

**UNITED STATES BANKRUPTCY COURT
DISTRICT OF NEW HAMPSHIRE**

In re:

Bk. No. 00-10021-JMD
Chapter 7

Edward E. Flanagan,
Debtor

Yvette Flanagan,
Plaintiff

v.

Adv. No. 00-1042-JMD

Edward E. Flanagan,
Defendant

MEMORANDUM OPINION

I. INTRODUCTION

The Court has before it a complaint filed by Yvette Flanagan, the Debtor's former spouse, seeking to except from discharge pursuant to 11 U.S.C. §§ 523(a)(4), (a)(5), (a)(6), and/or (a)(15) certain debts owed by the Debtor. Specifically, Ms. Flanagan seeks to except from discharge pursuant to section 523(a)(5) the Debtor's support obligations to the couple's minor child, including uninsured medical expenses that have been incurred. The Debtor does not contest the non-dischargeability of such obligations. Ms. Flanagan also seeks to except from discharge pursuant to sections 523(a)(4), (a)(5), (a)(6), and/or (a)(15) the Debtor's obligation to pay Ms. Flanagan the sum of \$14,330, which is one-half of a worker's compensation award made to the Debtor during the course of the parties' divorce.

This Court has jurisdiction of the subject matter and the parties pursuant to 28 U.S.C. §§ 1334 and 157(a) and the "Standing Order of Referral of Title 11 Proceedings to the United States Bankruptcy Court for the District of New Hampshire," dated January 18, 1994 (DiClerico, C.J.). This is a core proceeding in accordance with 28 U.S.C. § 157(b).

II. FACTS

The Debtor and Ms. Flanagan were married in 1995. On May 1, 1998, Ms. Flanagan filed a petition for divorce. In her petition, Ms. Flanagan noted that the Debtor had been offered a lump sum settlement award from his worker's compensation insurer for a work-related injury sustained during the marriage. On August 3, 1998, the Family Division of the Superior Court (the "Divorce Court") issued a temporary decree which required the Debtor to execute an authorization allowing Ms. Flanagan's attorney to speak to the Debtor's worker's compensation attorney and to review the records and medical reports relevant to his worker's compensation claim. In addition, the Divorce Court ordered that "[a]ny lump sum proceeds shall be held in escrow."

On or about September 11, 1998, Ms. Flanagan filed a motion to compel the Debtor to produce executed authorizations allowing the release of his worker's compensation records from the State of Florida, where his claim was pending, and from his medical providers and employers. On September 17, 1998, the Divorce Court granted Ms. Flanagan's motion. The Debtor failed to provide the authorizations as ordered and, on or about October 21, 1998, Ms. Flanagan filed a motion for contempt. Ms. Flanagan moved to postpone the contempt hearing scheduled for December 1, 1998 because the Debtor and Ms. Flanagan were trying to reconcile and the Debtor had allegedly promised to turnover half of his worker's compensation award to Ms. Flanagan.

The Debtor received a lump sum payment in the amount of \$28,660 on December 21, 1998. On December 29, 1998, Ms. Flanagan filed a verified ex parte motion for contempt indicating that, despite his receipt of the lump sum worker's compensation award, the Debtor had not paid any of the proceeds to Ms. Flanagan or her attorney.

On December 30, 1998, the Divorce Court issued an order requiring the Debtor to (1) account for all worker's compensation monies received, (2) sign all authorizations as previously ordered, and (3) deposit all funds from his worker's compensation with Ms. Flanagan's attorney who was required to place said money in an escrow account pending final hearing. The Divorce Court held a hearing on the motion on

January 6, 1999, at which the Debtor appeared pro se, and issued an order requiring the Debtor to account for the funds, by affidavit, no later than February 8, 1999. The Divorce Court also ordered that “[a]ll remaining monies shall be held in escrow, by wife’s attorney, pending final resolution of this matter.”

On April 15, 1999, the Divorce Court issued its final decree. In paragraph 14 of the decree, the Divorce Court award Ms. Flanagan one-half of the worker’s compensation lump sum award paid to the Debtor in December 1998. The decree stated further that “[u]nless the husband is able to show proof that he gave the wife \$14,000, this will be considered unpaid.”¹ Ms. Flanagan alleges that the Debtor’s obligation to pay her one-half of the award remains unsatisfied.

III. DISCUSSION

Ms. Flanagan seeks to have three debts excepted from discharge: (1) the Debtor’s obligation to pay child support; (2) the Debtor’s obligation to pay his daughter’s uninsured medical expenses; and (3) the Debtor’s obligation to pay Ms. Flanagan her one-half share of the worker’s compensation award.

A. Child Support

Ms. Flanagan alleges, and the Debtor does not contest, that the Debtor’s obligation to pay child support is non-dischargeable pursuant to section 523(a)(5) of the Bankruptcy Code. Section 523(a)(5) provides in relevant part:

A discharge under section 727 . . . of this title does not discharge an individual debtor from any debt—

(5) to a spouse, former spouse, or child of the debtor, for alimony to, maintenance for, or support of such spouse or child, in connection with a separation agreement, divorce decree or other order of a court of record . . . , but not to the extent that—

(A) such debt is assigned to another entity . . . ; or

(B) such debt includes a liability designated as alimony, maintenance or support, unless such liability is actually in the nature of alimony, maintenance or support.

¹ The Debtor has alleged that he paid Ms. Flanagan \$14,000 but, for purposes of this hearing, the Debtor did not contest that issue. The Debtor believed that he was bound by the doctrine of collateral estoppel because the Debtor failed to file an affidavit with the Divorce Court and did not otherwise challenge the issue there.

11 U.S.C. § 523(a)(5). As the child support award was actually in the nature of support, the Court finds the Debtor's support obligation non-dischargeable under section 523(a)(5).

B. Medical Expenses

Ms. Flanagan also alleges that the Debtor's obligation to pay his daughter's uninsured medical expenses is non-dischargeable pursuant to section 523(a)(5). Again, the Debtor does not contest the dischargeability of this debt. Accordingly, the Court holds the Debtor's obligation to pay uninsured medical expenses shall be excepted from discharge.

C. Worker's Compensation Award

Ms. Flanagan contends that the Debtor's obligation to pay her one-half of the lump sum worker's compensation award should be excepted from discharge pursuant to sections 523(a)(4), (a)(5), (a)(6), and/or (a)(15) of the Bankruptcy Code. The Debtor argues that this debt should be deemed dischargeable.

1. Section 523(a)(4)

Section 523(a)(4) of the Bankruptcy Code provides an exception from discharge for debts "for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny." 11 U.S.C. § 523(a)(4). Under the statute, there are four ways to establish non-dischargeability pursuant section 523(a)(4); the plaintiff can establish² either: (1) fraud while acting in a fiduciary capacity; (2) defalcation while acting in a fiduciary capacity; (3) embezzlement; or (4) larceny. Ms. Flanagan argues that the debt is non-dischargeable under all of these theories except larceny.

a. Fraud While Acting in a Fiduciary Capacity

"Fraud" for purposes of section 523(a)(4) has "generally been interpreted as involving intentional deceit, rather than implied or constructive fraud." 4 Collier on Bankruptcy at ¶ 523.10[1][a] (15th rev. ed.

² The burden of proving each element of under the statute rests with the party contesting the dischargeability of the debt. See Palmacci v. Umpierrez, 121 F.3d 781, 786 (1st Cir. 1997). The standard of proving each element is by a preponderance of the evidence. See Grogan v. Garner, 498 U.S. 279, 283 (1991); Reilly v. Beeman (In re Beeman), 225 B.R. 522, 525 (Bankr. D.N.H. 1998); Office of Public Guardian v. Messineo (In re Messineo), 192 B.R. 597, 599 (Bankr. D.N.H. 1996).

1998). “Fiduciary” as used in section 523(a)(4) “is limited to the class of fiduciaries including trustees of specific written declarations of trusts, guardians, administrators, executors, or public officers.” BAMCO 18 v. Reeves (In re Reeves), 124 B.R. 5, 9 (Bankr. D.N.H. 1990); see also Peerless Ins. v. Swanson (In re Swanson), 231 B.R. 145, 148 (Bankr. D.N.H. 1999). The definition of “fiduciary” is limited to a relationship involving either an express or technical trust and not trusts that are imposed by law as a remedy. See Swanson, 231 B.R. at 148; Collenge v. Runge (In re Runge), 226 B.R. 298, 304 (Bankr. D.N.H. 1998); Beeman, 225 B.R. at 525; Office of Public Guardian, 192 B.R. at 600; Reeves, 124 B.R. at 7. In other words, section 523(a)(4) “is aimed only at the express trust situation in which the debtor either expressly signified his intention at the outset of the transaction, or was clearly put on notice by some document in existence at the outset, that he was undertaking the special responsibilities of a trustee to account for his actions over and above the normal obligations that contracting parties have to each other in a commercial transaction.” Reeves, 124 B.R. at 10; see also Beeman, 225 B.R. at 525; Office of Public Guardian, 192 B.R. at 601; Ducey v. Doherty (In re Ducey), 160 B.R. 465, 469 (Bankr. D.N.H. 1993).

In this case, the Divorce Court did not designate the Debtor as a trustee nor did it establish an express or technical trust prior to any alleged breach of fiduciary duty by the Debtor. Rather, on August 3, 1998, the Divorce Court simply ordered the Debtor to execute authorizations and hold the worker’s compensation award “in escrow” upon its receipt. The Divorce Court, however, did not explain who should hold the funds in escrow. On December 30, 1998, the Divorce Court ordered the Debtor to deposit his worker’s compensation award with Ms. Flanagan’s attorney, who would place the money in escrow, pending a final hearing. Taking these two orders together, the Court is unable to find that the Debtor undertook any fiduciary duties with respect to the worker’s compensation award. “Moreover, it is also well established as a general rule, that the exception to discharge in Section 523(a)(4) has no application to controversies relating to property settlement agreements arising out of a divorce proceeding.” Pattie v. Pattie (In re Pattie), 108 B.R. 791, 797 (Bankr. D. Bankr. M.D. Fla. 1989). See also Sculler v. Rosen (In re Rosen), 232 B.R. 284, 296 (Bankr. E.D.N.Y. 1999) (noting that “courts have held that there is no

fiduciary relationship necessarily found between two divorcing spouses” and holding that the obligations imposed on a debtor pursuant to the terms of his divorce decree to provide his former wife with an accounting of whatever monies he removed their daughter’s bat mitzvah fund was not in the nature of an “express trust” of the kind required under section 523(a)(4) in order to except the debtor’s resulting obligation, for failing to properly account for these funds, from discharge in bankruptcy); Lanker v. Wheeler (In re Wheeler), 101 B.R. 39, 46-47 (Bankr. N.D. Ind. 1989) (“The court agrees that as a general rule, § 523(a)(4)’s fiduciary relationship should not apply in connection with a property settlement agreement and a divorce decree. Obligations other than maintenance, alimony, or support should only be excepted from discharge as fiduciary obligations where the intent of the parties at the time of the agreement was to establish a fiduciary relationship.”). As one court has explained, in situations of divorce, “one person must necessarily be in control of some property that must be given to the other when dividing up their assets.” Rosen, 232 B.R. at 298-97. This does not make the spouse in control of the property a fiduciary within the meaning of section 523(a)(4). For this reason, Ms. Flanagan cannot establish that the Debtor’s obligation was for fraud “while acting in a fiduciary capacity.”

b. Defalcation While Acting in a Fiduciary Capacity

Ms. Flanagan argues that the Debtor’s obligation should be excepted from discharge as a debt “for defalcation while acting in a fiduciary capacity.” “Defalcation” is defined as “a failure to observe clear and specific restrictions and limitation upon the fiduciary in either the trust document or the applicable statutory law and does not require as an element therefore some sort of bad faith on the part of the fiduciary [Defalcation also] includes innocent as well as intentional or negligent default so as to reach the conduct of all fiduciaries who are short in their accounts.” Swanson, 231 B.R. at 148; Beeman, 225 B.R. at 525; Office of Public Guardian, 192 B.R. at 601; Ducey, 160 B.R. at 468. In order to prove defalcation, the plaintiff must show that the “fiduciary failed to return property or account for same, even though no fraud, embezzlement, or even misappropriation on the party of the fiduciary is shown.” See Swanson, 231 B.R. at 149; Beeman, 225 B.R. at 525; Ducey, 160 B.R. at 468; Reeves, 124 B.R. at 6. In this case, Ms. Flanagan

cannot establish that the debt is for “defalcation while acting in a fiduciary capacity” because the Debtor was not acting as a “fiduciary” for the reasons outlined above.

c. Embezzlement

Ms. Flanagan also claims that the Debtor’s obligation is non-dischargeable under section 523(a)(4) as a debt for embezzlement. Ms. Flanagan argues that the Debtor fraudulently appropriated her share of the worker’s compensation award in contravention of the Divorce Court’s orders. Embezzlement under section 523(a)(4) is defined as “the fraudulent appropriation of property by a person to whom such property has been entrusted, or [into] whose hands it has lawfully come.” Rountrey v. Lee (In re Lee), 90 B.R. 202, 208 (Bankr. E.D. Va. 1988) (citing Commonwealth of Virginia Comm’n of Game and Inland Fisheries v. Myers (In re Myers), 52 B.R. 901, 905 (Bankr. E.D. Va. 1985) and Moore v. United States, 160 U.S. 268 (1985)). See also Russell v. Russell (In re Russell), 141 B.R. 107, 110 (Bankr. W.D. La. 1992); Collier at ¶ 523.10[2]. Unlike the first two grounds for non-dischargeability under section 523(a)(4), there is no prerequisite fiduciary duty to the creditor for an exception to discharge for embezzlement. See Russell, 141 B.R. at 110.

Ms. Flanagan has established that in May 1998 the Debtor was put on notice that she claimed an interest in any worker’s compensation award that the Debtor might receive. On August 3, 1998, the Divorce Court ordered the Debtor to execute authorizations so that Ms. Flanagan’s attorney could speak to the Debtor’s worker’s compensation attorney and review relevant medical reports. The Debtor was also put on notice by the Divorce Court’s order that Ms. Flanagan had an interest in any lump sum award that he

might receive.³ The Debtor admitted that he was aware that his use of any award was restricted because of his wife's claim to some of the proceeds.

Despite being ordered to execute the authorizations, which would permit Ms. Flanagan's attorney to investigate the Debtor's claim and put the insurance carrier on notice of Ms. Flanagan's interest in the money, the Debtor repeatedly failed to execute the authorizations. It is undisputed that the Debtor failed to comply with the Divorce Court's orders dated August 3, 1998 and September 17, 1998 regarding execution of the documents.

The Debtor received an award of \$28,660 on December 21, 1998. Despite the Divorce Court's order dated August 3, 1998 that the money should be placed "in escrow," the Debtor failed to do so. On December 30, 1998, the Divorce Court ordered the Debtor to sign the authorizations, account for all worker's compensation monies received, and deposit the award with Ms. Flanagan's attorney. The Debtor failed to do so. On January 6, 1999, the Divorce Court held a hearing at which time it ordered the Debtor to account for all funds by February 8, 1999 and to turn over any remaining monies to Ms. Flanagan's attorney, to be held in escrow pending a final resolution of the matter. Again, the Debtor failed to comply with the Divorce Court's order.

On April 15, 1999, the Divorce Court issued a final decree awarding Ms. Flanagan one-half of the \$28,660 worker's compensation award. The decree further indicated that the amount would be considered unpaid unless the Debtor provided proof that he gave Ms. Flanagan \$14,000, as he alleged. Again, the Debtor failed to comply with the court's order demanding proof of payment.

³ Pursuant to state statute, a couple's marital estate includes "all tangible and intangible property and assets, real or personal, belonging to either or both parties, whether title to the property is held in the name of either or both parties." RSA 458:16-a, I. The New Hampshire Supreme Court has held that pending a final decree a spouse possesses an equitable and legal interest in property within the marital estate. Bursey v. Town of Hudson, 143 N.H. 42 (1998). Accordingly, Ms. Flanagan had a protectable interest in the Debtor's worker's compensation award.

Taking these facts together, the Court finds sufficient evidence to establish non-dischargeability under section 523(a)(4) for the Debtor's fraudulent appropriation of property in his lawful possession, in which Ms. Flanagan had a legally protectable property interest. The Debtor offered no explanation for why he failed to turn over one-half of the worker's compensation award to his former spouse. The Court can infer from the Debtor's conduct during the period of the parties' divorce that he willfully and intentionally failed to cooperate in providing Ms. Flanagan with access to his worker's compensation records, and more importantly, in turning over her one-half share of the award. The Court finds the Debtor's actions come within the meaning of embezzlement under the Bankruptcy Code.

The Court finds support for its ruling in several cases. In Garza v. Garza (In re Garza), 217 B.R. 197 (Bankr. N.D. Tex. 1998), the couple's divorce decree ordered the debtor to pay his former wife a portion of any settlement or judgment he received from a pending lawsuit. Specifically, the debtor was ordered to pay his former wife fifty percent of the first \$50,000 recovered and sixty percent of the second \$50,000 recovered. When the debtor obtained a \$100,000 recovery, he paid \$38,250 to his lawyers and nothing to his former wife. The debtor retained the balance of the proceeds.

In proceedings before the divorce court, the court held that the debtor was aware of the court's prior rulings and findings that his former wife was awarded a percentage of his recovery and that he was to deliver to his former wife her share immediately upon receipt. The court further held that the debtor intentionally, willfully, and fraudulently refused to deliver the property awarded to his former wife in violation of the court's prior oral ruling.

In an adversary proceeding determining dischargeability of the debtor's obligation, the bankruptcy court ruled that the debtor was collaterally estopped from challenging the divorce court's findings. Based on the divorce court's rulings, the bankruptcy court held that the debtor's obligation to his former wife was non-dischargeable under section 523(a)(4) as a debt for embezzlement as the embezzlement issue was identical to the one involved in the prior action, the issue was actually litigated, and the divorce court's finding was a necessary part of its order.

In Rountrey v. Lee (In re Lee), 90 B.R. 202 (Bankr. E.D. Va. 1988), the bankruptcy court held that the debtor willfully, fraudulently, and intentionally converted the plaintiff's portion of a bonus to his own use despite his knowledge that he was obligated to pay it to the plaintiff and despite an outstanding state court order requiring him to turn it over. The bankruptcy court held that these facts supported a determination that the portion of the debt concerning the debtor's conversion of the bonus was non-dischargeable under section 523(a)(4).

In Russell v. Russell (In re Russell), 141 B.R. 107 (Bankr. W.D. La. 1992), the bankruptcy court held that the debtor's obligation to pay his wife a portion of his retirement was non-dischargeable. While the debtor had lawful possession of the funds, he fraudulently misused them for his own purposes in violation of a state court judgment. Because the debtor appropriated his former wife's property to his own use, the court found the resulting debt non-dischargeable under section 523(a)(4). See also Meis v. Meis (In re Meis), 200 B.R. 166, 170 (Bankr. N.D. Ohio 1996) (excepting from discharge under section 523(a)(4) the debtor's obligation to repay funds she embezzled from her mother-in-law and transferred to her own bank account).

Because the Court finds that the Debtor fraudulently failed to turn over Ms. Flanagan's share of the worker's compensation award and instead retained the money for his own use, in direct contravention of the Divorce Court's orders to place the funds in escrow with Ms. Flanagan's attorney pending a final property settlement in their divorce, the Debtor's obligation to pay Ms. Flanagan \$14,330, her one-half share of the award, is hereby deemed non-dischargeable under section 523(a)(4) of the Bankruptcy Code.

2. Sections 523(a)(5), (a)(6), and (a)(15)

Ms. Flanagan has also alleged that the Debtor's obligation to pay her one-half of the worker's compensation award is non-dischargeable pursuant to section 523(a)(6) as a debt "for willful and malicious injury by the debtor to another entity or to the property of another entity," pursuant to section 523(a)(5) as a debt "for alimony, maintenance, and support," and/or pursuant to section 523(a)(15) as a property settlement that the Debtor has the ability to pay and the discharge of which would be more detrimental to Ms. Flanagan than beneficial to the Debtor. Because the Court has ruled that the Debtor's obligation is excepted from discharge under section 523(a)(4), the Court need not address Ms. Flanagan's other contentions.

IV. CONCLUSION

For the reasons stated above, the Court holds that the Debtor's obligations to pay child support and to pay uninsured medical expenses are non-dischargeable under section 523(a)(5) of the Bankruptcy Code. The Debtor's obligation to pay one-half of his lump sum worker's compensation award to Ms. Flanagan is non-dischargeable under section 523(a)(4).

This opinion constitutes the Court's findings of fact and conclusions of law in accordance with Federal Rule of Bankruptcy Procedure 7052. The Court will issue a separate judgment consistent with this opinion.

DATED this 1st day of December, 2000, at Manchester, New Hampshire.

J. Michael Deasy
Bankruptcy Judge