UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF MISSISSIPPI

IN RE:

STEPHEN RICHARD COLSON,	**CASE NO. 09-51954-NPO**
DEBTOR.	**CHAPTER 7**
FIDELITY NATIONAL TITLE INSURANCE COMPANY	**PLAINTIFF**
VS.	**ADV. PROC. NO. 10-05007-NPO**
STEPHEN RICHARD COLSON	**DEFENDANT**

MEMORANDUM OPINION AND
ORDER GRANTING IN PART AND DENYING
IN PART MOTION FOR PARTIAL SUMMARY JUDGMENT ON
LIABILITY AND NON-DISCHARGEABILITY OF DEBT OF STEPHEN R. COLSON

There came on for consideration the Motion for Partial Summary Judgment on Liability and Non-Dischargeability of Stephen R. Colson (the "Motion") (Adv. Dkt. 73)[1] and Memorandum in Support of Motion for Partial Summary Judgment on Liability and Non-Dischargeability of Stephen R. Colson (the "Memorandum") (Adv. Dkt. 74) filed by Fidelity National Title Insurance Company, as successor-in-interest to Lawyers Title Insurance Corporation ("Lawyers Title"),[2] Defendant's Memorandum in Response to Motion for Summary Judgment (the "Response") (Adv. Dkt. 80) filed by the Debtor, Stephen R. Colson (the "Debtor"), and the Reply in Support of Motion for Partial

[1] Citations to the record are as follows: (1) citations to docket entries in this adversary proceeding, Adv. Proc. No. 10-05007-NPO, are cited as "(Adv. Dkt. ____)"; (2) citations to the docket entries in the main bankruptcy case, Case No. 09-51954-NPO, are cited as "(Dkt. ____)"; and (3) citations to docket entries in other related, but separate adversary proceedings are cited by the number of the proceeding followed by the docket number.

[2] *See* Order Regarding Motion to Change Name On the Court's Docket Regarding Lawyers Title Insurance Corporation. (Adv. Dkt. 46).

Summary Judgment (the "Reply") (Adv. Dkt. 83) filed by Lawyers Title in the above-styled adversary proceeding (the "Adversary"). In the Adversary, Lawyers Title is represented by Sheryl Bey, and the Debtor is represented by William Alex Brady, II. Having reviewed the pleadings and all the exhibits attached thereto, the Court finds that the Motion should be granted in part and denied in part.[3]

Jurisdiction

This Court has jurisdiction over the subject matter of and the parties to this proceeding pursuant to 28 U.S.C. § 1334. This matter is a core proceeding as defined in 28 U.S.C. § 157(b)(2)(I). Notice of the Motion was proper under the circumstances.

Facts

When deciding whether summary judgment is proper, the Court must view the evidence in the light most favorable to the Debtor. McPherson v. Rankin, 736 F.2d 175, 178 (5th Cir. 1984). With this standard in mind, the Court finds that the following facts are undisputed unless otherwise indicated.

1. Until recently, the Debtor was licensed to practice law in Mississippi and was heavily involved in the real estate business. At one time, he was the president and chief executive officer of Prestige Title Insurance, Inc. ("Prestige") and Advanced Title & Escrow, LLC ("Advanced Title").[4] These two title companies Prestige and Advanced Title were formed by the Debtor in

[3] Specifically, the Court makes the following findings of fact and conclusions of law pursuant to Federal Rule of Bankruptcy Procedure 7052.

[4] Lawyers Title explains in its Memorandum that although 51% of Advanced Title was owned by Sandion, A Texas General Partnership d/b/a Caldwell Bankers Realty Company, Advanced Title was managed by Prestige, which was managed by the Debtor. (Mem. at 2).

2001 and 2006, respectively, and were title insurance and escrow agents domiciled in Gulfport, Mississippi. (Lawyers Title Ex. 3). When they are referred to together, they are identified as the "Title Companies."

2. In his deposition, the Debtor generally described the work of Prestige (and, thus, the work of the Title Companies) as follows: "[t]itle work [was] ordered through our company, the notes [were] taken from the courthouse, reviewed to make sure title [was] clear, and then we wait[ed] on clients to set a closing date." (Debtor Dep. at 54, Lawyers Title Ex. 2).[5]

3. In addition to the Title Companies, the Debtor owned several other businesses outside his real estate practice, such as "Prestige Sports Management, SJS Development, TCG Telcom, Vic's Chophouse, and the Red Eye Grill, among others." (Mem. at 3, n.5). They are mentioned here only because of allegations by Lawyers Title that the Debtor commingled funds belonging to all of the businesses he controlled.

4. The Debtor entered into numerous contracts on behalf of the Title Companies for the provision of services and products related to his real estate practice. The focus of the Adversary is on the contractual relationship between Lawyers Title and the Title Companies.

Lawyers Title and the Title Companies

5. On May, 15, 2001, Prestige entered into a "Title Insurance Agency Agreement" (the "Prestige Agreement"), in which Lawyers Title appointed Prestige as "its agent solely for the purpose of issuing, on [Lawyers Title's] forms, title insurance commitments, policies and endorsements on

[5] Hereinafter, exhibits attached to the Motion are cited as "(Lawyers Title Ex. ____)". Exhibits attached to the Response are cited as "(Debtor Ex. ____)".

real estate located: in the State of MISSISSIPPI." (Prestige Agree. at 1, Lawyers Title Ex. 1).[6]

Terms of the Prestige Agreement

6. According to the Prestige Agreement, Prestige would "retain 70% of each title insurance policy premium as commission"[7] and would pay the remaining 30% of the premium to Lawyers Title each month. (Prestige Agree. at 1, Lawyers Title Ex. 1).

7. Once Prestige received any fees associated with issuing a title insurance policy, Lawyers Title was "deemed the owner of the entire amount thereof and [Prestige] shall hold and maintain such Premiums, as trustee for [Lawyers Title], strictly in accordance with the terms of this Agreement." (Prestige Agree. at 2, ¶ 2(a), Lawyers Title Ex. 1).

8. Prestige was charged with "keep[ing] all funds, received by [Prestige] from any source in connection with transactions in which title insurance policies of [Lawyers Title] are to be issued, in a federally insured financial institution, in an account separate from [Prestige's] individual accounts and designated as an 'escrow' or 'settlement funds' account, and disburse such funds only for the purposes for which the same were entrusted." (Prestige Agree. ¶ 2(c), Lawyers Title Ex. 1).

9. By express provision, "[Prestige] concede[d] that [Prestige's] escrow business is beyond the scope of the agency relationship created by this Agreement . . . ." (Prestige Agree. at 3, ¶ 2(l), Lawyers Title Ex. 1).

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[6] This exhibit is the first exhibit attached to the Motion but is incorrectly identified as "Exhibit 2 Colson." For the sake of clarity, and in order to maintain the sequential order of the exhibits, the mis-labeled exhibit will be cited herein as "Lawyers Title Ex. 1".

[7] The Prestige Agreement was amended by "Addendum Number 2" on January 1, 2003, to increase the commission so that thereafter Prestige would "retain eighty percent (80%) of each title insurance policy premium." (Lawyers Title Ex. 1).

10. The Prestige Agreement held Prestige liable to Lawyers Title for any losses "sustained or incurred by [Lawyers Title] and arising from the fraud, negligence or misconduct of [Prestige] . . ." (Prestige Agree. at 4, ¶ 4, Lawyers Title Ex. 1).

Growth of Prestige and Formation of Advanced Title

11. After Lawyers Title appointed Prestige as its title insurance agent in Mississippi, Prestige's business grew significantly, which, according to the Debtor, eventually led to financial management problems.

12. On February 1, 2005, the parties amended the Prestige Agreement and named Prestige an agent for Lawyers Title in all of Alabama, except for Mobile and Tuscaloosa Counties. (Lawyers Title Ex.1).

13. It was during this period of expansion that the Debtor formed Advanced Title.

14. On October 1, 2006, Advanced Title entered into a Title Insurance Agency Agreement (the "Advanced Title Agreement") with Lawyers Title. (Lawyers Title Ex. 3). The terms of the Advanced Title Agreement are nearly identical to those in the Prestige Agreement, as previously outlined. (Lawyers Title Ex. 3).

15. By 2007, Prestige had offices scattered throughout Mississippi, Alabama, Louisiana, and Florida. (*See* Debtor Ex. O).

16. The Debtor opened numerous accounts at different banks in different states in order to operate his many businesses. By 2009, with respect to the Title Companies only, the Debtor had opened 46 accounts at Wachovia Bank ("Wachovia") and 45 accounts at Regions Bank ("Regions") (the "Title Company Accounts"). (Mem. at 2-3).

Title Company Accounts

17. Each individual office of Prestige and Advanced Title had its own separate office account at Regions and Wachovia, referred to as an Escrow Account.[8] Proceeds from a real estate closing were deposited into the Escrow Account for the local office where the closing was scheduled to take place. (Resp. at 4).

18. Besides the individual Escrow Accounts, Prestige and Advanced Title each had the following accounts at Regions and Wachovia: (1) a Funding Account; (2) an Abstract Account, and (3) an Operating Account. (Mot. at 3).

19. In order to explain how the Debtor managed the Title Company Accounts, Lawyers Title presented the deposition testimony and expert report of Donna M. Ingram ("Ingram"), a certified public accountant in Mississippi and Louisiana. (Lawyers Title Exs. 6 & 9). Ingram is also a Certified Fraud Examiner and a Certified Forensic Accountant. (Debtor Ex. 8).

20. According to Ingram, the Funding Account was the master account, sometimes referred to as a "sweep" account. Each evening all of the funds remaining in that office Escrow Account would be "swept" into a Funding Account.[9] The Funding Account also held funds

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[8] Lawyers Title, in its Memorandum, claims that individual Escrow Accounts were opened at Regions for its offices located in Tupelo, Biloxi, Metairie, Mobile, and Pensacola, while the Escrow Accounts at Wachovia were opened in Destin, Pensacola, Niceville, Panama City, Mobile, Daphne, Gulfport, Biloxi, Ocean Springs, Southaven, Hattiesburg, Jackson, and Atlanta. (Mem. at 3).

[9] Quality Assurance Reviews ("Reviews") conducted in 2007 by LandAmerica at the behest of Lawyers Title, however, explained that title insurance funds were being directly deposited into the Funding Account, and then subsequently disbursed into individual office Escrow Accounts. (Debtor Ex. O).

unrelated to real estate closings. (Debtor Ex. B).

21. The Abstract Account, according to the Debtor, was for "monies received for abstract services that we charged. It was not a trust account."[10] (Debtor Dep. at 110, Debtor Ex. A). Ingram testified that the Abstract Account was used much like an operating account, to pay the bills of the Title Companies and to fund other companies owned by the Debtor. (Ingram Dep. at 18, Debtor Ex. B). The Debtor admitted that on at least one occasion, funds from the Abstract Account were transferred to one of his other companies. (Debtor Dep. at 110, Debtor Ex. A).

22. Finally, the Operating Account was used to pay the sundry daily expenses of the Title Companies, including payroll expenses. (Debtor Dep. at 154, Lawyers Title Ex. 2). Attorney's fees and recording fees were deposited into the Operating Account. (Debtor Dep. at 174-75, Debtor Ex. A). In his deposition testimony, the Debtor acknowledged that monies from the Operating Account were sometimes used to fund other companies he owned. (Debtor Dep. at 100-01, 169, Lawyers Title Ex. 2). The Debtor described these transfers as "loans." (Debtor Dep. at 171, Lawyers Title Ex. 2).

23. According to the Debtor, every employee of the Title Companies had the authority to withdraw funds from any of the Title Company Accounts. (Debtor Ex. A).

[10] Further explaining the Title Companies' use of the Abstract Accounts, the Debtor testified that "[a]t the direction of [Lawyers Title], we segregated certain fees, thus we had abstract accounts. One of the fees one of the services provided by our company was abstract services. Those deposits were made into the abstract account." (Debtor Dep. at 174, Debtor Ex. A).

24. The managers at each individual office of Prestige had the authority to sign checks,[11] however, all accounting functions, including reconciliations of bank statements and ledgers, were performed at the main office for all of the Title Companies in Gulfport, Mississippi. (Debtor Dep. at 62, Debtor Ex. C).

Quality Assurance Reviews

25. Prestige and Advanced Title were subjected to Reviews by LandAmerica as early as 2002. (Debtor Ex. C).

26. These Reviews were conducted intermittently throughout the relationship between Prestige and Lawyers Title. (*See, e.g.,* Debtor Ex. L).

27. As described in a letter dated May 31, 2007, from LandAmerica to Prestige, "[t]he purpose of LandAmerica's Quality Assurance Review Program is to provide an insightful and thoughtful review of an agency's practices and procedures, with particular emphasis on those areas that, in our experience, carry the greatest potential for loss . . . . [T]he Quality Assurance Review traditionally focuses on three primary areas underwriting, a policy audit and an escrow reconciliation review." (Debtor Ex. L).

28. Because of these Reviews, Lawyers Title was made aware as early as 2002 that Prestige carried a negative balance in several of its Escrow Accounts. (Debtor Ex. C).

29. In addition, a 2002 Review noted that Prestige was improperly reconciling its accounts and noted a concern for "many unexplained adjustments to [the Prestige] January 2002 reconciliation report." (Debtor Ex. H).

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[11] At least as of 2002, the Debtor's signature was the only authorized signature on the accounts, but apparently there was a stamp of his signature at each office location. (Debtor Ex. C).

30. A Review in 2002 also showed that bank penalty fees and charges were being charged to Prestige Escrow Accounts. (Debtor Ex. D).

31. More recently, a Review conducted in 2007 found that Prestige was not accurately reconciling a majority of its Escrow Accounts. The Review recommended that Prestige close these Escrow Accounts. (Debtor Ex. O).

32. Sometime between May 31, 2007 and April 15, 2008, Prestige closed many of its offices' Escrow Accounts and opened new Escrow Accounts (the "New Escrow Accounts") at various financial institutions. (Debtor Ex. R).

33. A Review of the New Escrow Accounts through February 29, 2008, showed that the new Escrow Accounts were being properly reconciled. (Debtor Ex. R; *see also* Debtor Ex. T).

Interpleader Actions

34. In February 2009, due to negative balances in the accounts, Wachovia and Regions froze the New Escrow Accounts. (Lawyers Title Ex. 7).

35. During this same time period, Lawyers Title concluded that monies in the Funding Accounts intended for real estate closings had been diverted by the Debtor into accounts owned or controlled by him and then used for other purposes. On February 6, 2009, Lawyers Title notified the Debtor of its intent to terminate its agency agreements with the Title Companies. (Adv. Dkt. 1).

36. Shortly thereafter, Wachovia filed an interpleader action against the Debtor in the Chancery Court of Harrison County, Mississippi, and tendered the funds remaining in the accounts into the registry of the state court (the "Wachovia Interpleader Action"). Regions filed its own interpleader action in the same state court (the "Regions Interpleader Action"). (Lawyers Title Ex.

7). Together, the Wachovia Interpleader Action and the Regions Interpleader Action are referred to herein as the "Interpleader Actions."

Bankruptcy Proceedings

37. On September 4, 2009, the Debtor filed a voluntary petition for relief (the "Petition") under chapter 7 of the United States Bankruptcy Code[12] to discharge his personal debts. (Dkt. 1).

38. After the filing of the Petition, the Interpleader Actions were removed to the United States District Court for the Southern District of Mississippi. Then, the Regions Interpleader Action was referred to the United States Bankruptcy Court for the Southern District of Mississippi (the "Bankruptcy Court") on December 4, 2009, and was assigned adversary proceeding number 10-05002-NPO. On May 7, 2010, the Wachovia Interpleader Action was referred to the Bankruptcy Court and was assigned adversary proceeding number 10-05032-NPO. (Lawyers Title Ex. 7).

39. Lawyers Title intervened in the Interpleader Actions. (Lawyers Title Ex. 7).

40. The chapter 7 trustee appointed to Debtor's bankruptcy case, Kimberly Lentz (the "Trustee"), intervened in the Interpleader Actions and filed cross-claims against the Debtor, the Title Companies, and others who she believed might have colorable claims to the interpled funds (the "Interpled Funds"). The Trustee sought to pierce in reverse the corporate veils of the Title Companies, as well as other entities, in order to bring the Interpled Funds into the bankruptcy estate of the Debtor, with the exception of any funds that could be traced to a particular claimant. (Lawyers Title Ex. 7).

41. In the Interpleader Actions, the Trustee obtained default judgments against the

[12] Hereinafter, all code sections refer to the United States Bankruptcy Code found at Title 11 of the United States Code unless otherwise noted.

Debtor, who had failed to respond to the Trustee's cross-claims against him. (Adv. Proc. No. 10-05002-NPO, Adv. Dkt. 230; Adv. Proc. No. 10-05032-NPO, Adv. Dkt. 149).

42. On March 8, 2010, Lawyers Title commenced the Adversary against the Debtor by filing a Complaint to Determine Dischargeability of the Debt to Lawyers Title Insurance Corporation under 11 U.S.C. §§ 523(a)(2)(A), 523(a)(2)(B), 523(a)(4) and 523(a)(6). (Adv. Dkt. 1). A few days later, on March 11, 2010, Lawyers Title filed a First Amended Complaint to Determine Dischargeability of the Debt to Lawyers Title Insurance Corporation under 11 U.S.C. §§ 523(a)(2)(A), 523(a)(2)(B), 523(a)(4) and 523(a)(6) (the "Complaint"). (Adv. Dkt. 2).

42. In the Complaint, Lawyers Title alleges that the Title Companies were the alter egos of the Debtor. Also, according to Lawyers Title, monies that were entrusted to the Title Companies in connection with real estate closings were instead deposited into accounts maintained by the Debtor. (Adv. Dkt. 2, Compl. ¶¶ 23-25).

43. Lawyers Title complains that the Debtor's alleged defalcation caused various mortgage lenders who were insured by Lawyers Title under Closing Protection Letters[13] to suffer significant financial losses. As a result, Lawyers Title "has paid over Five Million Dollars (as of February 2011) to cover losses caused by [Debtor's] breach of his fiduciary duties." (Reply at 10).

44. Lawyers Title seeks to hold the Debtor liable for damages in the amount of $10 million, not including attorney fees and interest. (Adv. Dkt. 2, Compl. ¶ 95). The litany of state-law claims alleged by Lawyers Title against the Debtor in support of its liability claim include: breach

[13] The Closing Protection Letters underwritten by Lawyers Title obligated Lawyers Title to pay "for actual loss incurred [by a lender] in connection with closings of real estate transactions provided the loss arises out of [f]raud, dishonesty or negligence of the Issuing Agent or Approved Attorney." (Adv. Dkt. 1, Lawyers Title Ex. 6).

of fiduciary duty, breach of contract, breach of duty of good faith and fair dealing, embezzlement, fraud, negligence, conversion, unjust enrichment, bad faith, and indemnity. (Adv. Dkt. 2, Compl. ¶¶ 33-90). In addition, Lawyers Tile alleges that the damages it sustained against the Debtor are non-dischargeable under §§ 523(a)(2)(A), 523(a)(2)(B), 523(a)(4), and 523(a)(6). (Adv. Dkt. 2, Compl. ¶¶ 91-95).

45. On February 2, 2012, Lawyers Title filed the Motion, seeking summary judgment as a matter of law against the Debtor for breach of a fiduciary duty[14] and seeking a declaratory judgment that his debt arose while the Debtor was acting in a fiduciary capacity and, for that reason, is non-dischargeable pursuant to § 523(a)(4).[15] In contrast, the Debtor asserts that summary judgment is inappropriate because issues of fact exist as to whether the Debtor was a fiduciary of Lawyers Title and as to whether the Debtor willfully neglected a fiduciary duty or acted in reckless disregard of his fiduciary duty. (Resp. at 1-2).

Discussion

A. Summary Judgment Standard

Under Federal Rule of Civil Procedure 56(a),[16] made applicable to adversary proceedings by Federal Rule of Bankruptcy Procedure 7056, summary judgment is appropriate when viewing the

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[14] The claim for breach of a fiduciary duty is only one of many claims alleged in the Complaint but is the only claim that is addressed in the Motion. (Compl. ¶¶ 33-90, Mot. at 4).

[15] In the Complaint, Lawyers Title also alleges that the debt owed by the Debtor is non-dischargeable pursuant to § 523(a)(2)(A) and (B), and § 523(a)(6). (Compl. ¶¶ 92-94). Only § 523(a)(4) is at issue in the Motion. (Mot. at 4, 16).

[16] Pursuant to the Rules Enabling Act, 28 U.S.C. § 2072, Rule 56 of the Federal Rules of Civil Procedure was amended, as of December 1, 2010. The amendment did not change the standard for granting summary judgment. *See* FED. R. CIV. P. 56 advisory committee's note to 2010 Amendments ("The standard for granting summary judgment remains unchanged.").

evidence in the light most favorable to the nonmoving party, the pleadings, depositions, answers to interrogatories, and admissions, together with any affidavits, show that there is no genuine dispute as to any material fact and the movant is entitled to judgment as a matter of law. Fed. R. Civ. P. 56(a); *see* Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 251 (1986); Celotex Corp. v. Catrett, 477 U.S. 317, 322-23 (1986). By its express terms, Rule 56(a) provides for partial summary judgment. FED. R. CIV. P. 56(a). Once the moving party has made its required showing, Rule 56(c)(1) further provides, in relevant part:

> A party asserting that a fact cannot be or is genuinely disputed must support the assertion by: (A) citing to particular parts of materials in the record . . . ; or (B) showing that the materials cited do not establish the absence or presence of a genuine dispute, or that an adverse party cannot produce admissible evidence to support the fact.

FED. R. CIV. P. 56(c)(1).

"Summary judgment . . . serves, among other ways, to root out, narrow, and focus the issues, if not resolve them completely." Calpetco 1981 v. Marshall Exploration, Inc., 989 F.2d 1408, 1415 (5th Cir. 1993). The effect of a partial summary judgment, if granted, is to lessen "the length and complexity of trial on the remaining issues. . . all to the advantage of the litigants, the courts, those waiting in line for trial, and the American public in general." Id. Ultimately, the role of this Court "is not . . . to weigh the evidence and determine the truth of the matter but to determine whether there is a genuine issue for trial." Anderson, 477 U.S. at 249; *see* Hamilton v. Segue Software Inc., 232 F.3d 473, 477 (5th Cir. 2000). Even absent the presence of any genuine issue, the Court has the discretion to deny motions for summary judgment and allow parties to proceed to trial so that the record might be more fully developed for the trier of fact. *See* Kunin v. Feofanov, 69 F.3d 59, 62 (5th Cir. 1995); Black v. J.I. Case Co., 22 F.3d 568, 572 (5th Cir. 1994); Veillon v. Exploration

Services, Inc., 876 F.2d 1197, 1200 (5th Cir. 1989).

B. Is the Debtor the alter ego of the Title Companies?

Lawyers Title asks the Court to attribute the alleged misconduct of the Title Companies to the Debtor in order to invoke the defalcation exemption to dischargeability, and more important, in order to reach the assets of the Debtor. In other words, Lawyers Title asks the Court to pierce the corporate veils of the Title Companies. (Mem. at 14).

It is a basic tenet of corporate law that a corporation is a distinct legal entity from its shareholder. Johnson & Higgins of Miss., Inc. v. Comm'r of Ins., 321 So. 2d 281, 284 (Miss. 1975). The corporate veil shields the individual owners of a company from liability, and the Mississippi Supreme Court has described piercing the corporate veil as an extreme remedy. *See* Gray v. Edgewater Landing Inc., 541 So. 2d 1044, 1046 (Miss. 1989). To disregard the corporate entity, the complaining party must show: "(A) some frustration of contractual expectations, (B) the flagrant disregard of corporate formalities; and (C) fraud or other equivalent malfeasance on the part of the corporate shareholder." Id. at 1047.

According to Lawyers Title, it is unnecessary for this Court to consider these elements because this Court has already pierced the corporate veils of the Title Companies in "reverse." (Mem. at 15). Therefore, whether the Debtor is the alter ego of the Title Companies is merely a matter of applying the doctrine of *res judicata*. Id.

In the Interpleader Actions, the Court granted the Trustee's request to pierce the corporate veils of the Title Companies in reverse to bring the Interpled Funds (except funds which certain claimants successfully traced as belonging to them) into the Debtor's bankruptcy estate. The veil-piercing issue in the Interpleader Actions was unusual because it required the Court to reverse the

direction of the veil piercing and because it required the Court to pierce multiple corporate veils. The Order on Motion to Approve Compromise and Settlement ("Settlement Orders") (Adv. Proc. No. 10-05002, Adv. Dkt. 224; Adv. Proc. No. 10-05032, Adv. Dkt. 135), entered in the Interpleader Actions provided, as follows:

> All claims which any person or any entity may have against [the Title Companies or any other company owned by the Debtor] shall be considered as a claim against the [Debtor's] bankruptcy estate on account of the failure of [the Debtor] to abide by corporate formalities, the co-mingling of funds and the Court's judgment allowing the Trustee to "reverse pierce" the corporate veils.

Id. In connection with the Settlement Orders, on February 1, 2012,[17] this Court entered a Default Judgment in the Regions Interpleader Action ordering that the corporate veils of the Title Companies (and certain other companies owned by the Debtor) be pierced and funds from their accounts be considered property of the Debtor's bankruptcy estate. The Title Companies were held responsible for the debts and misdeeds of the Debtor, insofar as the Interpled Funds were concerned.

Interestingly, the Debtor never directly refutes in his Response Lawyers Title's assertion that its piercing of the corporate veils claim is *res judicata*. Instead, the Debtor insists that the veils of the Title Companies should not be pierced given that "Lawyers Title contracted with Prestige and Advanced Title, not [the Debtor]." (Resp. at 9). In other words, the Debtor falls back on the basic tenet of corporate law that companies must be treated as entities apart from their shareholders.

Res judicata

The doctrine of *res judicata* bars parties from re-litigating certain issues which have already reached final judgment. Ries v. Paige (In re Paige), 610 F.3d 865, 870 (5th Cir. 2010), *quoting* Allen

[17] An analogous Default Judgment was entered in the Wachovia Interpleader Action on March 2, 2012. (Adv. Proc. No. 10-05032-NPO, Adv. Dkt. 149).

v. McCurry, 449 U.S. 90, 94 (1980). In the Fifth Circuit, "[f]or a prior judgment to bar an action on the basis of *res judicata*, the parties must be identical in both suits, the prior judgment must have been rendered by a court of competent jurisdiction, there must have been a final judgment on the merits and the same cause of action must be involved in both cases." Nilsen v. City of Moss Point, 701 F.2d 556, 559 (5th Cir. 1983) (en banc) (citation omitted). Once each of these four elements has been proved, the Court must consider whether the claim could have been brought in the previous adversary. *See* Paige, 601 F.3d at 870 (quotation omitted). The Court considers each of the four elements of *res judicata* in turn.

1. Identity of Parties

Both the Debtor and Lawyers Title were parties to the Interpleader Actions. Consequently, the Debtor and his then-current counsel received notice of the (1) Motion to Approve Compromise and Settlement (Adv. Proc. No. 10-05002-NPO, Adv. Dkt. 219; Adv. Proc. No. 10-05032-NPO, Adv. Dkt. 135), (2) Application (or Motion) for Entry of Default (Adv. Proc. No. 10-05002-NPO, Adv. Dkt. 198; Adv. Proc. No. 10-05032-NPO, Adv. Dkt. 120); (3) Amended Application for Entry of Default (Adv. Proc. No. 10-05002-NPO, Adv. Dkt. 214; Adv. Proc. No. 10-05032, Adv. Dkt. 129), and (4) Motion for Default Judgment (Adv. Proc. No. 10-05002-NPO, Adv. Dkt. 217; Adv. Proc. No. 10-05032, Adv. Dkt. 134). The Debtor failed to respond. This Court held a hearing (the "Hearing") on the Motion for Default Judgment on January 24, 2012. At the Hearing, the Trustee was represented by William J. Little. Neither the Debtor nor counsel for the Debtor, however, attended the Hearing.

This Court considered the evidence and exhibits provided by the Trustee at the Hearing and entered a Default Judgment in both Interpleader Actions that included the following identical

language:

> [T]he corporate veils of Prestige Title, Inc., Advanced Title and Escrow, LLC, SJS Development, LLC, TGC Telecom, Inc., Colson & Waller, PLLC and Title 1, Inc., [are] reverse pierced and that the funds interplead into the registry of the court in this Adversary Proceeding [are] property of the bankruptcy estate.

(the "Default Judgments") (Adv. Proc. No. 10-05002-NPO, Adv. Dkt. 230; Adv. Proc. No. 10-05032-NPO, Adv. Dkt. 149).

2. Court of Competent Jurisdiction

The Default Judgments were rendered by this Court, a court of competent jurisdiction. The Interpleader Actions were originally filed in the Chancery Court of Harrison County, Mississippi. After the Debtor filed the Petition, the Interpleader Actions were removed to the United States District Court for the Southern District of Mississippi and then referred to the Bankruptcy Court. None of the parties to the Interpleader Actions disputes the jurisdiction of this Court to enter judgments and orders in the Interpleader Actions.

3. Final Judgment on the Merits

The Default Judgments entered by this Court are final judgments on the merits of the alter ego issue. "A default judgment is a final judgment on the merits and has a preclusive effect under *res judicata*." W. Coast Distrib., Inc. v. Pearce, 3:07-CV-1869-O, 2010 WL 145283, *4 (N.D. Tex. Jan. 14, 2010), *citing* Morris v. Jones, 329 U.S. 545, 550-51 (1947) (unpublished). Here, the Default Judgments were not appealed and constituted final judgments.

4. Same Cause of Action

To determine whether the causes of action asserted in separate adversary proceedings are the same, the Fifth Circuit applies the transactional test. Cisco Sys., Inc. v. Alcatel USA, Inc., 301 F. Supp. 2d. 599, 602 (E.D. Tex. 2004). The transactional test looks at whether the separate claims

arise out of the same nucleus of operative facts. Paige, 610 F.3d at 872.

In the Interpleader Actions, the Trustee urged this Court to pierce in reverse the corporate veils of the Title Companies and the other companies owned by the Debtor *in order to reach the assets of the Debtor* on the ground that the Debtor failed to maintain corporate formalities, the Title Companies were not properly capitalized, and funds from the Title Company Accounts were routinely intermingled. Zahra Spiritual Trust v. United States, 910 F.2d 240, 243 (5th Cir. 1990). In the present Adversary, Lawyers Title asks the Court to pierce the corporate veils of the Title Companies under a straightforward application of the traditional veil-piercing test *in order to reach the assets of the Title Companies* on the ground that the "funds were freely commingled" and the Debtor was the alter ego of the Title Companies. (Mem. at 14). A&L, Inc. v. Grantham, 747 So. 2d 832, 839 (Miss. 1999).

Although phrased differently, the veil-piercing claim asserted by the Trustee in the Interpleader Actions and the veil-piercing claim asserted by Lawyers Title in the Adversary, are based on the same nucleus of operative facts. Both the Trustee and Lawyers Title asserted that the Debtor did not respect corporate formalities, that the Title Companies were not truly separate from the Debtor, and that the Debtor intermingled funds in the Title Company Accounts. As a result, the Debtor and the Title Companies should be treated by the Court as if they were one. "The direction of the piercing is immaterial where the general rule has been met." New York v. Easton, 169 Misc. 2d 282, 290 (N.Y. Sup. Ct. 1995); *see also* Bollore S.A. v. Import Warehouse, Inc., 448 F.3d 317, 325 (5th Cir. 2006) (standard for alter ego liability applies equally to reverse-piercing cases). The requirements for *res judicata* have been met here, and the Court finds that the Title Companies were simply alter egos of the Debtor.

C. Section 523(a)(4)[18]

Lawyers Title invokes § 523(a)(4) in order to deny the Debtor a discharge of his debt. "[A] debtor under Chapter 7 of the Bankruptcy Code is generally granted a discharge of all debts that arose before the filing of the bankruptcy petition '[e]xcept as provided in section 523.'" Hosack v. IRS (In re Hosack), 282 Fed. Appx. 309, 313 (5th Cir. 2008) (unpublished) (internal citation omitted). The exceptions listed in § 523(a), including § 523(a)(4), are construed liberally in favor of granting a debtor a discharge, given that the intent of the Code is to provide debtors with a "fresh start." Fezler ex rel. Fezler v. Davis (In re Davis), 194 F.3d 570, 573 (5th Cir. 1999), *citing* Lines v. Frederick, 400 U.S. 18, 19 (1970). On the other hand, the "fresh start" afforded by the Code is limited to the "honest but unfortunate debtor." Grogan v. Garner, 498 U.S. 279, 287 (1991) (citation omitted). For that reason, debts resulting from "fraud or defalcation while acting in a fiduciary capacity" are non-dischargeable under § 523(a)(4). FNFS, Ltd. v. Harwood (In re Harwood), 637 F.3d 615, 619 (5th Cir. 2011), *citing* 11 U.S.C. § 523(a)(4).

The purpose of the defalcation exception is "to reach those debts incurred through abuses of fiduciary positions and through active misconduct whereby a debtor has deprived others of their property by criminal acts; both classes of conduct involve debts arising from the debtor's acquisition or use of property that is not the debtor's." Miller v. J.D. Abrams, Inc. (In re Miller), 156 F.3d 598, 602 (5th Cir. 1998). To prove that a certain debt is non-dischargeable under § 523(a)(4), the

[18] Lawyers Title initiated the Adversary prior to any determination of the Debtor's liability and, therefore, prior to the liquidation of any claim. The Court nevertheless reaches the merits of the dischargeability issue raised by Lawyers Title as a matter of law. To the extent that Lawyers Title seeks a judgment of liability against the Debtor, the Court finds that there are genuine issues of dispute that remain for trial for the reasons essentially set forth in the discussion below.

complaining party must show: (1) there is a fiduciary relationship between the parties, and (2) while acting as a fiduciary, the debtor committed fraud or defalcation. Lanier v. Futch (In re Futch), No. 09-00144-NPO, 2011 WL 576071, *22 (Bankr. S.D. Miss. Feb. 4, 2011), aff'd, No. 3:11-cv-00415-HTW-LRA (S.D. Miss. Mar. 31, 2012). Each of these elements must be proven by a preponderance of the evidence. Harwood, 637 F.3d at 619, *citing* Grogan, 498 U.S. at 286.

1. Was the Debtor a fiduciary?

Having found that the Debtor was the alter ego of the Title Companies, this Court must now determine whether a disputed issue remains for trial as to the existence of a fiduciary relationship between Lawyers Title and the Debtor within the meaning of § 523(a)(4). The scope of a "fiduciary" for purposes of § 523(a)(4) is a question of federal law. Miller, 156 F.3d at 602. It is state law, however, that determines whether a trust obligation exists, the breach of which may render the debt non-dischargeable under § 523(a)(4). Shcolnik v. Rapid Settlements Ltd. (In re Shcolnik), 670 F.3d 624, 628 (5th Cir. 2012) (citation omitted). "Under § 523(a)(4), the term 'fiduciary' is distinct from the concept of a 'fiduciary' under the common law; it is 'limited' to instances involving express or technical trusts. The purported trustee's duties must . . . arise independent of any contractual obligation." Id. (citation omitted). Nevertheless, a technical or express trust can arise from "trust-type obligations" imposed by state statute or common law, and is not limited to trusts that arise pursuant to a formal trust agreement. LSP Inv. P'ship v. Bennett (In re Bennett), 989 F.2d 779, 784-85 (5th Cir. 1993) (citation omitted). Also, the express or technical trust must have existed prior to the alleged wrongdoing. Id. at 784.

In Mississippi, an agent and principal are in a fiduciary relationship, and as a result, an agent owes its principal a duty of loyalty and good faith. Brumfield v. Miss. State Bar Ass'n, 497 So. 2d

800, 807 (Miss. 1986) (citation omitted). Bankruptcy law, however, holds that an agent under state law is not necessarily a "fiduciary" within the meaning of § 523(a)(4). Merchants Fin. Serv. Group v. Smith (In re Smith), 386 B.R. 618, 620-21 (Bankr. N.D. Miss. 2007) (internal citations omitted). "[T]he broad, general definition of the term 'fiduciary' under state law . . ., is generally not applicable in the context of a nondischargeability proceeding under § 523(a)(4)." George H. Singer, Section 523 of the Bankruptcy Code: The Fundamentals of Nondischargeability in Consumer Bankruptcy, 71 AM. BANKR. L.J. 325, 365 (1997); *see also* Anderson v. Currin (In re Currin), 55 B.R. 928, 932 (Bankr. D. Colo. 1985) (holding that the traditional definition of "fiduciary," which includes a duty to act in good faith, is not how the term is defined under § 523(a)(4)). Thus, although an agent-principal relationship may give rise to a fiduciary relationship, an agent-principal relationship under state law is insufficient, without more, to meet the definition of a "fiduciary" under § 523(a)(4). In re Blaszak, 397 F.3d 386, 391 (6th Cir. 2005).

There is no evidence, from the facts presented, that the relationship between the Title Companies and Lawyers Title was anything other than purely contractual in nature.[19] Each of the Title Companies entered into contracts with Lawyers Title whereby each agreed to serve as an agent for Lawyers Title in Mississippi, and later in the case of Prestige, as an agent in Alabama as well for the purpose of selling title insurance policies. Additionally, Lawyers Title was apparently aware of the escrow services offered by the Debtor because the Prestige Agreement and the Advanced Title Agreement provided that the Debtor's "escrow business is beyond the scope of the agency relationship created by this Agreement." (Prestige Agree. at 3, Lawyers Title Ex. 1). In the Motion

[19] Whether a fiduciary relationship existed between the Title Companies and other entities is not before the Court.

and Memorandum, Lawyers Title argues that the Debtor should be denied a discharge of those debts because the Debtor had a fiduciary duty to hold monies intended for real estate closings in trust and he used the funds for his own benefit. Even if this is so, the agreements entered into with Lawyers Title by the Title Companies limited the scope of the agency relationship between the parties, clearly stating that the escrow business of the Title Companies was beyond the scope of the parties' agent-principal relationship. As previously mentioned, although under Mississippi law an agent-principal relationship gives rise to a fiduciary duty under § 523(a)(4), it is not enough.

Further, even if a contractual relationship, standing alone, were enough to create a fiduciary relationship between the parties, the language in the agency agreements appears to exclude the acts of defalcation alleged by Lawyers Title from the parties' agency relationship. Thus, there are genuine issues of material fact as to whether a fiduciary relationship existed between the parties given the apparent contractual nature of their relationship and the limiting language included in the Prestige Agreement and the Advanced Title Agreement.

Moreover, for a fiduciary relationship between the Title Companies and Lawyers Title to exist, the express or technical trust between the parties must have existed prior to the alleged defalcation. In the instant case, there is a genuine issue of material fact as to when, if ever, an alleged defalcation occurred. To ensure that the Title Companies were complying with the terms of their agreements with Lawyers Title, LandAmerica intermittently conducted Reviews of the Title Companies. Through these Reviews, Lawyers Title was made aware of some of the issues facing the Title Companies. For instance, as early as 2002, Lawyers Title knew that Prestige was carrying negative balances in many of its accounts. Yet, in 2006, Lawyers Title entered into the Advanced Title Agreement. When the Advanced Title Agreement was entered into, the Debtor's alleged

diversion of Title Company funds for his own personal use had allegedly already occurred. Because the alleged defalcation could have begun before the Advanced Title Agreement was entered into, there is a genuine issue of material fact with respect to the existence of a fiduciary relationship between Lawyers Title and Advanced Title.

2. Did the alleged defalcation occur while the Debtor was acting in a fiduciary capacity?

Because the Court has found that there are genuine issues of material fact as to whether the Title Companies owed a fiduciary duty to Lawyers Title, this Court need not consider whether the acts of the Debtor (as the alter ego of the Title Companies) constituted defalcation. Nevertheless, the Court notes that the Fifth Circuit has described defalcation as "a willful neglect of duty, even if not accomplished by fraud or embezzlement." Schwagger v. Fallas (In re Schwagger), 121 F.3d 177, 184 (5th Cir. 1997) (citation omitted). "Defalcation includes the failure to produce funds entrusted to a fiduciary, even where such conduct does not reach the level of fraud." Swor v. Barley Tex. Builder Hardware Inc., 347 Fed. Appx. 113, 116 (5th Cir. 2009) (unpublished).

Conclusion

In conclusion, given the evidence presented in the Motion, the Response, the Reply, and the exhibits attached thereto, this Court finds that the Motion should be granted in part in that a declaratory judgment should be entered holding that the corporate veils of the Title Companies should be pierced. However, this Court finds that the Motion is not well-taken and should be denied

in part because the Court cannot determine as a matter of law whether the Debtor committed defalcation while acting as a fiduciary. Accordingly, for the reasons set forth above, the Court finds that the Motion should be granted in part, and denied in part.

SO ORDERED.

Neil P. Olack
United States Bankruptcy Judge
Dated: May 30, 2012