

UNITED STATES BANKRUPTCY COURT
DISTRICT OF SOUTH DAKOTA
ROOM 211
FEDERAL BUILDING AND U.S. POST OFFICE
225 SOUTH PIERRE STREET
PIERRE, SOUTH DAKOTA 57501-2463

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BANKRUPTCY JUDGE

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May 10, 2002

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Subjects: *Estate of Robert Lacey v. Jeffrey L. Knopf*
(*In re Jeffrey L. and Heidi M. Knopf*),
Adversary No. 01-4030;
Chapter 7, Bankr. No. 01-40574

Estate of Robert Lacey v. Patrick J. Knopf
(*In re Patrick J. and Lisa F. Knopf*),
Adversary No. 01-4037;
Chapter 7; Bankr. No. 01-40828

Dear Counsel:

The matters before the Court are the motions for summary judgment, as amended, filed by each Defendant-Debtor and Plaintiff's responses. These are core proceedings under 28 U.S.C. § 157(b)(2). As set forth below, the motions will be granted in part and denied in part.

Summary. Patrick J. Knopf and Jeffrey L. Knopf were both shareholders in K-Nopf Assisted Living Centers, Inc. ("KALC"). KALC, a family corporation, operated housing units for senior citizens in Sioux Falls. In May 1995, Patrick Knopf and Jeffrey Knopf joined with their brother Michael A. Knopf to form K-Nopf Management, Inc. ("KMI"), with each brother holding one-third of the shares. KMI's purpose was to develop and manage more senior living centers in Sioux Falls and in other South Dakota towns.

In March 1999, KMI entered into a lease with LAL, Inc., to manage three independent living facilities for senior citizens in

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Sioux Falls. Robert and Dorothy Lacey signed a contract with KMI that gave them the right to occupy one independent living unit. The Laceys were also to receive other services, from meals to maintenance, for a monthly fee of \$600. In addition to the monthly fee, the Laceys gave KMI an entrance fee of \$89,000. Regarding the entrance fee, the contract provided, in pertinent part:

The Entrance Fee shall entitle [the Laceys] to occupy the Home and enjoy the use and benefits thereof during the entire term of this [contract.] Upon termination of this [contract], whether due to the death of the Resident or as otherwise provided in this [contract], [the Laceys] shall be entitled to receive an amount equal to ninety percent (90%) of the Entrance Fee. Such amount shall be paid by [KMI] to [the Laceys], without any interest accruing or being paid thereon, within thirty (30) days after the resale of the Home. In the event this [contract] has terminated due to the death of [one of the Laceys], such payment shall be made [the Laceys'] legal representative or estate.

Upon receipt of the entrance fee from the Laceys, the funds were deposited into a general operating account for KMI. Michael Knopf, Patrick Knopf, Jeffrey L. Knopf, and their mother could all write checks from this account. Michael Knopf was not aware of any state regulation that required the entrance fee funds to be placed in an escrow account.

At the same time the contract between the Laceys and KMI was signed, the three shareholders in KMI -- Michael Knopf, Patrick Knopf, and Jeffrey L. Knopf -- signed a guaranty of KMI's obligation to return 90% of the entrance fee to the Laceys.

Dorothy Lacey passed away in June 2000. Around that time, Robert Lacey moved from the independent living unit to an assisted living unit, which was also operated by the Knopf family. He eventually required nursing home care prior to his death in November 2000.

By mid 2000, KMI was experiencing financial problems. In November 2000, KMI's assets, including bank accounts, were taken by Deerfield Bank. KMI also surrendered its license to operate the Sioux Falls facilities, and the corporation was essentially dissolved. Michael Knopf filed a Chapter 7 bankruptcy and received a discharge.

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While KMI was going out of business, K-NOPF Management, Inc. ("KNOPF"), was formed, the state issued KNOPF a license, and KNOPF immediately took over management of the Sioux Falls independent and assisted living facilities for seniors where the Laceys had resided. KNOPF differed from KMI only in that it was not involved in developing and managing living facilities for seniors in communities outside Sioux Falls. Michael Knopf serves as president of KNOPF; the secretary and treasurer are the wives of Jeffrey and Patrick Knopf. Jeffrey Knopf and Patrick Knopf are not officers in KNOPF, the new corporation, at the request of LAL, Inc., the lessor of the senior living facilities in Sioux Falls.

In March 2001, KNOPF, who was now operating the independent living units previously operated by KMI, resold to another couple the right to occupy the same unit in which the Laceys had lived. KNOPF, however, did not refund any of the entrance fee to the Laceys under the terms of the Laceys' earlier agreement with KMI. The sale moneys were deposited into KNOPF's operating account. None of the Knopfs paid the Laceys based on their personal guarantee of the debt.

On May 30, 2001, Jeffrey Knopf and his wife Heidi M. Knopf filed a Chapter 7 petition in bankruptcy. They included Robert Lacey as an unsecured creditor. Patrick Knopf and his wife Lisa F. Knopf filed a Chapter 7 petition on July 30, 2001. They also included Robert Lacey as an unsecured creditor.

The Estate of Robert Lacey timely commenced nondischargeability actions against Debtors Jeffrey Knopf and Patrick Knopf under 11 U.S.C. § 523(a)(4) for fraud by a fiduciary or larceny. With Defendants-Debtors' consent, the complaints were later amended to include nondischargeability under § 523(a)(4) for embezzlement. Each Defendant-Debtor moved for summary judgment on the grounds that he was not a fiduciary for the Laceys and that larceny did not apply because KMI had lawful possession of the entrance fee. Each Defendant-Debtor further argued that an embezzlement of the entrance fee did not occur because KMI, not Debtors, had possession of the funds, and because there has been no showing by the Estate of Robert Lacey that KMI's or Defendants-Debtors' use of the entrance fee was improper.

In response to Defendants-Debtors' summary judgment motions, the Estate of Robert Lacey argued that the "substance" of the contract allowing the Laceys to occupy an independent living unit, coupled with the personal guarantees by Michael Knopf, Jeffrey

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Knopf, and Patrick Knopf, created an express trust that established a fiduciary relationship between the parties. The Estate of Robert Lacey further argued that the sequence of events, with the new KNOPF corporation eventually being formed by the Knopf family, established the fraud. While it is not entirely clear, it appears the Estate of Robert Lacey also argued that a larceny occurred because members of the Knopf family are shareholders of KNOPF, who received the resale proceeds for the occupancy of the Laceys' former independent living unit. Finally, the Estate of Robert Lacey argued that an embezzlement occurred because Defendants-Debtors were under a "prior restraint" governing the use of the entrance fee funds, that is, the entrance fee could only be used to later repay the Laceys.

Applicable law - summary judgment. Summary judgment is appropriate when "there is no genuine issue [of] material fact and . . . the moving party is entitled to a judgment as a matter of law." Fed.R.Bankr.P. 7056 and Fed.R.Civ.P. 56(c). An issue of material fact is *genuine* if it has a real basis in the record. *Hartnagel v. Norman*, 953 F.2d 394, 395 (8th Cir. 1992) (quotes therein). A genuine issue of fact is *material* if it might affect the outcome of the case. *Id.* (quotes therein).

The matter must be viewed in the light most favorable to the party opposing the motion. *F.D.I.C. v. Bell*, 106 F.3d 258, 263 (8th Cir. 1997); *Amerinet, Inc. v. Xerox Corp.*, 972 F.2d 1483, 1490 (8th Cir. 1992) (quoting therein *Matsushita Elec. Industrial Co. v. Zenith Radio*, 475 U.S. 574, 587-88 (1986), and cites therein). The non moving party is entitled to all reasonable inferences that can be drawn from the evidence without resorting to speculation. *P.H. v. School District of Kansas City, Missouri*, 265 F.3d 653, 658 (8th Cir. 2001) (quoting therein *Sprenger v. Federal Home Loan Bank of Des Moines*, 253 F.3d 1109, 1110 (8th Cir. 2001)). Only disputes over facts that might affect the outcome of the suit under the applicable law properly preclude the entry of summary judgment. *P.H. v. School District*, 265 F.3d at 658.

The movant meets his burden if he shows that the record does not contain a genuine issue of material fact and he identifies that part of the record that bears out his assertion. *Handeen v. LeMaire*, 112 F.3d 1339, 1346 (8th Cir. 1997) (quoting therein *City of Mt. Pleasant v. Associated Electric Coop*, 838 F.2d 268, 273 (8th Cir. 1988)). No defense to an insufficient showing is required. *Adickes v. S.H. Kress & Co.*, 398 U.S. 144, 156 (1970) (cite

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therein); *Handeen*, 112 F.3d at 1346. If the movant meets his burden, however, the non movant, to defeat the motion, "must advance specific facts to create a genuine issue of material fact for trial." *Bell*, 106 F.3d at 263 (quoting *Rolscreen Co. v. Pella Products of St. Louis, Inc.*, 64 F.3d 1202, 1211 (8th Cir. 1995)). The non movant must do more than show there is some metaphysical doubt; he must show he will be able to put on admissible evidence at trial proving his allegations. *Bell*, 106 F.3d at 263 (citing *Kiemele v. Soo Line R.R. Co.*, 93 F.3d 472, 474 (8th Cir. 1996), and *JRT, Inc. v. TCBY System, Inc.*, 52 F.3d 734, 737 (8th Cir. 1995)). Hearsay cannot defeat a motion for summary judgment. *Johnson v. Baptist Medical Center*, 97 F.3d 1070, 1073 (8th Cir. 1996) (cite therein). Further, the non movant must make a sufficient showing on every essential element of claim on which he bears the burden of proof. *P.H. v. School District*, 265 F.3d at 658.

The Court must consider the actual quantum and quality of proof necessary to support liability under the applicable law. *Hartnagel*, 953 F.2d at 396. Where motive and intent are at issue, disposition of the matter by summary judgment may be more difficult. See *United States v. One 1989 Jeep Wagoneer*, 976 F.2d 1172, 1176 (8th Cir. 1992).

Applicable law - nondischargeability under § 523(a)(4). To prevail on a nondischargeability complaint, the creditor must establish by a preponderance of the evidence all the elements required. *Grogan v. Garner*, 498 U.S. 279, 286-87 (1991); *Jafarpour v. Shahrokhi (In re Shahrokhi)*, 266 B.R. 702, 707 (B.A.P. 8th Cir. 2001). The exceptions to discharge are construed narrowly in order to effect the fresh start policy of the Bankruptcy Code. *Owens v. Miller (In re Miller)*, 276 F.3d 424, 429 (8th Cir. 2002).

Two elements must be established to prove that a debt is nondischargeable because it arose from the **fraud or defalcation of a fiduciary**: that a fiduciary relationship existed between the creditor and the debtor and that the debtor committed fraud or defalcation while acting in that fiduciary capacity. *Shahrokhi*, 266 B.R. at 707; *E.W. Wylie Corp. v. Montgomery (In re Montgomery)*, 236 B.R. 914, 922 (Bankr. D.N.D. 1999). Whether a party is a fiduciary under § 523(a)(4) is a question of federal law. *Tudor Oaks Limited Partnership v. Cochrane (In re Cochrane)*, 124 F.3d 978, 984 (8th Cir. 1997). The fiduciary capacity necessary for a debt to be declared nondischargeable under 11 U.S.C. § 523(a)(4)

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must arise from an express trust, not a constructive¹ trust. *Barclays American/ Business Credit, Inc. v. Long (In re Long)*, 774 F.2d 875, 878-79 (8th Cir. 1985). Generally, for an express trust to exist, the agreement between the parties must include an explicit declaration of a trust, identify a trust *res*, and set forth the terms of a trust relationship; a mere contractual relationship is insufficient. *Werner v. Hofmann (In re Hofmann)*, 144 B.R. 459, 463-64 (Bankr. D.N.D. 1992), *aff'd*, 5 F.3d 1170 (8th Cir. 1993). 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). A fiduciary under § 523(a)(4) is more narrowly defined than it is under the common law. *Montgomery*, 236 B.R. at 922. Accordingly, a broad, general definition of a fiduciary relationship as one arising from confidence, trust, and good faith is not applicable under § 523(a)(4). *Shahrokhi*, 266 B.R. at 707 (quoting therein *Mills v. Gergely (In re Gergely)*, 110 F.3d 1448, 1450 (9th Cir. 1997)).

To establish nondischargeability under § 523(a)(4) for **larceny**, the creditor must establish that the debtor wrongfully took the creditor's property with an intent to convert the property to the debtor's benefit. *Kansas Bankers Surety Co. v. Eggleston (In re Eggleston)*, 243 B.R. 365, 378 (Bankr. W.D. Mo. 2000). To establish nondischargeability for **embezzlement**, the creditor must establish that the debtor improperly used the creditor's property before complying with some obligation to the creditor. *Werner v. Hofmann*, 5 F.3d 1170, 1172 (8th Cir. 1993) (cite therein). Implicit in an embezzlement claim under § 523(a)(4) is a showing that the debtor acted with malevolent intent. *Neff v. Knodle (In re Knodle)*, 187 B.R. 660, 664 (Bankr. D.N.D. 1995). It differs from larceny in that the debtor's original possession of the property was lawful or authorized. *Eggleston*, 243 B.R. at 378.

Discussion. The agreement between KMI and the Laceys, even coupled with the personal guarantees by Michael Knopf, Defendant-Debtor Jeffrey Knopf, and Defendant-Debtor Patrick Knopf did not create a fiduciary relationship under § 523(a)(4) between KMI and

¹ A constructive trust is one that arises out of the wrongdoing itself. See *Werner v. Hofmann (In re Hofmann)*, 144 B.R. 459, 463 (Bankr. N.D. 1992), *aff'd*, 5 F.3d 1170 (8th Cir. 1993).

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