

IN THE UNITED STATES BANKRUPTCY COURT  
FOR THE DISTRICT OF NEBRASKA

IN THE MATTER OF: )  
)  
TIMOTHY & MARY JO KURMEL, )  
)  
Debtor(s). ) CASE NO. BK03-82722  
A03-8075  
JUDITH LETRUD; SHELLY KOEHLER; )  
& HEARTLAND PHYSICAL THERAPY, )  
INC., )  
)  
Plaintiff, ) CH. 7  
)  
vs. )  
)  
TIMOTHY & MARY JO KURMEL, )  
)  
Defendant. )

MEMORANDUM

This matter is before the court on the plaintiffs' motion for summary judgment (Fil. #17) and the debtors' resistance (Fil. #21). Charles Benish and Gregory Scaglione represent the plaintiffs, and William Biggs and Donald Dworak represent the debtors. The motion was taken under advisement as submitted and without oral arguments. 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).

The motion will be denied.

I. Background

This action was filed to determine the dischargeability of a debt under 11 U.S.C. § 523(a)(2)(A), and perhaps under 11 U.S.C. § 523(a)(4). The plaintiffs hold a judgment from the Madison County (Nebraska) District Court for \$378,386.30 against Timothy Kurmel and one of his corporations. They seek to have this amount, plus costs and interest, excepted from discharge as a debt for property obtained by false pretenses, false representations, or actual fraud, or one for fraud or defalcation while acting in a fiduciary capacity.

The judgment arises from an arrangement Mr. Kurmel and one of his companies, Partners in Physical Therapy, Inc. ("PIPT"), had with another of his companies, Heartland Physical Therapy, Inc., by which PIPT would provide contract laborers to Heartland and handle the workers' wages, benefits, and expenses. Heartland was to reimburse PIPT for these costs plus a 10 percent administrative fee.

Mr. Kurmel failed to pay the payroll taxes and 401(k) contributions for the contract workers. He also used corporate money as his own and charged personal and unrelated business expenses to Heartland. These findings of fact are part of the Madison County District Court's decree. Moreover, that court found "overwhelming" evidence that PIPT was the alter ego of Mr. Kurmel, so judgment was entered against him personally as well as against PIPT.

The individual plaintiffs in the present case are, or at the relevant times were, shareholders, officers, and directors of Heartland Physical Therapy, Inc. They move for summary judgment on the grounds that, as demonstrated by the state court judgment, no genuine issue of material fact exists and they are entitled to a judgment of non-dischargeability under § 523(a)(2)(A) for fraud and § 523(a)(4) for defalcation while acting in a fiduciary capacity.

The debtors resist the motion for summary judgment, arguing that the plaintiffs have not heretofore alleged a cause of action under § 523(a)(4) and that the state court judgment cannot serve as a basis for a finding of fraud or of defalcation because the judgment is not based on either of those grounds.

## II. Summary Judgment Standard

Summary judgment is appropriate only if the record, when viewed in the light most favorable to the non-moving party, shows there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law. Fed. R. Civ. P. 56(c) (made applicable to adversary proceedings in bankruptcy by Fed. R. Bankr. P. 7056); see, e.g., Celotex Corp. v. Catrett, 477 U.S. 317, 322-23 (1986); Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 249-50 (1986); Morgan v. Rabun, 128 F.3d 694, 696 (8th Cir. 1997), cert. denied, 523 U.S. 1124 (1998); Get Away Club, Inc. v. Coleman, 969 F.2d 664, 666 (8th Cir. 1992); St. Paul Fire & Marine Ins. Co. v. FDIC, 968 F.2d 695, 699 (8th Cir. 1992).

The court's role is simply to determine whether the evidence in the case presents a sufficient dispute to place before the trier of fact.

At the summary judgment stage, the court should not weigh the evidence, make credibility determinations, or attempt to determine the truth of the matter. Rather, the court's function is to determine whether a dispute about a material fact is genuine. . . . If reasonable minds could differ as to the import of the evidence, summary judgment is inappropriate.

Quick v. Donaldson Co., Inc., 90 F.3d 1372, 1376-77 (8th Cir. 1996) (internal citations omitted). See also Bell v. Conopco, Inc., 186 F.3d 1099, 1101 (8th Cir. 1999) (on summary judgment, court's function is not to weigh evidence to determine truth of any factual issue); Mathews v. Trilogy Communications, Inc., 143 F.3d 1160, 1163 (8th Cir. 1998) ("When evaluating a motion for summary judgment, we must . . . refrain from assessing credibility.").

"Rule 56(c) mandates the entry of summary judgment, after adequate time for discovery and upon motion, against a party who fails to make a showing sufficient to establish the existence of an element essential to that party's case, and on which that party will bear the burden of proof at trial." Celotex, 477 U.S. at 322. "We look to the substantive law to determine whether an element is essential to a case, and only disputes over facts that might affect the outcome of the suit under the governing law will properly preclude the entry of summary judgment." Williams v. Marlar (In re Marlar), 252 B.R. 743, 751 (B.A.P. 8th Cir. 2000) (quoting Ries v. Wintz Properties, Inc. (In re Wintz Cos.), 230 B.R. 848, 858 (B.A.P. 8th Cir. 1999)) (internal quotations omitted).

### III. Law

#### A. 11 U.S.C. § 523(a)(2)(A)

For a debt to be declared nondischargeable under § 523(a)(2)(A) for fraud, the creditor must show, by a preponderance of the evidence, that: (1) the debtor made a representation; (2) the representation was made at a time when the debtor knew the representation was false; (3) the debtor made the representation deliberately and intentionally with the

intention and purpose of deceiving the creditor; (4) the creditor justifiably relied on such representation; and (5) the creditor sustained a loss as the proximate result of the representation having been made. Universal Bank, N.A. v. Grause (In re Grause), 245 B.R. 95, 99 (B.A.P. 8th Cir. 2000) (citing Thul v. Ophaug (In re Ophaug), 827 F.2d 340, 342 n.1 (8th Cir. 1987), as supplemented by Field v. Mans, 516 U.S. 59 (1995)). In Field v. Mans, the Supreme Court held that § 523(a)(2)(A) requires justifiable reliance, in which "[j]ustification is a matter of the qualities and characteristics of the particular plaintiff, and the circumstances of the particular case, rather than of the application of a community standard of conduct to all cases." Id. at 71 (citing the Restatement (Second) of Torts § 545A cmt. b (1976)).

B. 11 U.S.C. § 523(a)(4)

Section 523(a)(4) of the Bankruptcy Code excepts from discharge any debt for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny.

Whether a relationship is a fiduciary relationship within the meaning of section 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), cert. denied, 522 U.S. 1112 (1998).

"Acting in a fiduciary capacity" is limited in application to technical or express trusts, not to trusts that may be imposed because of the alleged act of wrongdoing from which the underlying indebtedness arose. See Barclays Am./Bus. Credit, Inc. v. Long (In re Long), 774 F.2d 875, 878-79 (8th Cir. 1985) (for purposes of § 523(a)(4) fraud or defalcation exception, fiduciary capacity must arise from express trust, not constructive trust or mere contractual relationship). A fiduciary relationship is not limited to trusts arising under a formal trust agreement, but it does not encompass ordinary commercial relations such as debtor-creditor or principal-agent. Brown v. Heister (In re Heister), 290 B.R. 665, 673 (Bankr. N.D. Iowa 2003) (citing In re Dove, 78 B.R. 630, 633 (Bankr. M.D. Ga. 1986) and In re Cook, 263 B.R. 249, 255 (Bankr. N.D. Iowa 2001)).

Bankruptcy courts often look to state law to determine whether a fiduciary relationship exists. In Nebraska, a fiduciary duty "arises out of a confidential relationship which

exists when one party gains the confidence of the other and purports to act or advise with the other's interest in mind. American Driver Serv., Inc. v. Truck Ins. Exch., 10 Neb. Ct. App. 318, 324, 631 N.W.2d 140, 145 (2001); Wolf v. Walt, 247 Neb. 858, 870, 530 N.W.2d 890, 898 (1995); Bloomfield v. Nebraska St. Bank, 237 Neb. 89, 465 N.W.2d 144 (1991).

As for the fiduciary nature of the relationship of a corporate officer, a corporate officer or director is precluded from acting "in such a manner as to cause or contribute to the injury or damage of the corporation, or deprive it of business[.]" Anderson v. Bellino, 265 Neb. 577, 658 N.W.2d 645, 657 (2003) (quoting 3 W. Fletcher, *Cyclopedia of the Law of Private Corporations* § 861 (rev. perm. ed. 1975)).

According to the caselaw in the Eighth Circuit, a bankruptcy court can find a "defalcation" under 11 U.S.C. § 523(a)(4) without evidence of intentional fraud or other intentional wrongdoing. The Eighth Circuit Court of Appeals in the case of Tudor Oaks Ltd. P'ship v. Cochrane, *supra*, stated:

Defalcation is defined as the "misappropriation of trust funds or money held in any fiduciary capacity; [the] failure to properly account for such funds." Under section 523(a)(4), defalcation "includes the innocent default of a fiduciary who fails to account fully for money received." . . . An individual may be liable for defalcation without having the intent to defraud.

124 F.3d at 984 (quoting Lewis v. Scott, 97 F.3d 1182, 1186 (9th Cir. 1996)).

#### C. Liability of corporate officer

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, 530 N.W.2d 890, 896-98 (Neb. 1995).

#### IV. Discussion

Collateral estoppel applies in bankruptcy dischargeability proceedings brought under 11 U.S.C. § 523. Hobson Mould Works, Inc. v. Madsen (In re Madsen), 195 F.3d 988, 989 (8th Cir. 1999). When the parties have previously litigated an issue in a state court, the bankruptcy court will apply the collateral estoppel law of the state. Id. In Nebraska, collateral estoppel applies when an issue of ultimate fact has been determined by a final judgment, and that issue cannot again be litigated between the same parties in a future lawsuit. In re Marcus W., 11 Neb. Ct. App. 313, 325, 649 N.W.2d 899, 910 (2002). Four factors must be established to impose collateral estoppel: (1) the identical issue was decided in a prior case; (2) a judgment on the merits was entered, which is final; (3) the party against whom the rule is applied was a party, or in privity with a party, to the prior action; and (4) the parties had an opportunity to fully and fairly litigate the issue in the prior action. R.W. v. Schrein, 268 Neb. 708, 714-15, 642 N.W.2d 505, 511 (2002).

The test in the state courts as to whether the prior judgment decided the identical issue generally is whether or not the same evidence would be necessary in both actions. Marcus W., 649 N.W.2d at 910 (quoting Suhr v. City of Scribner, 207 Neb. 24, 27, 295 N.W.2d 302, 304 (1980)). However, in a non-dischargeability proceeding in a bankruptcy case, the question becomes whether the state court judgment establishes the elements of a prima facie case under § 523. Madsen, 195 F.3d at 989-90; Bankers Trust Co., N.A., v. Hoover (In re Hoover), 301 B.R. 38, 45-46 (Bankr. S.D. Iowa 2003).

In the present case, there is no dispute that the second, third, and fourth parts of the collateral estoppel test have been met. The Madison County District Court's decree is a final judgment on the merits, after a trial between the same plaintiffs and defendants involved in this case. The issue is whether the state court's ruling rests on the same elements of fraud and breach of fiduciary duty as would a finding of non-dischargeability under §§ 523(a)(2)(A) and/or (a)(4).

Although it is tempting to say that the state court decree supports a finding of non-dischargeability under § 523(a)(2)(A) based on Mr. Kurmel's misuse of the funds paid to PIPT by Heartland, such a ruling would be inappropriate. Section 523(a)(2)(A) contains an intent element requiring the court to find that the debtor made a representation that he knew was false, with the intention and purpose of deceiving the plaintiffs. The state court decree does not reveal any findings as to Mr. Kurmel's intent concerning any alleged misrepresentations. Moreover, the amended complaint in this case contains numerous allegations that appear to state a claim for breach of contract rather than a § 523(a)(2)(A) claim. In other words, it is not clear to the court specifically what representation(s) Mr. Kurmel is alleged to have made, other than the terms of the oral contract in general; that he knew such representations were false; or that the plaintiffs justifiably relied on such representations.

By the same token, the state court decree cannot be used to establish fraud or defalcation by a fiduciary. The decree does not address those elements. To the extent such a cause of action is alleged in the amended complaint in this case, fairness requires that evidence be adduced on the elements of the cause of action, particularly on whether Mr. Kurmel was acting in a fiduciary capacity as that term is used in the Bankruptcy Code.

#### V. Dismissal of Mrs. Kurmel

Although the debtors have not raised the issue of whether Mrs. Kurmel is properly a party to this action,<sup>1</sup> I have reviewed the amended complaint and see no allegations against her. All of the wrongdoing complained of appears to have been committed by Mr. Kurmel. Therefore, it appears that Mrs. Kurmel could be dismissed from this lawsuit. The plaintiffs shall have until June 10 to show cause why Mrs. Kurmel should not be dismissed as a defendant, or judgment of dismissal will be entered in her

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<sup>1</sup>Nor are they required to raise it at this juncture. A defense of failure to state a claim upon which relief can be granted may be made in a pleading, by motion for judgment on the pleadings, or at the trial on the merits. Fed. R. Civ. P. 12(h)(2), made applicable in adversary proceedings by Fed. R. Bankr. P. 7012(b). However, to best allocate the resources of both the parties and the court, it would seem to be of benefit to dismiss her sooner rather than later, if possible.

favor at that time.

A separate order will be entered.

DATED: May 19, 2004

BY THE COURT:

/s/ Timothy J. Mahoney  
Chief Judge

Notice given by the Court to:

\*Charles Benish/Gregory Scaglione  
William Biggs  
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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ORDER

This matter is before the court on the plaintiffs' motion for summary judgment (Fil. #17) and the debtors' resistance (Fil. #21). Charles Benish and Gregory Scaglione represent the plaintiffs, and William Biggs and Donald Dworak represent the debtors.

IT IS ORDERED the plaintiffs' motion for summary judgment (Fil. #17) is denied.

IT IS FURTHER ORDERED the plaintiffs shall show cause by June 10, 2004, why Mrs. Kurmel should not be dismissed from this lawsuit.

See Memorandum entered this date.

DATED: May 19, 2004

BY THE COURT:

/s/ Timothy J. Mahoney  
Chief Judge

Notice given by the Court to:  
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