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8 **UNITED STATES BANKRUPTCY COURT**
9 **EASTERN DISTRICT OF CALIFORNIA**
10 **SACRAMENTO DIVISION**

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|--------------------------------|---|-------------------------------------|
| 10 In re: |) | Bankruptcy Case No. 09-38717 |
| 11 MARTIN F. SULLIVAN, JR., |) | Voluntary Petition Chapter 7 |
| 12 Debtor. |) | Adversary Proceeding No. 09-02771-A |
| 13 _____ |) | (DC NO. AD-3) |
| 14 UNIVERSAL CASUALTY COMPANY, |) | |
| 15 Plaintiff, |) | |
| 16 v. |) | |
| 17 MARTIN F. SULLIVAN, JR., |) | |
| 18 Defendant. |) | |
| 19 _____ |) | |

20 **ORDER**

21
22 This cause coming to be heard on Plaintiff's Motion for Summary Judgment, all parties
23 having been given due notice, the Court being fully advised in the premises and having jurisdiction
24 over the parties and subject matter;

25 IT IS HEREBY ORDERED:

- 26 1. For the reasons set forth in the Court's Final Ruling dated, November 8, 2010,
27 docket No. 90, and which is hereby adopted, Plaintiff UNIVERSAL CASUALTY
28


1 COMPANY's ("UNIVERSAL" or "UCC") Motion for Summary Judgment is
2 granted, pursuant to Bankruptcy Rule 7056(c)(2);

3 2. Judgment is entered in favor of Plaintiff UNIVERSAL and against Defendant/Debtor
4 MARTIN F. SULLIVAN, JR. in the amount of \$2,377,041.60; and

5 3. The judgment of \$2,377,041.60 is non-dischargeable, pursuant to 11 U.S.C.
6 §523(a)(4), due to MARTIN F. SULLIVAN, JR.'s defalcation while acting in a
7 fiduciary capacity.

8 Dated: November 10, 2010

By the Court

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10 
11 Michael S. McManus
12 United States Bankruptcy Judge
13
14

15 Order Prepared by:

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UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF CALIFORNIA
SACRAMENTO DIVISION

Honorable Michael S. Manus

9. 09-38717-A-7 MARTIN SULLIVAN CONT. HEARING - PLAINTIFF'S
09-2771 AD #3 MOTION FOR SUMMARY JUDGMENT
UNIVERSAL CASUALTY CO., VS. 9-14-10 [42]
MARTIN SULLIVAN, JR.

Tentative Ruling: The motion will be granted as provided in the ruling below.

The plaintiff, Universal Casualty Company, moves for summary judgment on four causes of action pursuant to sections 523(a)(2)(A), 523(a)(2)(B), 523(a)(4), and 523(a)(6).

Despite repeated extensions of time and promises by the defendant, Martin Sullivan, Jr., to file an opposition to this motion, he has filed no opposition to the motion. The motion was continued from October 12, 2010, prior to which the defendant had requested a continuance to file an opposition. The court continued the motion to November 8, giving the defendant more time to file opposition. Although the court posted a ruling on the October 12, 2010 calendar, that ruling was a *tentative* ruling, pending the final hearing on the motion.

The plaintiff has filed a reply to the court's tentative ruling posted on October 12, 2010, noting the absence of an opposition to the motion and urging the court to enter summary judgment in the plaintiff's favor. The reply also says that the October 12 ruling did not address the plaintiff's defalcation while acting fiduciary capacity claim pursuant to section 523(a)(4).

The defendant was a principal shareholder in Sovereign General Insurance Services, Inc. and served as SGI's vice president. Amended Answer ¶ 3. SGI specialized in writing or brokering insurance coverage on behalf of various insurance carriers, including the plaintiff, to commercial customers. SGI was a "program manager" for the plaintiff. Exhibit A to Motion, Giles Decl. ¶ 6. Pursuant to its program management agreement with the plaintiff, SGI would collect premiums, deduct its commissions and forward the balance of the premiums to the plaintiff. Exhibit A to Motion, Giles Decl. ¶ 5; Amended Answer ¶¶ 7, 12; Exhibit A to Motion, PMA, Exhibit 1 to Giles Decl. The funds owed to the plaintiff were required to be held in a trust account, segregated from SGI's own funds. Amended Answer ¶ 15; Exhibit A to Motion, PMA, Exhibit 1 to Giles Decl. The account was reconciled based on monthly Bordereaux reports prepared by SGI and submitted to the plaintiff. Amended Answer ¶¶ 37, 38, 39; Exhibit A to Motion, Giles Decl. ¶ 5; Exhibit F to Motion, Brignolio Dep. at 28-31; Exhibit I to Motion, Barragan Dep. at 13.

Starting in the Spring of 2009, the plaintiff discovered that SGI's trust account for the plaintiff was approximately \$1.9 million short based on SGI's Bordereaux reports. Amended Answer ¶ 44; Exhibit A to Motion, Giles Decl. ¶¶

November 8, 2010 at 9:00 a.m.

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19, 20. After terminating the PMA and conducting further investigation, the plaintiff discovered that SGI owed and had not paid approximately \$2.4 million under the PMA. Exhibit A to Motion, Giles Decl. ¶¶ 24-27. Martin Sullivan, Sr., the defendant's father and former CEO of SGI, has admitted that SGI delved into the trust accounts, including the account for the plaintiff, to close gaps in SGI's operating budget. Exhibit P to Motion, Sullivan, Sr. Dep. at 27-28; Exhibit Q to Motion, Sullivan, Jr. Dep. at 48-49.

The defendant has admitted that SGI breached its fiduciary duties to the plaintiff by failing to segregate and hold premiums for the plaintiff, "with [his] knowledge, participation, acquiescence and/or reckless or negligent oversight or supervision." Amended Answer ¶ 47. The defendant has also admitted that he was fiduciary to the plaintiff with respect to the collected premiums (Amended Answer ¶ 17); that the plaintiff is owed premiums collected by SGI on the plaintiff's behalf (Exhibit Q to Motion, Sullivan, Jr. Dep. at 44); that he took no steps to insure the integrity of the plaintiff's trust account at SGI or even apprise himself of matters relating to the accounting of the premiums owed to the plaintiff, by way of audit, oversight, or otherwise (Exhibit Q to Motion, Sullivan, Jr. Dep. at 20-21, 42-44).

Under the terms of the PMA, the defendant, along with SGI, is a party to the PMA. The PMA identifies the defendant, along with SGI, as a manager. The PMA states that it "is between [SGI] and all related entities as identified in the ENDORSEMENTS attached hereto and made part of this Agreement (collectively and individually: "Manager"), and [UCC]." Exhibit A to Motion, PMA at 5, Exhibit 1 to Giles Decl. In Endorsement G to the PMA, titled Manager's Personal Guaranty, the defendant is identified as an officer of SGI, personally guaranteeing SGI's performance under the PMA. Exhibit A to Motion, PMA at 42, Exhibit 1 to Giles Decl. As manager under the PMA, the defendant was required by the PMA to provide the plaintiff with accounting of all transactions and insurance written pursuant to the PMA. Exhibit A to Motion, PMA at 8, ¶ M1-3, Exhibit 1 to Giles Decl.

The defendant has also admitted that he is an insurance broker and agent licensed by the California Department of Insurance and he is subject to the statutory fiduciary duties California imposes on licensees with respect to the premiums licensees collect on behalf of insurers. Amended Answer ¶¶ 9, 10, 18. Specifically, the defendant has admitted to having statutory fiduciary duties to the plaintiff and being a statutory trustee over insurance premiums SGI collected for the plaintiff, pursuant to Cal. Ins. Code §§ 1733 and 1734. Amended Answer ¶¶ 30, 31.

Summary judgement is appropriate when there exists "no genuine issue as to any material fact and the moving party is entitled to judgment as a matter of law." Fed. R. Civ. P. 56(c). The Supreme Court discussed the standards for summary judgment in a trilogy of cases, Celotex Corporation v. Catrett, 477 U.S. 317, 327 (1986), Anderson v. Liberty Lobby, Inc., 477 U.S. 242 (1986), and Matsushita Electrical Industry Co. v. Zenith Radio Corp., 475 U.S. 574 (1986). In a motion for summary judgment, the moving party bears the initial burden of persuasion in demonstrating that no issues of material fact exist. See Anderson at 255. A genuine issue of material fact exists when the trier of fact could reasonably find for the non-moving party. Id. at 248. The court may consider pleadings, depositions, answers to interrogatories and any affidavits. Celotex at 323. Where the movant bears the burden of persuasion as to the claim, it must point to evidence in the record that satisfies its claim. Id. at 252.

Section 523(a)(4) provides that an individual is not discharged "from any debt for fraud or defalcation while acting in a fiduciary capacity." The fiduciary capacity requirement applies only to debts for fraud or defalcation.

Only two questions exist under section 523(a)(4) when defalcation is involved, whether the defendant committed defalcation and whether it was committed in relation to the debtor's fiduciary responsibilities. Bugna v. McArthur (In re Bugna), 33 F.3d 1054, 1057 (9th Cir. 1994).

Initially, the court will examine the requirements for establishing a fiduciary relationship for purposes of section 523(a)(4).

The definition of fiduciary capacity under section 523(a)(4) is a narrow question of federal law. Cantrell at 1125. The broad and general state definition of fiduciary capacity is inapplicable. Id. The fiduciary relationship must arise from an express or technical trust that was imposed before and without reference to the wrongdoing that caused the debt. Id. (citing Lewis at 1185). Courts rely on state law only to ascertain whether the required trust relationship exists. Cantrell at 1125.

"In general, a statutory fiduciary is considered a fiduciary for the purposes of § 523(a)(4) if the statute: (1) defines the trust res; (2) identifies the fiduciary's fund management duties; and (3) imposes obligations on the fiduciary prior to the alleged wrongdoing." Blyler v. Hemmeter (In re Hemmeter), 242 F.3d 1186, 1190 (9th Cir. 2001).

In this case, the statutes which the defendant has admitted apply here are Cal. Ins. Code §§ 1733 and 1734. Cal. Ins. Code § 1733 provides that:

"All funds received by any person acting as a licensee under this chapter, Chapter 5A (commencing with Section 1759), Chapter 6 (commencing with Section 1760), or Chapter 7 (commencing with Section 1800), as premium or return premium on or under any policy of insurance or undertaking of bail, are received and held by that person in his or her fiduciary capacity. Any such person who diverts or appropriates those fiduciary funds to his or her own use is guilty of theft and punishable for theft as provided by law. Any premium that a premium financier agrees to advance pursuant to the terms of a premium finance agreement shall constitute fiduciary funds as defined in this section only if actually received by a person licensed in one or more of the capacities herein specified."

Cal. Ins. Code § 1734 further provides that:

"This section applies to any person licensed, whether under a permanent license, restricted license, temporary license, or certificate of convenience, to act in any of the capacities specified in Section 1733. If fiduciary funds, as defined in Section 1733, are received by such person, he shall:

(a) Remit premiums, less commissions, and return premiums received or held by him to the insurer or the person entitled thereto, or

(b) Maintain such fiduciary funds on California business at all times in a trustee bank account or depository in California separate from any other account or depository, in an amount at least equal to the premiums and return premiums, net of commissions, received by him and unpaid to the persons entitled thereto or, at their direction or pursuant to written contract, for the account of such persons. As used in this section, "trustee bank account or

depository" includes but is not limited to a checking account, demand account, or savings account, each of which shall be designated as a trust account. However, such person may commingle with such fiduciary funds in such account or depository such additional funds as he may deem prudent for the purpose of advancing premiums, establishing reserves for the paying of return commissions or for such contingencies as may arise in his business of receiving and transmitting premium or return premium funds, or

(c) Maintain such fiduciary funds pursuant to Section 1734.5."

These statutes satisfy the requirements for a statutory fiduciary to qualify as a fiduciary under § 523(a)(4). Cal. Ins. Code § 1733 defines the trust res as "premium or return premium on or under any policy of insurance or undertaking of bail." The fiduciaries and their management duties are also defined. Cal. Ins. Code § 1733 identifies the fiduciaries as "any person acting as a licensee under this chapter, Chapter 5A (commencing with Section 1759), Chapter 6 (commencing with Section 1760), or Chapter 7 (commencing with Section 1800)." The fiduciary duties are defined in Cal. Ins. Code § 1734 as requiring the fiduciaries to remit premiums and return premiums received or held to the insurer and to maintain fiduciary funds in a segregated account. Cal. Ins. Code § 1734(a), (b). And, the statutes impose the obligations on the fiduciaries prior to the alleged wrongdoing because the obligations are triggered when the premiums or return premiums "are received and held by" the defined fiduciaries. Cal. Ins. Code § 1733. The obligations are not triggered at the time of the alleged wrongdoing, i.e., when the fiduciary fails to remit or maintain the premiums or return premiums, but prior to it. Cal. Ins. Code §§ 1733 and 1734 then satisfy the requirements for a statutory fiduciary, for purposes of § 523(a)(4).

The defendant has admitted to having fiduciary duties to the plaintiff and being a statutory trustee over insurance premiums SGI collected for the plaintiff, under Cal. Ins. Code §§ 1733 and 1734. Amended Answer ¶¶ 30, 31; Complaint ¶¶ 30, 31. Hence, the defendant is a fiduciary to the plaintiff with respect to the premiums SGI collected, held, and was required to remit to the plaintiff, for purposes of section 523(a)(4).

Finally, the court turns to whether the plaintiff has satisfied the requirements for defalcation. For purposes of section 523(a)(4), defalcation is defined as the misappropriation of trust funds or money held in any fiduciary capacity, or the failure to properly account for such funds, including the innocent default of a fiduciary who fails to account fully for money received. Lewis v. Scott (In re Lewis), 97 F.3d 1182, 1186 (9th Cir. 1996). While defalcation includes innocent, as well as intentional or negligent defaults, it does not require intent to defraud. Lewis at 1187.

As noted above, the defendant has admitted that SGI has defaulted on its obligations under the PMA to the plaintiff, by failing to segregate, hold and/or remit premiums and return premiums to the plaintiff. The defendant has admitted that SGI's default was "with [his] knowledge, participation, acquiescence and/or reckless or negligent oversight or supervision." As a fiduciary to the plaintiff with respect to the premiums SGI collected, held, and was required to remit to the plaintiff, then, the defendant is liable for defalcation under section 523(a)(4) because of SGI's default under the PMA. The plaintiff did not receive funds, including premiums and return premiums, SGI had collected and was required to remit to the plaintiff, meaning that the funds as to which the defendant is a fiduciary, for purposes of section 523(a)(4), have been misappropriated. Whether or not the defendant had

fraudulent intent is immaterial because even an innocent default or failure to properly account for the funds suffices to establish defalcation under section 523(a)(4). Lewis at 1186-87.

The plaintiffs have shown that the defendant's defalcation has caused damages to the plaintiff in the amount of \$2,377,041.60, consisting of net premiums for April through July of 2009 that were not remitted to the plaintiff and return premiums that were not refunded to insured parties. Exhibit A to Motion, Giles Decl. ¶¶ 24, 26, 27. The court will enter a judgment pursuant to section 523(a)(4) consistent with this ruling in favor of the plaintiff. It is unnecessary to address other grounds for relief.