defendant was personally a guarantor, and payments to Defendant's bankruptcy attorney.

Similarly to Defendant's treatment of real estate, Defendant appears to have commingled his personal assets with those of N&A with regard to investments in antiques. Steven White,

who works in the antiques business, testified that he had received investments from N&A, from Defendant individually, and from Armas individually. White traced the investments by whose name was on the checks he received, such that a check from Defendant individually was treated as an investment by Defendant and a check with both Defendant's and Armas' names would be treated as an investment by N&A. White fully paid back the investment from Defendant individually and has continued to make repayments to N&A. White further testified that he had sold antiques for Defendant, Armas' wife, and N&A and that the proceeds from the sales had been paid to Defendant and Armas' wife, individually. No evidence was presented to show that N&A received any of the proceeds from the antiques sold. The antiques appear to have been sold near the time that Defendant filed his bankruptcy petition, with the payments to Defendant and Armas' wife being made post-petition.

Another complicating factor in tracing N&A's assets, and the use thereof, is that Defendant's management of N&A's finances has involved multiple bank accounts. Initially, N&A used a corporate account at Citizens First Bank. Defendant closed that account and opened a new personal account at Citizens First Bank in October of 2006. (Plaintiff's Exhibit 9). Defendant consolidated N&A's assets into the new account in an attempt to protect N&A's creditors from the freezing of Armas' assets and from any attempts by Armas to use N&A funds for his personal expenses. Defendant maintained that account until he filed his Chapter 7 bankruptcy petition in April of 2007. Defendant opened another account at River City Bank in order to continue operating N&A after Defendant filed for bankruptcy. Defendant testified that he deposited any money N&A received into the accounts and either paid debts directly out of N&A's account or paid the debts out of his own account and then reimbursed himself from the

N&A account.

At trial, Defendant testified that N&A remained current on all payments due to Plaintiff under the terms of their loan agreements in the time between November of 2006 and Defendant's filing of his bankruptcy petition in April of 2007. Defendant also presented evidence of monthly automatic withdrawals of payments to Plaintiff from Defendant's bank account. (Defendant's Exhibits 4–4(f)). Those withdrawals were each for $1250.00, which is the amount due monthly on the Second Note between Plaintiff and N&A. While it is unclear from the documentation whether Plaintiff also received payments due under the First Note, Plaintiff offered no evidence at trial to contradict Defendant's testimony on this issue.

II. DISCHARGEABILITY PURSUANT TO 11 U.S.C. § 523 (a)(4)

Section 523(a) of the Bankruptcy Code provides for various exceptions to the discharge of specific debts. Section 523(a)(4) states that a discharge under § 727 does not discharge an individual debtor from any debt "for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny." 11 U.S.C. § 523(a)(4). The creditor bears the burden of proving nondischargeability by a preponderance of the evidence. *Grogan v. Garner*, 498 U.S. 279, 288 (1991).

The first question is whether a fiduciary relationship existed between Plaintiff and Defendant. Under Georgia common law, the officers and directors of an insolvent corporation "stand as trustees of corporate properties for the benefit of creditors first and stockholders second." *Bank Leumi-Le-Israel, B.M., Philadelphia Branch v. Sunbelt Industries, Inc.*, 485 F. Supp. 556, 559 (S.D. Ga. 1980). In such a case, "[b]y operation of law, a fiduciary relationship

does exist." *Id.* Whether a fiduciary relationship exists for purposes of § 523(a)(4), however, is a question of federal law. *In re Khalif*, 308 B.R. 614, 622 (Bankr. N.D. Ga. 2003). The United States Supreme Court has articulated a narrow definition of "fiduciary," holding that the trust upon which the fiduciary relationship relies must be an express or technical trust. *Davis v. Aetna Acceptance Co.*, 293 U.S. 328, 333 (1934). The fiduciary duties "must be specifically set forth so that a trust relationship is expressly and clearly imposed." *In re Eavenson*, 243 B.R. 160, 165 (N.D. Ga. 1999). Georgia law, as stated above, clearly imposes a duty on the officers and directors of insolvent corporations to act as trustees over corporate property for the benefit of creditors and stockholders. Defendant was the officer of N&A in November of 2006, when N&A became insolvent as evidenced by its inability to pay its debts as they came due. Plaintiff was a creditor of N&A at that time. Therefore, Defendant did owe a fiduciary duty to Plaintiff to act as the trustee of N&A's property for the benefit of all creditors, including Plaintiff, beginning in November of 2006.

The second question is whether Defendant's debt to Plaintiff is for defalcation while acting in Defendant's fiduciary capacity. To establish nondischargeability pursuant to § 523(a)(4) when a fiduciary duty has been established, the Court must find that the trust relationship existed prior to the act that created the debt. *In re Eavenson*, 243 B.R. 160, 165 (N.D. Ga. 1999). The language of the Bankruptcy Code clearly states that a debt exempted from discharge pursuant to § 523(a)(4) must be a debt "for fraud or defalcation." 11 U.S.C. § 523(a)(4). The phrase "debt for," as it is used repeatedly in § 523(a), means "debt as a result of" or "debt by reason of," such that § 523(a)(4) requires that the debt at issue result from the debtor's defalcation. *Cohen v. De La Cruz*, 523 U.S. 213, 219 (1998); *see Greenberg v. Schools*,

711 F.2d 152, 156 (11th Cir. 1983)(holding that a debt that was "the result of debtor's fraud" could be exempted from discharge under 11 U.S.C. § 523(a)(4) when the parties had later entered into a settlement agreement).

Here, Plaintiff seeks a determination that Defendant's debts, which relate to loan agreements signed in June and July of 2006, are nondischargeable. While the Court has found a fiduciary relationship between the parties, that relationship existed only after N&A became insolvent. Therefore, Defendant's fiduciary duty to Plaintiff arose in November of 2006 when N&A became insolvent. Plaintiff's loans to N&A, and Defendant's corresponding debt as a guarantor of those loans, were created in June and July of 2006. Defendant's debts pre-existed Defendant's fiduciary obligation to Plaintiff and could not have resulted from any act of defalcation by Defendant as a fiduciary. While the facts of this case suggest that Defendant may have improperly used N&A funds during the period of insolvency, those acts did not create Defendant's loan-based debts to Plaintiff. Plaintiff has failed to prove any harm to Plaintiff individually as a result of defalcation by Defendant while acting in a fiduciary capacity. Accordingly, it is

ORDERED that Defendant's debts to Plaintiff based on Plaintiff's loans of $60,000 and $100,000 to N&A in June and July of 2006 are hereby deemed **DISCHARGEABLE.** Judgment for Defendant will be entered accordingly.

The Clerk shall serve a copy of this Order upon the Plaintiff, counsel for Plaintiff, the Defendant, counsel for Defendant, and the Chapter 7 Trustee.

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