

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF NEBRASKA

IN THE MATTER OF:)	
)	CASE NO. BK99-42288
RODNEY G. ZWYGART and)	A00-04030
MARILYN F. ZWYGART,)	
)	CH. 11
Debtor(s).)	FILING NO. 1
_____)	
)	
DAVID M. FAUSS, PATTI FAUSS)	
GOHRING, and TERI/DOUGLAS)	
ENTERPRISES, INC.,)	
)	
Plaintiffs,)	
)	
vs.)	
)	
RODNEY G. ZWYGART and)	
MARILYN F. ZWYGART,)	
)	
Defendants.)	

MEMORANDUM

Trial was held on May 5 & 6, 2003, before a United States Bankruptcy Judge for the District of Nebraska on the complaint to determine dischargeability, Filing No. 1. Kathryn J. Derr and Thomas A. DeLay appeared for the plaintiffs, and Rodney G. Zwygart and Marilyn F. Zwygart appeared pro se. This memorandum contains findings of fact and conclusions of law required by Federal Rule of Bankruptcy Procedure 7052 and Federal Rule of Civil Procedure 52. This is a core proceeding as defined by 28 U.S.C. § 157(b)(2)(I).

This adversary proceeding was brought by the plaintiffs for a determination of the liability of the defendants/debtors to the plaintiffs, for determination of the amount of damages owed by the debtors to the plaintiffs, and for determination that the debt is nondischargeable under Section 523 of the Bankruptcy Code.

The debtors and the individual plaintiffs were shareholders in several corporations, each of which owned the assets of a liquor store. At a certain point in time, the Zwygarts apparently determined that the liquor stores being operated by Mr. Fauss and his former wife Patti Fauss Gohring were losing money. The Zwygarts determined that the cause of the loss had to do with mismanagement and perhaps even misuse of corporate assets. The Zwygarts, who were in charge of the books of the corporations, took action to terminate the services of the Fausses, remove the Fausses from their positions as directors of the corporations, transfer the Fauss stock, at least on the books, to the original owners of one or more of the liquor stores, reappointed, at least on the books, the original owners as directors, and transferred assets of the liquor business to a third party, all without the consent of the Fausses and without their knowledge. These actions were taken by Mr. and Mrs. Zwygart in their capacity as shareholders, directors, and officers. In addition, although

Mr. Zwygart had not been paid for his accounting services for many years, at or about the same time that he eliminated the Fausses from participation in the business, he paid himself thousands of dollars for his services to the company.

Mr. Fauss and Mrs. Fauss Gohring sued the Zwygarts in state court with regard to all of these activities concerning two of the corporations. A judgment was entered against the Zwygarts in state court. The Zwygarts then filed bankruptcy, and this adversary proceeding concerning the last of the corporations was filed. The allegations in this adversary proceeding track the similar allegations in the state court litigation, but with the additional allegations necessary to bring the matter under 11 U.S.C. § 523(a)(4) & (6).

The Bankruptcy Code at 11 U.S.C. § 523(a)(4) prohibits the discharge of a debt which is incurred by defalcation while acting in a fiduciary capacity. The Code, at 11 U.S.C. § 523(a)(6), prohibits the discharge of a particular debt if it was incurred by willful and malicious injury by the debtor to another entity or the property of another entity.

In this case, the debtors, officers and directors as well as shareholders of the corporate entity, are fiduciaries with regard to their relationship with other shareholders, Mr. and Mrs. Fauss. Davis v. Walker, 170 Neb. 891, 909, 104 N.W.2d 479, 489 (1960) (“[A]n officer or director of a corporation occupies a fiduciary relation towards the corporation and its stockholders, and is treated by courts of equity as a trustee; and . . . every violation by a trustee of a duty required of him by law, whether willful and fraudulent, or done through negligence, or arising through mere oversight or forgetfulness, is a breach of trust.”) See also Woodward v. Andersen, 261 Neb. 980, 990, 627 N.W.2d 742, 751 (2001); Fisher v. National Mortgage Loan Co., 132 Neb. 185, 271 N.W. 433, 437 (1937).

Even after the Zwygarts took control of the closely held corporation in January of 1997, they continued to have a fiduciary relationship to Mr. and Mrs. Fauss for purposes of the Bankruptcy Code’s fiduciary fraud or defalcation exception to discharge. See In re Frain, 230 F.3d 1014 (7th Cir. 2000).

For the purposes of the defalcation standard under 11 U.S.C. § 523(a)(4), the misappropriation of money held in a fiduciary capacity, including innocent or negligent misdeeds, even without the intent to defraud, satisfies the defalcation standard. Tudor Oaks Ltd. P’ship v. Cochrane (In re Cochrane), 124 F.3d 978, 984 (8th Cir. 1997).

On May 1, 1997, the Zwygarts presented to Elkhorn Valley Bank & Trust Company a corporate resolution purportedly adopted by the directors of Teri/Douglas Enterprises, Inc., and pursuant to the resolution, made corporate notes and drew funds from the corporate account. The Zwygarts used funds in that account to pay the accounting firm of Zwygart & Morgan in the sum of \$20,394.41. Mr. Zwygart testified that the payment was for services rendered by the accounting firm to the corporation from 1985 through April 22, 1997. The Zwygarts provided no information to Mr. or Mrs. Fauss concerning such corporate financial obligation, nor did the Zwygarts tell Mr. and Mrs. Fauss that the payment had been made. That payment by the Zwygarts, officers of the corporation, to Mr. Zwygart or his accounting firm from corporate funds, without consent by Mr. or Mrs. Fauss, was a misappropriation of corporate assets.

In Fisher v. National Mortgage Loan Co., 132 Neb. 185, 271 N.W. 433 (1937), a case with

facts similar to this one, the Nebraska Supreme Court, considering whether the president and director of the corporation could divert corporate property to himself in payment of attorney fees without authority from the board of directors, stated the general rule that an officer or director of a corporation occupies a fiduciary relationship toward the corporation and its shareholders, and held that an officer or director of a corporation cannot take property of the corporation to pay or secure a debt due himself from the corporation without authorization from the proper corporate authority. 271 N.W. at 437. The Nebraska Business Corporation Act, at Neb. Rev. Stat. § 21-20,112(1), codifies the decision in Fisher.

Similarly, the Zwygarts, after January of 1997, drew funds from the corporate account for the benefit of Budget Bottle Shop, Inc., one of the corporations that the Zwygarts controlled. The transfer of such funds was not approved by the board of directors, nor was it made known to the Fausses, who were also shareholders. There were no loan agreements, promissory notes, security agreements or interest provided in connection with the transfers of funds. There is no evidence that any of the funds were repaid to Teri/Douglas Enterprises, Inc., or that the transfers furthered any corporate purposes of Teri/Douglas Enterprises, Inc.

The Zwygarts, as officers and directors, diverted corporate funds for their benefit, and, because of their officer and director status, they had a fiduciary relationship with the Fausses. Such use of corporate funds for their personal benefit in derogation of the rights of the Fausses, even though not necessarily fraudulent, is a breach of trust. Rettinger v. Pierpont, 145 Neb. 161, 196-197, 15 N.W.2d 393, 411-412 (1944). Mr. and Mrs. Zwygart are therefore jointly and severally liable to the corporation for the loss and damage. Ashby v. Peters, 128 Neb. 338, 258 N.W. 639 (1935).

It is clearly established, in Nebraska and elsewhere, that a director or officer of a corporation is individually liable for fraudulent acts or false representations of his own or in which he participates, even though his actions may be in furtherance of the corporate business. Huffman v. Poore, 569 N.W.2d 549, 558 (Neb. Ct. App. 1997) (citing 18B Am. Jur. 2d *Corporations* § 1882 at 730-32 (1985)).

The corporate veil may be pierced to hold a shareholder liable when the shareholder has used the corporation to commit fraud, violate a legal duty, or perpetrate a dishonest or unjust act in contravention of the rights of another. Huffman, 569 N.W.2d at 557. However, when a tort action is brought against an officer or director, there is no need to pierce the corporate veil, and liability will be imposed if the elements of the tort are satisfied. Id. See also discussion in Wolf v. Walt, 247 Neb. 858, 530 N.W.2d 890, 896-98 (1995).

In addition to transferring funds for their own benefit, without approval of the board of directors and in derogation of the rights of the Fausses, Rodney Zwygart, in his capacity as president, "sold" substantially all of the assets of the corporation to a friend. No shareholder meeting or board of directors' meeting was held and Mr. Zwygart was not authorized either by the shareholders or directors to sell the property. Such a sale violates the Nebraska corporate statute found at Neb. Rev. Stat. § 21-20,136, which requires a two-thirds vote of shareholders before substantial assets of the corporation can be sold. The property was sold for \$15,000, and the value of the inventory was \$15,771.62.

With regard to the action brought under 11 U.S.C. § 523(a)(4), the plaintiffs have proved by a preponderance of the evidence that the Zwygarts are guilty of defalcation in their fiduciary capacity,

and the damages, referred to below, are nondischargeable.

To obtain a judgment of nondischargeability under 11 U.S.C. § 523(a)(6), the plaintiffs need to prove that the injury caused was done with actual intent. Kawaahau v. Geiger, 523 U.S. 57, 118 S. Ct. 974 (1998). The plaintiffs have met their burden. The activities of the Zwygarts referred to above were purposefully designed by the Zwygarts to exclude Mr. and Mrs. Fauss from the corporate affairs of Teri/Douglas Enterprises, Inc. The Fausses had no information about the operation of the business because the Zwygarts did not permit them to have any such information. The Zwygarts were able to use corporate funds for their own benefit without knowledge of Mr. and Mrs. Fauss. The Zwygarts sold the assets to a friend and business associate, and permitted the friend and business associate to use and deplete the assets of the corporation without payment to Teri/Douglas Enterprises, Inc.

The defenses raised by the Zwygarts are not sufficient. They take the position that Mr. and/or Mrs. Fauss must have been misappropriating funds, which gave the Zwygarts the right to act in the manner in which they did act. They also take the position that they were following legal advice provided by counsel concerning the actions they took to remove Mr. and Mrs. Fauss from their corporate capacities. Neither defense is satisfactory. The Zwygarts, as officers and directors and shareholders of the corporation, had a fiduciary duty to Mr. and Mrs. Fauss, which they breached. A breach of such fiduciary duty on the theory that Mr. and Mrs. Fauss were the "bad guys" or on the theory that they had advice of counsel does not excuse the Zwygarts' actions either under the case law or the corporate statutes of Nebraska.

A payment of professional fees in the amount of \$20,394.41, the transfers to Budget Bottle Shop identified by checks in the amount of \$7,410.97, the funds transferred to Budget Bottle in the amount of \$4,640, unexplained cash transfers in the amount of \$13,057, the cash balance of \$9,004.30 in the checking account as of December 31, 1999, and the sale of assets for a total of \$30,771.62 are all representative of the use of corporate funds for the benefit of the debtors and in derogation of the rights of Mr. and Mrs. Fauss. The total amount of damages caused to the corporation resulting from the above activities is \$85,278.30.

This amount, \$85,278.30, is owed to the corporation and is nondischargeable under both 11 U.S.C. § 523(a)(4) and 11 U.S.C. § 523(a)(6). Mr. Fauss and Mrs. Fauss Gohring own 49.8 percent of the shares in the corporation. Therefore, they are owed 49.8 percent of the amount due the corporation and that amount is nondischargeable. The debt to them is included in the total.

Separate judgment will be entered in the amount of \$85,278.30 plus costs and attorneys' fees in favor of the plaintiff corporation. \$42,468.59 of that amount, plus costs and attorneys' fees, is a judgment in favor of the plaintiffs David M. Fauss and Patti Fauss Gohring. The total amount is nondischargeable.

DATED this 7th day of October, 2003.

BY THE COURT:

/s/ Timothy J. Mahoney
Chief Judge

Notice given by the Court to:

*Kathryn J. Derr & Thomas A. DeLay
Rodney G. Zwycart
Marilyn F. Zwycart
U.S. Trustee

Movant (*) is responsible for giving notice of this order to all other parties not listed above if required by rule or statute.

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DAVID M. FAUSS, PATTI FAUSS)	
GOHRING, and TERI/DOUGLAS)	
ENTERPRISES, INC.,)	
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Plaintiffs,)	
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RODNEY G. ZWYGART and)	
MARILYN F. ZWYGART,)	
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Defendants.)	

JUDGMENT

Trial was held on May 5 & 6, 2003, before a United States Bankruptcy Judge for the District of Nebraska on the complaint to determine dischargeability, Filing No. 1. Kathryn J. Derr and Thomas A. DeLay appeared for the plaintiffs, and Rodney G. Zwygart and Marilyn F. Zwygart appeared pro se.

Judgment is hereby entered in favor of Teri/Douglas Enterprises, Inc., and against the debtors, in the amount of \$85,278.30 plus costs and attorneys' fees. Of that amount, \$42,468.59, plus costs and attorneys' fees, is a judgment in favor of David M. Fauss and Patti Fauss Gohring. The total amount is nondischargeable.

SO ORDERED.

DATED this 7th day of October, 2003.

BY THE COURT:

/s/ Timothy J. Mahoney
Chief Judge

Notice given by the Court to:

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Rodney G. Zwycart
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