United States Bankruptcy Court
Northern District of Illinois
Eastern Division

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Bankruptcy Caption: In re Hugh Barrett Schlenk

Bankruptcy No. 02 B 00264

Adversary Caption: Anthony Bruno v. Hugh Barrett Schlenk

Adversary No. 02 A 01021

Date of Issuance: April 17, 2003

Judge: John H. Squires

Appearance of Counsel:

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UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

IN RE	)	
HUGH BARRETT SCHLENK,	)	Chapter 7
	)	Bankruptcy No. 02 B 00264
Debtor.	)	Judge John H. Squires
	)	
	)	
ANTHONY BRUNO,	)	
	)	
Plaintiff,	)	
	)	
v.	)	Adversary No. 02 A 01021
	)	
HUGH BARRETT SCHLENK,	)	
	)	
Defendant.	)	

MEMORANDUM OPINION

This matter comes before the Court on the motion of Anthony J. Bruno (the "Creditor") for summary judgment pursuant to Federal Rule of Civil Procedure 56 and Federal Rule of Bankruptcy Procedure 7056 on the complaint he filed against the debtor, Hugh Barrett Schlenk (the "Debtor"), to determine the dischargeability of a debt under 11 U.S.C. § 523(a)(4). For the reasons set forth herein, the Court grants the motion. The Court finds that the debt owed by the Debtor to the Creditor for the Debtor's failure to make an accounting, as trustee of the Helene D. Bruno Family Trust, to the Creditor, as a beneficiary thereof, constitutes a defalcation under § 523(a)(4), and thus, is non-dischargeable.

I. JURISDICTION AND PROCEDURE

The Court has jurisdiction to entertain this matter pursuant to 28 U.S.C. § 1334 and Internal Operating Procedure 15(a) of the United States District Court for the Northern District of Illinois. It is a core proceeding under 28 U.S.C. § 157(b)(2)(I).

II. APPLICABLE STANDARDS

In order to prevail on a motion for summary judgment, the movant must meet the statutory criteria set forth in Rule 56 of the Federal Rules of Civil Procedure, made applicable to adversary proceedings by Federal Rule of Bankruptcy Procedure 7056. Rule 56(c) reads in part:

> [T]he judgment sought shall be rendered forthwith if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law.

Fed. R. Civ. P. 56(c). See also Dugan v. Smerwick Sewerage Co., 142 F.3d 398, 402 (7th Cir. 1998). The primary purpose for granting a summary judgment motion is to avoid unnecessary trials when there is no genuine issue of material fact in dispute. Trautvetter v. Quick, 916 F.2d 1140, 1147 (7th Cir. 1990); Farries v. Stanadyne/Chicago Div., 832 F.2d 374, 378 (7th Cir. 1987) (quoting Wainwright Bank & Trust Co. v. Railroadmen's Federal Sav. & Loan Ass'n of Indianapolis, 806 F.2d 146, 149 (7th Cir. 1986)). Where the material facts are not in dispute, the sole issue is whether the moving party is entitled to a judgment

as a matter of law. ANR Advance Transp. Co. v. International Bhd. of Teamsters, Local 710, 153 F.3d 774, 777 (7th Cir. 1998).

In 1986, the United States Supreme Court decided a trilogy of cases that encourages the use of summary judgment as a means to dispose of factually unsupported claims. Anderson v. Liberty Lobby, Inc., 477 U.S. 242 (1986); Matsushita Electric Indus. Co., Ltd. v. Zenith Radio Corp., 475 U.S. 574 (1986); Celotex Corp. v. Catrett, 477 U.S. 317 (1986). The burden is on the moving party to show that no genuine issue of material fact is in dispute. Anderson, 477 U.S. at 248; Matsushita, 475 U.S. at 585-86; Celotex, 477 U.S. at 322.

All reasonable inferences drawn from the underlying facts must be viewed in a light most favorable to the party opposing the motion. Parkins v. Civil Constructors of Ill., Inc., 163 F.3d 1027, 1032 (7th Cir. 1998). The existence of a material factual dispute is sufficient only if the disputed fact is determinative of the outcome under applicable law. Anderson, 477 U.S. at 248; Frey v. Fraser Yachts, 29 F.3d 1153, 1156 (7th Cir. 1994). "Summary judgment is not an appropriate occasion for weighing the evidence; rather the inquiry is limited to determining if there is a genuine issue for trial." Lohorn v. Michal, 913 F.2d 327, 331 (7th Cir. 1990). The Seventh Circuit has noted that trial courts must remain sensitive to fact issues where they are actually demonstrated to warrant denial of summary judgment. Opp v. Wheaton, 231 F.3d 1060 (7th Cir. 2000); Szymanski v. Rite-way, 231 F.3d 360 (7th Cir. 2000).

The party seeking summary judgment always bears the initial responsibility of informing the Court of the basis for its motion, identifying those portions of the "pleadings, depositions, answers to interrogatories, and affidavits, if any," which it believes demonstrates the absence of a genuine issue of material fact. Celotex, 477 U.S. at 323. Once the motion is supported by a prima facie showing that the moving party is entitled to judgment as a matter of law, a party opposing the motion may not rest upon the mere allegations or denials in its pleadings, rather its response must show that there is a genuine issue for trial. Anderson, 477 U.S. at 248; Celotex, 477 U.S. at 323; Matsushita, 475 U.S. at 587; Patrick v. Jasper County, 901 F.2d 561, 564-566 (7th Cir. 1990). The manner in which this showing can be made depends upon which party will bear the burden of persuasion at trial. If the burden of persuasion at trial would be on the non-moving party, the party moving for summary judgment may satisfy Rule 56's burden of production by either submitting affirmative evidence that negates an essential element of the non-moving party's claim, or by demonstrating that the non-moving party's evidence is insufficient to establish an essential element of the non-moving party's claim. See Union Nat'l Bank of Marseilles v. Leigh (In re Leigh), 165 B.R. 203, 212-13 (Bankr. N.D. Ill. 1993) (citation omitted).

Local Bankruptcy Rule 402.M of the Local Bankruptcy Rules for the United States Bankruptcy Court for the Northern District of Illinois, which deals with summary judgment motions, was modeled after LR56.1 of the Local Rules of the United States District Court for the Northern District of Illinois. Hence, the case law construing LR56.1 and its predecessor Local Rule 12(M) applies to Local Bankruptcy Rule 402.M.

Pursuant to Local Bankruptcy Rule 402, a motion for summary judgment imposes special procedural burdens on the parties. Specifically, Rule 402.M requires the moving party to supplement its motion and supporting memorandum with a statement of undisputed material facts ("402.M statement"). The 402.M statement "shall consist of short numbered paragraphs, including within each paragraph specific references to the affidavits, parts of the record, and other supporting materials relied upon to support the facts set forth in that paragraph. Failure to submit such a statement constitutes grounds for denial of the motion." Id.

The Creditor filed a 402.M statement that partially complies with the requirements of Rule 402.M. It contains numbered paragraphs setting out uncontested facts with specific references to parts of the record.

The party opposing a summary judgment motion is required by Local Rule 402.N to respond ("402.N statement") to the movant's 402.M statement, paragraph by paragraph, and to set forth any material facts that would require denial of summary judgment, specifically referring to the record for support of each denial of fact. Local Bankr. R. 402.N. The opposing party is required to respond "to each numbered paragraph in the moving party's statement" and make "specific references to the affidavits, parts of the record, and other supporting materials relied upon." Local Bankr. R. 402.N(3)(a). Most importantly, "[a]ll material facts set forth in the [402.M] statement required of the moving party will be deemed to be admitted unless controverted by the statement of the opposing party." Local Bankr. R. 402.N(3)(b).

The Debtor has not filed a 402.N statement within the time allotted by the Court. The

Seventh Circuit has upheld strict application of local rules regarding motions for summary judgment. See Dade v. Sherwin-Williams Co., 128 F.3d 1135, 1140 (7th Cir. 1997); Feliberty v. Kemper Corp., 98 F.3d 274, 277-78 (7th Cir. 1996); Bourne Co. v. Hunter Country Club, Inc., 990 F.2d 934, 938 (7th Cir.), cert. denied, 510 U.S. 916 (1993); Schulz v. Serfilco, Ltd., 965 F.2d 516, 519 (7th Cir. 1992); Maksym v. Loesch, 937 F.2d 1237, 1240-41 (7th Cir. 1991).

Local Bankruptcy Rules 402.M and 402.N are patterned after and substantially similar to Local District Court Rules 56.1(a) and 56.1(b). The precedents decided about the latter are instructive and applicable to the former. Compliance with Local Rules 402.M and 402.N is not a mere technicality. Courts rely greatly upon the information presented in these statements in separating the facts about which there is a genuine dispute from those about which there is none. American Ins. Co. v. Meyer Steel Drum, Inc., 1990 WL 92882 at *7 (N.D. Ill. June 27, 1990). The statements required by Rule 402 are not merely superfluous abstracts of evidence. Rather, they "are intended to alert the court to precisely what factual questions are in dispute and point the court to specific evidence in the record that supports a party's position on each of these questions. They are, in short, roadmaps, and without them the court should not have to proceed further, regardless of how readily it might be able to distill the relevant information on its own." Waldridge v. American Hoechst Corp., 24 F.3d 918, 921 (7th Cir. 1994). Because the Debtor failed to comply with Rule 402.N, all material facts set forth in the Creditor's 402.M statement are deemed admitted.

III. FACTS AND BACKGROUND

The following facts are deemed admitted and were extracted from the Creditor's 402.M statement as well as the complaint and answer thereto. On February 20, 1997 in a document entitled "Fifth Amendment to the Helene D. Bruno Family Trust Dated February 20, 1997 Declaration of Trust" (the "Bruno Family Trust"), the Debtor was named as a beneficiary of the Bruno Family Trust as well as successor trustee thereof. See Exhibit A to the Complaint. The Creditor is also a beneficiary of the Bruno Family Trust. Id.

On March 31, 1998, the Creditor commenced an action for an accounting against the Debtor individually and as trustee of the Bruno Family Trust in the Circuit Court of DuPage County, Illinois (the "State Court Complaint"). See Exhibit A to Creditor's Rule 402.M statement. On July 30, 1999, the state court entered an order which provided in pertinent part that "[the Debtor] shall provide an accounting in accordance with 760 ILCS 5/11 by October 1, 1999." Subsequently, the Debtor filed an accounting.

Thereafter, on February 16, 2000, that accounting was found to be insufficient by the state court. See Exhibit B to Creditor's Rule 402.M statement. The state court appointed the Public Guardian for DuPage County, Illinois as the successor trustee and removed the Debtor as trustee. Id. On October 15, 2001, the Public Guardian resigned as successor trustee and an agreed order was entered allowing his resignation. See Exhibit C to Creditor's Rule 402.M statement. This October 15, 2001 order further appointed the Debtor successor trustee and required him to render an accounting of the Bruno Family Trust within sixty days pursuant to 760 ILCS 5/11. Id. The Debtor has failed to render any accounting of the Bruno Family Trust

within the prescribed time frame as required by the October 15, 2001 state court order.

The Debtor filed a voluntary Chapter 7 petition on January 3, 2002. On June 17, 2002, the Court lifted the automatic stay on the Creditor's motion with respect to the pending State Court Complaint to allow the Creditor's action for an accounting against the Debtor to proceed in the state court. The State Court Complaint remains pending and undetermined.

The Creditor commenced this adversary proceeding against the Debtor on July 23, 2002. The Creditor alleges that the Debtor's failure to account for estate funds of the Bruno Family Trust while acting as a fiduciary constitutes a defalcation under § 523(a)(4), and thus, the debt should be held non-dischargeable. This adversary proceeding was set for trial on March 21, 2003. On March 14, 2003, the Court struck the trial date based on the stipulation of the parties that the matter be heard on the basis of the instant summary judgment motion.

IV. DISCUSSION

A. Standards for Dischargeability in the Seventh Circuit

The party seeking to establish an exception to the discharge of a debt bears the burden of proof. In re Harasymiw, 895 F.2d 1170, 1172 (7th Cir. 1990); Banner Oil Co. v. Bryson (In re Bryson), 187 B.R. 939, 961 (Bankr. N.D. Ill. 1995). The United States Supreme Court has held that the burden of proof required to establish an exception to discharge is a preponderance of the evidence. Grogan v. Garner, 498 U.S. 279, 291 (1991). See also In re McFarland, 84 F.3d 943, 946 (7th Cir.), cert. denied, 519 U.S. 931 (1996); In re Thirtyacre,

36 F.3d 697, 700 (7th Cir. 1994). To further the policy of providing a debtor a fresh start in bankruptcy, "exceptions to discharge are to be construed strictly against a creditor and liberally in favor of a debtor." In re Scarlata, 979 F.2d 521, 524 (7th Cir. 1992) (quoting In re Zarzynski, 771 F.2d 304, 306 (7th Cir. 1985)). Accord In re Morris, 223 F.3d 548, 552 (7th Cir. 2000); In re Reines, 142 F.3d 970, 972-73 (7th Cir. 1998), cert. denied, 525 U.S. 1068 (1999).

B. 11 U.S.C. § 523(a)(4)

Section 523(a)(4) of the Bankruptcy Code provides that a debtor cannot discharge any debt "for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny." 11 U.S.C. § 523(a)(4). In order for the Creditor to prevail under § 523(a)(4), he must prove that the Debtor committed (1) fraud or defalcation while acting as a fiduciary; or (2) embezzlement; or (3) larceny. The Creditor does not allege that the Debtor's actions constituted embezzlement or larceny. Moreover, the Creditor does not argue the alternative fraud theory under the first prong of § 523(a)(4).

To establish that a debt is non-dischargeable for reason of defalcation while acting in a fiduciary capacity, the Creditor must establish, by a preponderance of the evidence, the existence of an express trust or fiduciary relation, and a debt caused by the Debtor's defalcation while acting as a fiduciary. Grogan, 498 U.S. at 291; In re Woldman, 92 F.3d 546, 547 (7th Cir. 1996). A threshold inquiry is whether a fiduciary obligation runs from the Debtor to the Creditor under the facts of this matter. Whether a debtor was acting in a

fiduciary capacity for purposes of § 523(a)(4) is a question of federal law. In re Bennett, 989 F.2d 779, 784 (5th Cir.), cert. denied, 510 U.S. 1011 (1993).

1. Fiduciary Duty

The first requirement for application of § 523(a)(4) is that a "fiduciary" relationship exists. To qualify under § 523(a)(4), a fiduciary relation must have an existence independent of a debtor's wrongdoing. In re Marchiando, 13 F.3d 1111, 1115-16 (7th Cir.), cert. denied, 512 U.S. 1205 (1994). The hallmark of such a relationship is a:

> difference in knowledge or power between fiduciary and principal which . . . gives the former a position of ascendancy over the latter. The fiduciary may know much more by reason of professional status, or the relation may be one that requires the principal to repose a special confidence in the fiduciary.... These are all situations in which one party to the relation is incapable of monitoring the other's performance of his undertaking, and therefore the law does not treat the relation as a relation at arm's length between equals.

Id. at 1116 (citations omitted). Under Illinois law, a number of relationships can constitute fiduciary relationships: attorney and client, Marchiando, 13 F.3d at 1115; joint venturers or partners, Woldman, 92 F.3d at 547; corporate directors and shareholders, Marchiando, 13 F.3d at 1115; and trustee and beneficiary under an express trust. Id. The latter relationship is undeniably present in this matter.

Under Illinois law, an express trust exists where there is (1) intent to create a trust; (2) definite subject matter or trust property; (3) ascertainable beneficiaries; (4) a trustee; (5) specifications of a trust purpose; and (6) delivery of trust property to the trustee. Yardley v. Yardley, 137 Ill. App.3d 747, 760, 484 N.E.2d 873, 882 (2d Dist. 1985). While fiduciary

relationships may arise outside of express trusts, the mere existence of a state law fiduciary relationship may not be sufficient to except from discharge under § 523(a)(4). Woldman, 92 F.3d at 547. "[O]nly a subset of fiduciary obligations is encompassed by the word 'fiduciary' in section 523(a)(4)." Id. (citation omitted). The Seventh Circuit has made a distinction between a trust or other fiduciary relationship that has "an existence independent of the debtor's wrong and a trust or other fiduciary relation that has no existence before the wrong is committed. A lawyer's fiduciary duty to his client, or a director's duty to his corporation's shareholders, pre-exists any breach of that duty, while in the case of a constructive or resulting trust there is no fiduciary duty until a wrong is committed." Marchiando, 13 F.3d at 1115-16. Constructive, resulting and implied trusts do not fall within the confines of § 523(a)(4). Id. at 1115. The real distinction is that fiduciary relations that impose actual duties in advance of the breach generally involve a difference in knowledge or power between the fiduciary and principal. Generally, to satisfy the Marchiando requirement, the fiduciary must hold a position of ascendancy over the principal. Id. at 1116 (citation omitted).

First, the Creditor must establish, by a preponderance of the evidence, the existence of an express trust or fiduciary relationship between him and the Debtor. The Creditor must also establish that the Debtor was in a fiduciary relation owing him such a level of duties, and not strictly in a debtor-creditor relationship. The Court finds that the undisputed evidence shows that the Debtor was serving as trustee of the Bruno Family Trust when the state court first ordered him to perform an accounting, and is now the successor trustee who has again been ordered to render an accounting. The Creditor is a beneficiary of the Bruno Family Trust.

Hence, there exists an express trust as well as a fiduciary relationship between the Debtor and the Creditor. As the Seventh Circuit Court of Appeals has stated:

> When the bankrupt is a trustee and the creditor a beneficiary of the trust, the balance has been deemed to incline against discharge. Nondischarge becomes another token of the law's imposition of the highest standard of loyalty and care on trustees. In a trust relationship the settlor and beneficiary repose "trust" in a literal sense in the trustee, and the abuse of that trust is considered a serious wrong.

Marchiando, 13 F.3d at 1115. The Court finds that the Creditor has demonstrated the existence of an express trust and a fiduciary relationship based upon the Debtor's status as the trustee of the Bruno Family Trust and the Creditor's status as beneficiary thereof.

2. Defalcation

Next, the Creditor must establish, by a preponderance of the evidence, that the debt was caused by the Debtor's defalcation while acting as a fiduciary. The Creditor alleges that the Debtor's acts constituted defalcation, not fraud. There is no hard and fast definition of "defalcation," the alternative conduct proscribed under the first prong of tortious conduct barred from discharge under § 523(a)(4). The Seventh Circuit, however, has adopted the position, like the Fifth and Sixth Circuits, that mere negligence does not constitute defalcation. Meyer v. Rigdon, 36 F.3d 1375, 1382-85 (7th Cir. 1994) (construing "defalcation" under § 523(a)(11)); In re Johnson, 691 F.2d 249, 255-57 (6th Cir. 1982); Carey Lumber Co. v. Bell, 615 F.2d 370, 375-76 (5th Cir. 1980). The Seventh Circuit has not clearly defined the level of tortious conduct necessary to constitute a defalcation in the context of § 523(a)(4); it has only required something more than a negligent breach of a fiduciary duty. Meyer, 36 F.3d at 1385.

This is something less culpable than intentional fraud. One court has defined defalcation within the context of § 523(a)(4) as "the misappropriation of trust funds held in any fiduciary capacity, and the failure to properly account for such funds." Strube Celery & Vegetable Co., Inc. v. Zois (In re Zois), 201 B.R. 501, 506 (Bankr. N.D. Ill. 1996) (citation omitted). An objective standard is used to determine a defalcation, and intent or bad faith is not required. See Green v. Pawlinski (In re Pawlinski), 170 B.R. 380, 389 (Bankr. N.D. Ill. 1994) (citations omitted).

The Court finds that the Creditor has demonstrated by a preponderance of the evidence that the Debtor initially held trust funds in his fiduciary capacity as trustee of the Bruno Family Trust and currently holds those trust funds in his capacity as successor trustee. Further, the Creditor established that the Debtor has failed to properly account for such funds as ordered by the state court. It is undisputed that initially, when the Debtor was the trustee of the Bruno Family Trust, his accounting was rendered insufficient. After the Public Guardian resigned as successor trustee, the Debtor was appointed successor trustee and the state court entered an order on October 15, 2001 requiring him to file an accounting with sixty days of that order. The Debtor did not comply with that order. Consequently, the Court finds that the Debtor's conduct in initially rendering an insufficient accounting for the Bruno Family Trust and his failure to render an accounting in his capacity as successor trustee, constitutes a defalcation of trust funds held in a fiduciary capacity, and the failure to properly

account for such funds. In short, the Debtor's actions constitute a defalcation for purposes of § 523(a)(4) while acting in a fiduciary capacity as trustee of the Bruno Family Trust.

C. The Debtor's Affirmative Defenses

The Debtor has set forth several affirmative defenses in his answer to the complaint: (1) impossibility of defalcation under the Bruno Family Trust as it was written and administered; (2) statutory shield against liability; and (3) he did not accept the position as successor trustee. The Debtor has failed to set forth any evidence to establish these affirmative defenses on which he has the burden of proof. Hence, merely pleading these defenses without any supporting evidence to establish a prima facie showing that he has property invoked them does not serve to defeat the Debtor's motion for summary judgment.

V. CONCLUSION

For the foregoing reasons, the Court grants the Creditor's motion for summary judgment. The Court finds that the debt owed by the Debtor to the Creditor for the Debtor's failure to make an accounting, as trustee of the Bruno Family Trust, to the Creditor, as a beneficiary thereof, constitutes a defalcation under § 523(a)(4), and thus, is non-dischargeable.

This Opinion constitutes the Court's findings of fact and conclusions of law in accordance with Federal Rule of Bankruptcy Procedure 7052. A separate order shall be entered pursuant to Federal Rule of Bankruptcy Procedure 9021.

ENTERED:

DATE: _____ _____

John H. Squires
United States Bankruptcy Judge

cc: See attached Service List

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

IN RE	)	
HUGH BARRETT SCHLENK,	)	Chapter 7
	)	Bankruptcy No. 02 B 00264
Debtor.	)	Judge John H. Squires
	)	
	)	
ANTHONY BRUNO,	)	
	)	
Plaintiff,	)	
	)	
v.	)	Adversary No. 02 A 01021
	)	
HUGH BARRETT SCHLENK,	)	
	)	
Defendant.	)	

O R D E R

For the reasons set forth in a Memorandum Opinion dated the 17th day of April, 2003, the Court grants the motion of Anthony Bruno for summary judgment. The Court finds that the debt owed by Hugh Barrett Schlenk to Anthony Bruno for his failure to make an accounting, as trustee of the Helene D. Bruno Family Trust, to Anthony Bruno, as a beneficiary thereof, constitutes a defalcation under 11 U.S.C. § 523(a)(4), and thus, is non-dischargeable.

ENTERED:

DATE:_____ _____

John H. Squires
United States Bankruptcy Judge

cc: See attached Service List