In the United States Bankruptcy Court

for the Northern District of Iowa

RICHARD P. MINETTE *Debtor(s).*	Bankruptcy No. X89-01742M Chapter 7
MICHAEL C. DUNBAR Trustee of the Paul David Hanson Bankruptcy *Plaintiff(s)* vs. RICHARD P. MINETTE *Defendant(s)*	Adversary No. X90-0026M

MEMORANDUM OF DECISION AND ORDER RE:

MOTION FOR SUMMARY JUDGMENT

The matter before the court is a Motion for Summary Judgment filed by plaintiff Michael C. Dunbar (DUNBAR), trustee of the Paul David Hanson (HANSON) bankruptcy estate. Dunbar asserts that a $604,834.83 Iowa state court judgment entered against debtor Richard Minette (MINETTE) precludes Minette from disputing the nondischargeability of the debt. Dunbar claims that the state court judgment entered against Minette is excepted from discharge pursuant to 11 U.S.C. § 523(a)(4) and § 523(a)(6).

The parties have filed briefs and affidavits in support of their positions. A hearing concerning this matter was held in Sioux City on October 30, 1990. This is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(I).

I.

On April 30, 1984, Hanson commenced a lawsuit against Minette in Iowa District Court for Cerro Gordo County. The lawsuit complained of numerous transgressions committed by Minette in his role as Hanson's personal attorney and as co-trustee of an inter vivos trust created by Hanson. Among the legal theories asserted against Minette were breach of fiduciary duty as attorney-in-fact for Hanson, fraudulent concealment, breach of fiduciary duty as trustee of Hanson's inter vivos trust, breach of contract, and legal malpractice.

On May 24, 1985, Hanson filed a chapter 11 bankruptcy petition. Shortly thereafter, Hanson converted the case to chapter 7 whereupon Dunbar was appointed trustee. Hanson's lawsuit against Minette constituted property of Hanson's chapter 7 estate pursuant to 11 U.S.C. § 541(a)(1). As a result, Hanson's state court petition was amended to include Dunbar as a party-in-interest.

A non-jury trial was held between January 17, 1989 and February 24, 1989 before state district Judge Ronald Schechtman. On May 10, 1989, Judge Schechtman issued a 102-page decision in which he found Minette liable to the Hanson estate in the amount of $468,988.05, plus costs and interest.

The state court's decision includes six separate findings of liability. The most substantial finding relates to Minette's failure to file income tax returns on behalf of Hanson for 1980 and 1981. Judge Schechtman computed resultant damages in the amount of $364,987.19 (including federal interest and penalty) plus 9.15 per cent interest computed from November 16, 1987. The court also assessed damages against Minette for the costs incurred by Hanson in employing a certified public accountant to compute the 1980 and 1981 taxes.

Minette was ordered to repay excessive fees in the amount of $76,248.86 plus interest. The court awarded damages against Minette in the amount of $9,000.00 plus interest for an "improper appropriation" of Hanson's trust funds and a recovery in the amount of $10,000.00 plus interest as repayment of a loan made by Hanson to Minette in 1973. Also, Minette was found liable in the amount of $2,000.00 plus interest as a result of a loan to a third-party made by Minette in his role as co-trustee of Hanson's inter vivos trust.

On November 14, 1989, Minette filed a petition for relief under chapter 7. On February 15, 1990, Dunbar filed the instant complaint.

II.

Statement of the Issues

Dunbar's motion for summary judgment seeks to except Minette's debt to Hanson's bankruptcy estate from discharge pursuant to 11 U.S.C. § 523 (a) (4) and § 523 (a) (6). In support of his motion, Dunbar claims that Judge Sohechtman's state court decision collaterally estops Minette from relitigating factual issues underlying the determination of dischargeability.

Minette resists Dunbar's motion. He contends that differences in the standards of proof in the state court action and in the pending bankruptcy proceeding require denial of plaintiff's motion.

III.

DISCUSSION

In order for Dunbar to prevail on his motion for summary judgment, he must satisfy Bankr. R. 7056 which incorporates Fed. R.Civ. P. 56. Summary judgment is proper when no genuine issue of material fact exists and the movant is entitled to judgment as a matter of law. Bankr. R. 7056(c); see also, Barker v. Sac Osage Electric Co-op, 857 F.2d 486, 487-8 (8th Cir. 1988).

The threshold legal question is whether the state court judgment precludes Minette from relitigating issues which the state court decided and which are directly relevant to dischargeability. Collateral estoppel, or issue preclusion, refers to the effect of findings of fact actually litigated in one lawsuit upon subsequent litigation which involves a different cause of action, but some or all of the same facts. Brown v. Felsen, 442 U.S. 127 (1979).

Although the determination of dischargeability of indebtedness is within the sole jurisdiction of the bankruptcy court, principles of issue preclusion can be applied in a dischargeability proceeding.

Under the doctrine of issue preclusion, the following criteria must be met before a factual determination is conclusive in a subsequent proceeding: (1) the issue sought to be precluded must be the same as that involved in the prior litigation; (2) that issue must have been actually litigated; (3) it must have been determined by a valid and final judgment; and (4) the determination must have been essential to the judgment. Lovell v. Mixon, 719 F.2d 1373, 1376 (8th Cir. 1983).

The state court must also have determined factual issues using the same standards as those employed by the federal courts in determining issues of dischargeability. Henson v. Garner (In re Garner), 881 F.2d 579, 581 (8th Cir. 1989), cert. granted ___ U.S. ___, 110 S.Ct. 1945, citing Brown v. Felsen, 442 U.S. 127, 139, n. 10 (1979); MA & M, Inc. v. Supple (Matter of Supple), 14 B.R. 898, 904 (Bankr. D. Conn. 1981).

Both parties agree that the standard of proof applied in the state court proceeding was preponderance of the evidence. It is settled in this circuit that the standard of proof in a § 523(a)(6) proceeding is proof by clear and convincing evidence. American Honda Finance Corp. v. Loder, 77 B.R. 213 (N.D. Iowa 1987); In re Holtz, 62 B.R. 782 (Bankr. N.D. Iowa 1986); In re Bothwell, 32 B.R. 617 (N.D. Iowa 1983). Consequently, since the burden of proof used by the state court did not "comport with federal standards," the court cannot give preclusive effect to the state court judgment as it relates to Dunbar's § 523(a)(6) claim.

To establish that a debt is non-dischargeable under § 523(a)(4), a creditor must show that: (1) an express trust existed; (2) the debt was caused by fraud or defalcation; and (3) the debtor acted as a fiduciary to the creditor at the time the debt was created. Klingman v. Levinson, 831 F.2d 1292, 1295 (7th Cir. 1987). "Fraud" for purposes of § 523(a) (4) refers to intentional "positive fraud, involving moral terpitude." In re Peters, 90 B.R. 588, 605 (Bankr. N.D.N.Y. 1988). In contrast, "defalcation" does not require evidence of any intentional wrong doing by the debtor. In re Smith, 72 B.R. 61, 63 (N.D. Iowa 1987). Defalcation is broadly defined to include the failure of a fiduciary to account for money he received in his fiduciary capacity, In re Gans, 75 B.R. 474, 490 (Bankr. S.D.N.Y. 1987); In re Waters, 20 B.R. 277, 280 (Bankr. W.D. Tex. 1982). Simple negligence or ignorance may constitute defalcation. Smith, 72 B.R. at 63. In fact, it is not even necessary that the debtor have benefited from such acts. Id.

According to the Court of Appeals for the Eighth Circuit, the standard of proof for fraud in a § 523(a) objection is "clear and convincing evidence." See Henson v. Garner (In re Garner), 881 F.2d 579 (8th Cir. 1989), cert. granted U.S. , 110 S.Ct. 1945, 109 L.Ed.2d 308 (1990). In some courts, proof of defalcation by a fiduciary is measured by a preponderance of the evidence. In re Peters, 90 B.R. at 605; In re Oot, 112 B.R. 497, 500 (Bankr. N.D.N.Y. 1989). At least one jurisdiction has added the further twist of requiring the creditor prove the existence of a fiduciary relationship by clear and convincing evidence while any resulting act of defalcation need only be proven by a preponderance of evidence. In re Feldman, 111 B.R. 481, 485 (Bankr. E.D. Pa. 1990); In re Bergman, 103 B.R. 660 (Bankr. E.D. Pa. 1989).

In contrast, the "overwhelming majority of bankruptcy courts" apply the clear and convincing standard in all dischargeability proceedings. In re Braen, 94 B.R. 35, 39 (D. N.J. 1988); Billings, 94 B.R. at 810. This majority position also includes courts specifically addressing § 523(a)(4) objections. Matter of Bogstad, 779 F.2d 370, 372 (7th Cir. 1985); In re Sawyer, 112 B.R. 386 (D. Colo. 1990); Matter of Michel, 74 B.R. 88 (N.D. Ohio 1986); In re Wightman, 36 B.R. 246 (D. N.D. 1984). The reasoning supporting the majority position holds that the clear and convincing standard best effectuates the Bankruptcy Code's general policy of providing a debtor the opportunity for a "fresh

start." Garner, 881 F.2d at 582; Matter of Van Horne, 823 F.2d 1285 (8th Cir. 1987); American Honda Finance Corp., 77 B.R. at 215.

The U.S. District Court for the Northern District of Iowa in a recent bankruptcy decision applied the "clear and convincing" standard to an exception to discharge based upon defalcation by a fiduciary under 11 U.S.C. § 523(a)(4). Benson, et al. v. Richardson (In re Richardson), No. 87-0221-M, slip op. at 156 (N.D. Iowa, July 16, 1990). Since the standard of proof used by the state court was preponderance of the evidence, the doctrine of collateral estoppel is not applicable to Dunbar's § 523 (a)(4) objection.

The court concludes the requisites for the application of collateral estoppel have not been satisfied by Dunbar. Accordingly, Dunbar's Motion for Summary Judgment should be denied.

ORDER

IT IS ORDERED that plaintiff's Motion for Summary Judgment is denied.

SO ORDERED ON THIS 26th DAY OF DECEMBER, 1990.

William L. Edmonds
Bankruptcy Judge