

UNITED STATES BANKRUPTCY COURT
DISTRICT OF SOUTH DAKOTA
Western Division

In re:) Bankr. No. 02-50372
)
MICHAEL ALLEN KLEIN) Chapter 7
dba M & M Enterprises)
Soc. Sec. No. 264-37-9624)
)
and)
)
MARYANN KLEIN)
Soc. Sec. No. 261-33-0527)
)
Debtors.)
)
)
PINE LAWN MEMORIAL PARK, INC.) Adv. No. 02-5016
)
Plaintiff,)
)
-vs-) DECISION RE:
) DISCHARGEABILITY OF
MICHAEL ALLEN KLEIN) PLAINTIFF'S PRE-PETITION
) CLAIM
and MARYANN KLEIN)
)
Defendants.)

The matter before the Court is Plaintiff Pine Lawn Memorial Park, Inc.,'s complaint for a determination of the dischargeability of its pre-petition claim against Defendants-Debtors Michael A. Klein and MaryAnn Klein. This is a core proceeding under 28 U.S.C. § 157(b)(2). This Decision and accompanying Order and Judgment shall constitute the Court's findings and conclusions under Fed.R.Bankr.P. 7052. As set forth below, the Court concludes that Plaintiff's claim of \$25,656.67 is nondischargeable under 11 U.S.C. § 523(a)(4).

I.

Michael A. and Mary Ann Klein ("Debtors") filed a Chapter 7 petition. On their schedules, Debtors included Pine Lawn Memorial Park, Inc., ("Pine Lawn") as one of their creditors with an unsecured claim of \$26,000.

Pine Lawn timely commenced an adversary proceeding against Debtors seeking a declaration that the pre-petition claim it holds against them is nondischargeable under either 11 U.S.C. § 523(2)(a) or § 523(a)(4).¹ It argued that Debtors, while acting in their capacities as corporate officers and directors for Pine Lawn, failed to properly account for all corporate and related trust funds coming under their control and fraudulently used some of those funds for personal benefit. In particular, Pine Lawn alleged that Debtors took \$26,000 from Pine Lawn as an advance on commissions for the sale of cemetery plots and related services but that these advances were "unearned, unauthorized, fraudulent, illegal, and a result of fiduciary wrongdoing."

After several delays -- some expected, some unexpected -- a trial was held July 19, 2004. The testimony from three

¹ An amended complaint to clarify the relief sought was filed by Plaintiff at the Court's direction.

witnesses and several exhibits² were received in evidence. Based on this evidence, the Court makes the following findings of fact:

Pine Lawn cemetery in Rapid City, South Dakota, is a nonprofit corporation that is communally owned. Membership in the corporation arises from the purchase of a cemetery plot or niche. For about 15 years, KC Sales, which was operated by Karl Castor, had a contract with Pine Lawn to manage the cemetery and handle the sale of burial plots and related items, such as bronze memorials, vaults, and vault beds. Karl Castor was compensated only by KC Sales; he did not receive a salary directly from Pine Lawn. He served on the board of directors and was the president.

Under Pine Lawn's by-laws, the cemetery corporation had five directors on its board.³ Two of the primary officers were the president and the secretary. The president was charged, among other duties, to have "general supervision over the affairs of

² Pine Lawn's Exhibit 1, the "Articles of Incorporation for Pine Lawn Memorial Park, Inc.," was virtually impossible to read. Exhibit 2, Pine Lawn's by-laws and amendments, was handwritten and only slightly easier to read. Debtor Michael Klein was unable to clearly state whether Exhibit 5 contained all minutes transcribed during his term with Pine Lawn through January 2002.

³ For a few years, the board membership had been increased to thirteen.

the corporation and over the other officers, [and to] perform all acts and duties usually performed by an executive and presiding officer....” The secretary, among other duties, was directed to give “notices of all meetings of the directors and of the members of the corporation, ... attend and keep minutes of such meetings, and ... have charge of all corporate books, records, and papers.... and attest his signature and impress with the corporate seal all written contracts of the corporation[.]”

Under Pine Lawn’s by-laws and regulations, a perpetual care fund existed. The perpetual care fund was comprised of a set percentage of each paid-in-full sale of a plot, niche, or crypt. Under the by-laws, the Board was directed to adopt regulations to establish this permanent fund, which was “to be supervised, under and pursuant to a written trust agreement between the Board of Directors and [a] qualified and bonded trustee[.]” As stated in both the by-laws and the regulations, only the income from the perpetual care fund was to be used. The applicable regulation stated:

Rule 16-D: Expenditure Limited to Income: Perpetual care, whether applied to lots, graves, or to any space within the confines of the cemetery, shall be limited absolutely to the income received from the investment of the perpetual care fund – no part of the principal being expended -- anything herein stated to the contrary notwithstanding, or according to State Law.

....

Rule 16-F: Directors of Pine Lawn to Direct Expenditures: The income from the perpetual care funds shall be expended by the Board of Directors in such manner as will, in its judgement, be most advantageous to the property owners as a whole, and in accordance with the purposes and provisions of the laws of the State applicable to the expenditure of such funds. The Board of Directors is hereby given the full power and authority to determine upon what property, for what purpose and in what manner the income from said fund shall be expended and it shall expend said income in such a manner as, in its sole judgement, it may deem advisable for the care, reconstruction, repair and maintenance of all or any portion of the cemetery grounds, and it may also expend said income for attorney's fees and other costs necessary to the preservation of the legal rights of Pine Lawn, and for the payment of the services of a regularly constituted trust company or trustees to act as Trustee for such fund.

The regulations further stated:

Rule 16-A: Perpetual Care of Plots: The term "perpetual care", used in reference to plots, shall be held to mean the cutting of the grass upon said plots at reasonable intervals, the raking and cleaning of the plots, the pruning of the shrubs and trees that may be placed by Pine Lawn; meaning and intending the general preservation of the plots, and the grounds, walks, roadways, boundaries and structures, to the end that said grounds shall remain and be reasonably cared for as cemetery grounds forever.

Rule 16-B: Perpetual Care Exceptions: The term "perpetual care" shall in no case be construed as meaning the maintenance, repair or replacement of any monumental structures or memorials placed or erected upon plots unless purchased through Pine Lawn; nor the planting of flowers or ornamental plants; nor the maintenance or doing of any special or unusual work in the cemetery; nor does it mean the reconstruction of any marble, granite, bronze or concrete work on any section or plot, or any portion or portions thereof in the cemetery, buildings or structures, caused by elements, an act of God, common enemy, thieves, vandals, strikers, malicious mischief makers, explosions, unavoidable accidents, invasions, insurrections, riots, or by the order of any military or civil authority, whether the damage be direct or collateral, other than as herein provided.

The second perpetual fund, also established by Pine Lawn's regulations,⁴ was for the regular, continuous placement of flowers on graves. It was funded by an optional contribution of \$500 by plot owners, which was to be placed in a certificate of deposit. The CD was to be used to purchase flowers for Memorial

⁴ The regulations also provided for a "Special Care" fund. It apparently was not in use during the Kleins' tenure with Pine Lawn.

Day and Christmas only.

In the past, Pine Lawn also kept an account called the merchandise reserve account. It is referenced in the corporation's by-laws:

The proceeds arising from the sale of sections or lots after deducting all expenses of purchasing, enclosing, laying out, and improving the grounds, and of erecting buildings, shall be exclusively applied, appropriated, and used in protecting, preserving[,] improving, and embellishing the cemetery and its appurtenances, and paying the necessary expenses for the corporation, and must not be appropriated to any purposes of profit to the corporation or its members.

It was intended to be a savings account for any profit the cemetery may have generated. The cemetery also had a general operating account for regular and usual expenses.

Michael Klein's association with Pine Lawn began in 1991 when he became a part-time sales associate with Castor's KC Sales. At Castor's request, MaryAnn Klein began to help in the cemetery office. Eventually, Michael Klein also helped in the office. In June 1992, Castor fired the bookkeeper and hired Michael Klein as the replacement. Thus, Michael Klein became in charge of all the cemetery's financial records. In addition, Michael Klein managed the office, supervised employees, and provided customer service. He was paid \$450 per week by KC Sales to be the office manager. Michael Klein also continued as a sales counselor on commission with KC Sales.

In the spring of 1999, Michael and MaryAnn Klein purchased from Castor the contract KC Sales had with Pine Lawn.⁵ The purchase contract stated Pine Lawn's board of directors consented to it on April 15, 1999.⁶ The Kleins formed M&M Enterprises as the new sales agent for Pine Lawn. Karl Castor resigned from Pine Lawn as an officer and board member. Michael and MaryAnn Klein each became a director for Pine Lawn on or shortly before July 15, 1999. Michael Klein was elected President; MaryAnn Klein was elected secretary. Carson Quin was

⁵ When Karl Castor sold to the Kleins the contract between KC Sales and Pine Lawn, the price negotiated between the parties reflected an exchange of commissions owed by KC Sales to the Kleins for KC Sales' accounts receivable against Pine Lawn. No sums were owed by Pine Lawn directly to the Kleins when the sales contract was assigned to the Kleins. On their schedule of personal property the Kleins did not list any claim owed to them by Pine Lawn or by KC Sales. In their answer to Pine Lawn's amended complaint, however, the Kleins indicated they were owed \$48,000 in unpaid sales commissions and bonus money [that paragraph of their answer erroneously identified the Kleins as the Plaintiff)], though the answer did not clarify whether KC Sales or Pine Lawn owed them this \$48,000; the answer did not denominate this statement as a counterclaim.

⁶ The dates in this agreement are not in accord. The text states that Pine Lawn's board of directors met on April 15, 1999, and approved the Kleins' purchase of Castor's contract with Pine Lawn. The document is first signed by Castor, both MaryAnn and Michael Klein, and Pine Lawn's director Carson Quinn and Clifford A. Nelson. The notary's date by these signatures, however, is March 25, 1999, which would have been *before* the April 15, 1999, board meeting. On the next page are the Kleins' and Castor's signatures again, apparently affirming that a contingent payment had been made. The notarization of these signatures is dated June 15, 1999.

the only incumbent board member at that time.

Upon Michael Klein's proposal at one of his first board meetings on July 15, 1999, the board of directors changed the organizational structure for Pine Lawn. Where in the past KC Sales had been both the managing and sales agent for the cemetery, Michael Klein became the executive officer of the cemetery and his salary was set at \$600 per week. Also, a person was hired as the sexton and office manager and her salary was set at \$250 per week. Those salaries were to be paid by the cemetery, not by the sales contracting agent, which was now M&M Enterprises, as had been done in the past. Employee bonuses were specifically discontinued but a 5% annual cost of living adjustment was adopted.

Michael Klein never fully read the corporation's Articles of Incorporation, regulations and by-laws until February 2001. During the Kleins' tenure with the corporation, the number of regular board meetings decreased, by amendment to the by-laws, to only three times per year. Not all board members received adequate notice of special meetings.

When the Kleins began their close involvement with Pine Lawn in 1999, the perpetual care fund had approximately \$179,000 in it.

Despite Pine Lawn's by-laws and regulations to the contrary,

Michael Klein nonetheless invaded principal in the perpetual care fund on several occasions. At a board meeting on January 20, 2000, the board approved construction of a granite niche wall at an estimated cost of \$62,532.50⁷ but the minutes do not reflect that Michael Klein was authorized to withdraw any of these funds from either of the perpetual funds. At board meetings on July 20, 2000, and January 17, 2001, replacement of a backhoe was discussed. Neither minutes mention that a purchase would be made with principal from the perpetual care fund. When the Kleins were forced out of Pine Lawn in April 2002, the perpetual care fund was down to less than \$5,000.

Other funds were depleted while the Kleins managed the cemetery. While the perpetual flower fund should have held \$6,500 in CDs, by the time the Kleins left, only about \$1,200 was left. Further, the merchandise reserve fund was totally depleted of \$90,000 and had been closed by Michael Klein.

Other evidence of the cemetery's financial decline during the Kleins' tenure was significant. For the first six months of 2000, expenses exceeded income by \$20,447.21. At the January 2001 meeting, Board President Michael Klein reported cash flow

⁷ These minutes also state, apparently regarding the projected income from the niche wall, that "[n]et proceeds estimated to cemetery after all commissions and costs is \$98,000." Board minutes from January 17, 2001, indicate that the final cost of the niche wall was at least \$101,008.

problems. He also advised the board that he had obtained three new corporate credit cards (in addition to an existing card) and had put in place two new lines of credit totaling \$95,000; the board did not vote on these actions. Michael Klein also stated that the merchandise reserve fund had been exhausted because sales revenues had failed to add any money to this account for the past three years and because installment payments on the niche wall had been made from it. At the July 2001 board meeting, Michael Klein reported that "the cemetery loses [sic] \$70k to 100k a year even when 'scraping by,'" that "[a]ll cash reserves and the bulk of what trust fund there was has been exhausted," and that the cemetery needed to recover from "significant financial setback." The board raised prices for services and merchandise at its January 2002 meeting. Board President Michael Klein also reported that he was cancelling accounts receivable to offset sales tax obligations.

Board minutes further reflect concern about the management of the cemetery. Following the January 17, 2001, board of directors' meeting, Director Carson Quinn resigned. In his letter of resignation, which was appended to the board minutes, he stated that he had received complaints from customers. He also stated:

My condemnation of recently discovered deceptive practices and suggestions to correct them have been

largely ignored. My feeling is that there are not sufficient checks and balances in place since the merging of the Board of Directors and the employees of July 1999 to satisfy the growing concern the general public has with the operation of the cemetery.

The board minutes of January 17, 2002, also reflect that former sales agent and manager Karl Castor had filed a lawsuit against the Kleins. The board decided to seek legal advice to protect the cemetery's interest in the lawsuit between those parties; *pro bono* assistance was sought since the board felt the cemetery could not afford to hire counsel.

Despite the cemetery's obvious financial decline, the Kleins always ensured that they received their salaries. Moreover, they took sales commission advances directly from Pine Lawn, rather than from the sales agent, M&M Enterprises, as had been done when KC Sales held the sale contract. These advances ranged from \$500 to \$1,000 per event and totaled \$25,656.67, ending on February 28, 2002.⁸ Michael Klein felt these advances were somewhat offset by the nonperforming accounts he acquired when he purchased KC Sales' contract with the cemetery. He also said that while there may not have been written authority for these advances, he had received similar advances when he was employed by KC Sales, and he said he received oral approval for

⁸ In Pine Lawn's records, these advances were labeled ADVANCE ON SALES BONUS, with the accounting received in evidence running from June 1, 1999, to February 28, 2002.

these advances based on contacts with either his wife, who was also a board member, or to one other board member, Harold Littlefield. In addition to the sales commission advances, between January 31, 2000, to April 30, 2002, Pine Lawn also paid M&M Enterprises \$124,861.19 in regular sales commissions.

Michael Klein acknowledged that the cemetery's credit cards were occasionally used by him personally. He said he offset the amount he needed to reimburse the corporation with the amount that he was owed on sales commission.

Michael Klein's financial activities at the cemetery were investigated by the Rapid City police department. According to Detective Steve Neville, the department was able to substantiate that Michael Klein had taken sales commission advances of approximately \$26,000 from Pine Lawn between June 1999 and April 2002. Some advances were for sales that had not been paid in full. Michael Klein acknowledged these commission advances to Detective Neville in their conversations. The police department's investigation further revealed that on several instances Michael Klein withdrew funds from one of Pine Lawn's perpetual trust accounts and placed the money in Pine Lawn's operating account shortly before he gave himself an advance on sales commissions from the operating account.

Michael Klein admitted to Detective Neville that he (Michael

Klein) had used Pine Lawn's credit cards for personal use. When Detective Neville was first involved in the Klein investigation, he had found that the unpaid balance on the credit cards was about \$9,000. He was unable to determine how much of that may have been for the Kleins' personal use.

When the Kleins became corporate officers in mid-1999, the cemetery's board was just completing the purchase of a van to replace a Suburban. In August 2001, the Kleins traded this van for a new van. This purchase was financed with corporate credit of over \$30,000. The corporation authorization to incur the debt was signed only by MaryAnn Klein, the corporate secretary. There are no board minutes in evidence approving this trade for a new van. For a time, the Kleins used a corporate van to drive back and forth from their home in Hot Springs to the cemetery in Rapid City. Michael Klein said they paid for the gas for the van on these commutes, except for one tank a week that he charged to the cemetery for business errands he completed with the van.

Michael Klein stated that he had obtained board approval for all financial transactions he conducted based on consultations, sometime by telephone, with one or two board members, which may

have included his wife.⁹ He acknowledged that he did not have any board meeting notices or board meeting minutes to substantiate his claim that the board approved his many financial transactions or his deviations from cemetery policies, including taking substantial principal from the perpetual funds. He said principal from the perpetual funds was only used when the corporation was in financial straits. Many of Michael Klein's financial decisions and actions for Pine Lawn were based on what he considered to be historical precedence rather than what was authorized under Pine Lawn's by-laws and regulations.

While Carson Quin was on Pine Lawn's board of directors, sporadic board meetings were held, and he did not always receive notice of them. He said some special meetings were conducted by telephone. He never saw a sales contract with the Kleins. Quin confirmed that no commission advances were ever approved for Michael Klein and the Kleins were never authorized to invade the principal for the perpetual care fund except for certain capital expenditures, such as a \$16,000 down payment for a backhoe. He also stated board authority was never given to invade the perpetual flower trust fund.

⁹ On adverse examination, Michael Klein stated he sometimes just conferred with one other board member, which may have been only his wife. Upon friendly examination by his wife (both parties appeared *pro se*), he testified that he never conferred with only his wife.

Though the cemetery's finances drastically declined, Michael Klein thought his work nonetheless benefitted the cemetery because he kept it open despite financial problems; he thought he had increased sales; he felt it was to Pine Lawn's advantage that he had opened several lines of credit, some used and some not; and he thought he had improved public access through the internet and other means.

MaryAnn Klein testified that the cemetery office was run the same way it had been run before their involvement. She said it was a small office and they did not have any specific legal knowledge that guided them in their decision-making. Nonetheless, according to board meeting minutes, Michael Klein often referenced the state code during meetings.

II.

Under 11 U.S.C. § 523(a)(4), a pre-petition claim will not be discharged if the debt arose due to fraud or defalcation by a fiduciary. The creditor seeking a determination of nondischargeability under § 523(a)(4) bears the burden of proof by a preponderance of the evidence. *Grogan v. Garner*, 498 U.S. 279 (1991).

[E]vidence presented must be viewed consistent with the congressional intent that exceptions to discharge be narrowly construed against the creditor and liberally against the debtor, thus effectuating the fresh start policy of the [Bankruptcy] Code. [Cite

therein.] These considerations, however, "are applicable only to honest debtors."

Caspers v. Van Horne (In re Van Horne), 823 F.2d 1285, 1287 (8th Cir. 1987)(quoting *In re Hunter*, 771 F.2d 1126, 1130(8th Cir. 1985)); see *The Merchants National Bank of Winona v. Moen (In re Moen)*, 238 B.R. 785, 790-91 (B.A.P. 8th Cir. 1999).

Fraud by a fiduciary. The elements for fraud under § 523(a)(4) are the same as for fraud under § 523(a)(2)(A). *McDaniel v. Border (In re McDaniel)*, 181 B.R. 883, 887 (Bankr. S.D. Tex. 1994):

- (1) the debtor represented a falsehood;
- (2) the debtor knew the representation was false at the time it was made;
- (3) the debtor made the false representation with an intent to deceive; and
- (4) the creditor was damaged as a proximate result of the representation;

Id. at 886. Since direct proof of fraudulent intent is difficult, a creditor may present evidence of the surrounding circumstances from which intent may be inferred. *Caspers v. Van Horne (In re Van Horne)*, 823 F.2d 1285, 1287 (8th Cir. 1987)(cites therein). The debtor cannot overcome that circumstantial evidence with an unsupported assertion of honest intent. *Id.* The Court must consider whether the debtor's

actions are inconsistent with the debtor's self-serving statements. *Id.* at 1288.

Defalcation by a fiduciary. Defalcation is a failure by a person to account for money or property that has been entrusted to him or her. *Hunter v. Philpott*, 373 F.3d 873, 875 n.1 (8th Cir. 2004). It includes an innocent default of a fiduciary; thus, an individual may be liable for defalcation without an intent to defraud. *Tudor Oaks Ltd. Partnership v. Cochrane (In re Cochrane)*, 124 F.3d 978, 984 (8th Cir. 1997)(quoting *Lewis v. Scott*, 97 F.3d 1182, 1186 (9th Cir. 1996)(cites therein)). Consequently, evidence of intentional wrongdoing is not required. *Cochrane*, 124 F.3d at 984. Whether a defalcation has occurred is evaluated on objective criteria. *Buchholz v. Cook (In re Cook)*, 263 B.R. 249, 256 (Bankr. N.D. Iowa 2001)(citing *Cochrane*, 124 F.3d at 984).

Some courts define defalcation as something broader than either embezzlement or misappropriation. *Leeb v. Guy (In re Guy)*, 101 B.R. 961, 991-92 (Bankr. N.D. Ind. 1988). They hold that it can be shown by simply proving that a fiduciary has failed to return property or account for property, even though no fraud, embezzlement, or even misappropriation on the part of the fiduciary is shown. *Bamco 18 v. Reeves (In re Reeves)*, 124

B.R. 5, 6 (Bankr. D.N.H. 1990). As also stated in the Eighth Circuit decision in *Cochrane*, 124 F.3d at 984, since even negligent conduct is not excused, proof of intent is not required. *Guy*, 101 B.R. at 991-92. Moreover, using a trust fund for a purpose other than for what it was intended may create a nondischargeable defalcation. *Guy*, 101 B.R. at 992.

Definition of a Fiduciary. For § 523(a)(4) to apply, the debtor's fiduciary capacity must arise from an express, not constructive, trust. *Barclays American/ Business Credit, Inc., v. Long (In re Long)*, 774 F.2d 875, 878-79 (8th Cir. 1985). The property that is alleged to have been affected by fraud or defalcation must be specific property that the debtor was legally obligated to hold for the benefit of the complaining creditor. *Hunter*, 373 F.3d at 875.

It is the substance of a transaction, rather than the labels assigned by the parties, which determines whether there is a fiduciary relationship for bankruptcy purposes.

Long, 774 F.2d at 878 (citing *Davis v. Aetna Acceptance Co.*, 293 U.S. 328, 333 (1934)). The fiduciary relationship to which § 523(a)(4) applies does not cover trusts imposed on transactions by operation of law or as a matter of equity. *ITT Life Insurance Co. v. Haakenson (In re Haakenson)*, 159 B.R. 875, 887 (Bankr. D.N.D. 1993). Instead, the term is used in a

"strict and narrow sense." *Hunter*, 373 F.3d at 876 (citing *Long*, 774 F.2d at 878). It does not embrace a trust relationship that is not created until the malfeasance occurs; instead, the fiduciary duty must have pre-existed the incident that created the subject debt. *Hunter*, 373 F.3d at 876.

Whether a party is a fiduciary under § 523(a)(4) is a question of federal law. *Kunzler v. Bundy (In re Bundy)*, 95 B.R. 1004, 1013 (Bankr. W.D. Mo. 1989). However, state law is relevant when deciding whether an express trust relationship exists. *Ragsdale v. Haller*, 780 F.2d 794, 795-97 (9th Cir. 1986); *Bundy*, 95 B.R. at 1013.

We recognize that there are cases charging individuals, by virtue of their corporate officer status, with the corporation's fiduciary duties. *In re Interstate Agency, Inc.*, 760 F.2d 121, 124-25 (6th Cir. 1985); *Matter of Whitlock*, 449 F.Supp. 1383, 1390 (W.D. Mo. 1978). To the extent these cases hold that a statute or other state law rule may create fiduciary status in an officer which is cognizable in bankruptcy proceedings, we agree.

Long, 774 F.2d at 878. In South Dakota,

any [corporate] director chosen has a fiduciary duty which obligates him or her to avoid acting as a rubber stamp for either side. Directors are held to a high degree of diligence and due care in the exercise of their fiduciary duties to shareholders. *Case v. Murdock*, 488 N.W.2d 885, 889-90 (S.D. 1992) (citing *Mobridge Community Industries v. Toure*, 273 N.W.2d 128, 133 (S.D. 1978)). "Directors of a corporation occupy a fiduciary position in respect to the corporation and its shareholders, and are required to exercise the utmost good faith in all transactions

touching a director's duty." *Case*, 488 N.W.2d at 890 (citing *Schurr v. Weaver*, 74 S.D. 378, 384, 53 N.W.2d 290, 293 (1952)). See also *Landstrom v. Shaver*, [...] 561 N.W.2d 1, 18 [S.D. 1997]. A director must exercise independent judgment and act in the corporation's best interest, not as a puppet for a particular shareholder.

Lien v. Lien, 674 N.W.2d 816, 824 (S.D. 2004).

III.

The Kleins were fiduciaries of Pine Lawn. The record is clear that Michael and MaryAnn Klein both served Pine Lawn as corporate directors between July 1999 and April 2002. As directors, as provided by the South Dakota Supreme Court in *Lien*, 674 N.W. 2d at 824, they each had a fiduciary obligation to Pine Lawn, its members, and its related perpetual funds, which were specifically to be held in trust. The Kleins were obligated to always act in the cemetery's and the perpetual funds' best interest.

The Kleins failed to fulfill their fiduciary duty. It is equally clear that Michael Klein and MaryAnn Klein each failed to fulfill their fiduciary duties. While Pine Lawn was under their directorship, the by-laws and regulations regarding the perpetual care fund and the perpetual flower fund were ignored. The principal in the perpetual funds was improperly invaded and substantially depleted, the merchandise reserve account was totally depleted, and the non profit corporation was rendered

financially unstable by their erroneous expenditures in light of available income. As corporate officers, the Kleins failed to insure that appropriate board approval was sought, obtained, and documented for non routine expenses or transactions. Moreover, they used their dual status as corporate officers and office personnel to take unauthorized advances on sales commissions and to use corporate credit cards for personal benefit.

These many failures while in a fiduciary capacity constituted defalcation under § 523(a)(4).¹⁰ Accordingly, Pine Lawn's pre-petition claim against the Kleins is nondischargeable.

Amount of nondischargeable claim. The cemetery's accounting revealed that the Kleins, on their petition date, still owed the cemetery \$25,656.67 for unauthorized sales commission advances. The Rapid City police department's investigation confirmed that amount. The record did not sufficiently establish the amount of any additional pre-petition claim arising from the unauthorized use of corporate credit cards and the unauthorized invasions of

¹⁰ The present record did not clearly establish that the Kleins' failures were the product of fraudulent intent. However, fraudulent intent was not found in this nondischargeability action only because the "evidence presented must be viewed consistent with the congressional intent that exceptions to discharge be narrowly construed against the creditor and liberally against the debtor, thus effectuating the fresh start policy of the [Bankruptcy] Code," as required by *Van Horne*, 823 F.2d at 1287.

the perpetual care fund and the perpetual flower fund.
Accordingly, Pine Lawn's nondischargeable claim is \$25,656.67.

An appropriate order and judgment shall be entered.

Dated this 22nd day of September, 2004.

BY THE COURT:
/s/ Irvin N. Hoyt

Irvin N. Hoyt

Bankruptcy Judge

ATTEST:
Charles L. Nail, Jr., Clerk

By: /s/ Alta Otterness
Deputy Clerk
(SEAL)