DO YOU HAVE TRUST ISSUES?
THE SURETY'S USE OF TRUST FUND RIGHTS IN BANKRUPTCY

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I. INTRODUCTION[2]

It has been said "where large sums of money are concerned, it is advisable to trust nobody."[3] Yet trusts abound in statutes, indemnity agreements and contracts, and trusts are even implied by law under certain circumstances. The question that arises is what rights flow from such trusts in the bankruptcy context and the corollary question is how can the surety use such rights to its advantage. To address these questions, this paper will first look at the nature of trusts in general, their characteristics and elements, the duties and obligations of the parties and the rights of the beneficiaries in general. Forming a solid understanding of the law of trusts is essential for the surety to be able to identify and assert such rights in the myriad of circumstances which may arise. Next, the paper will focus on the various forms of trusts, such as statutory trust funds, contractually created trusts and trusts at common law. The paper will then discuss the surety's trust rights in the context of bankruptcy focusing on trust property under §541(d) of the Bankruptcy Code, use of trust rights in the cash collateral context and use of trust fund rights to assert non-dischargeability under §523 of the Bankruptcy Code. It is the author's intent that this discussion will provide the surety with the general framework to evaluate the issue of how a trust might benefit the surety in certain bankruptcy situations; however, given the many and varied forms that trusts can take, the factual circumstances in which they can arise, and the variations in the law from jurisdiction to jurisdiction, it is virtually impossible to attempt to provide concrete answers for individual specific circumstances. In the course of researching and writing this paper, the author has reviewed numerous prior works which are collected in the notes and such works are commended to the reader for further development of trust fund issues.[4]

II. TRUSTS IN GENERAL

A. NATURE OF TRUSTS

A trust is a very comprehensive institution.[5] "It is as general and as elastic as contract. It originated and was reduced to practice under the jurisdiction of courts by the civil law, was expanded and developed in the courts of chancery, and has been employed in nearly every field of human activity."[6] Generally speaking, anyone competent to create a contract may dispose of the legal title to his/her property as he/she pleases, may attach such conditions and limitations to the enjoyment of said property as he/she chooses, and may vest said property in trustees for the purpose of carrying out his/her specific intention. One has the same power to create trusts as one has to alienate the legal title to his/her property.[7]

The principles, rules, and standards of the law of trusts owe their origin and development in large part to the fact that for centuries in England there were separate courts of common law and chancery. The distinction between legal interests and equitable interests, which is now fundamental to the American law of trusts, is traceable to this separateness of judicial functions.[8] Indeed, it has been observed that the "fundamental nature of a trust is the division of legal and equitable title."[9] The trustee of the trust holds legal title to the trust property while the beneficiaries

of the trust hold equitable title to the trust property.[10] Thus, the definition of an express trust has been stated as follows:

> A trust may be defined as a fiduciary relationship in which one person holds a property interest subject to an equitable obligation to keep or use that interest for the benefit of another.[11]

Courts define trusts as, "where the legal title to property is held by one or more persons, under an equitable obligation to convey, apply, or deal with such property for the benefit of other persons."[12] Similarly, the Third Circuit Court of Appeals, quoting the Restatement (Second), has defined a trust as, "[A] fiduciary relationship with respect to property, subjecting the person by whom the title to the property is held to equitable duties to deal with the property for the benefit of another person, which arises as a result of a manifestation of an intention to create it."[13] A trust is not a legal entity distinct from the trustee and is not capable of legal action on its own behalf;[14] rather a trust is a fiduciary relationship consisting of specific characteristics.[15]

There are three primary parties to a trust: the settlor, the trustee(s) and the beneficiary(ies). The "settlor" is the creator of the trust.[16] Generally speaking, the settlor is the party that provides the trust property, even if the form of the trust was created by someone else.[17] The "trustee" is the party who is "appointed, or required by law, to execute a trust, and the one in whom an estate, interest, or power is vested, under an express or implied agreement to administer or exercise it for the benefit of another."[18] The settlor of a trust may also serve as the trustee. The "beneficiary" is the person for whose benefit the trust property is being held.[19] The settlor and/or trustee may also be beneficiaries of the trust, but the sole trustee cannot also be the sole beneficiary because of the doctrine of merger.[20]

B. FORMATION OF TRUSTS

There are numerous types of trusts and trusts can be created in a variety of ways. Trusts can be either express or implied. Express trusts are created by the direct and willful acts or conduct of the parties; by some writing, deed or words expressly evidencing the intention to create a trust.[21] Trusts can also arise by statute, such as a construction trust fund statute.[22] Implied trusts generally arise by operation of law and are generally categorized as "constructive trusts" or "resulting trusts."[23]

Trusts can be either "executed" or "executory."[24] An executory trust involves a circumstance where a trust is intended, but the transaction has not been completed and remains imperfect. It is a trust which is not fully and finally declared, but requires some other act or acts in order to perfect it and carry out the intention of the settlor. Equity will not aid in the enforcement of an executory trust unless the trust is supported by consideration.[25] An executed trust is one fully and finally declared by the person creating it, so that nothing further remains to be done in order to make it effective.

An express trust is created when the parties affirmatively manifest an intention that certain property be held in trust for the benefit of a third party.[26] An express trust may be created without the use of technical words; all that is necessary are words or circumstances, "which unequivocally show an intention that the legal estate was vested in one person, to be held in some manner or for some purpose on behalf of another . . .,"[27] The words "trust" or "trustee" need not be used and the

parties creating the trust need not even have an understanding of the concept of a trust.[28] Conversely, the mere use of the words "trust" or "trustee" will not necessarily result in a trust relationship being created if the requirements for a valid trust are not satisfied or if a trust is not intended.[29] The Fourth Circuit has stated that, "any words which unequivocally show an intention that the legal estate was vested in one person, to be held in some manner or for some purpose on behalf of another, if certain as to all other requisites, are sufficient to create a trust."[30]

Similarly, the Massachusetts Supreme Judicial Court has observed that whether a trust is created by a contract is to be ascertained by the words used in that contract or by the terms of that contract, however phrased, which show in the light of the surrounding circumstances that the parties intended by the executed instrument to create an express trust in furtherance of the object sought to be attained.[31]

Unlike in the law of contracts, trusts do not require consideration to be valid and enforceable. The owner of property can create a trust of that property by will, declaration or transfer inter vivos, whether or not consideration is received for doing so.[32] It is also immaterial that the trustee receives no consideration apart from the transfer of the trust property.[33] Moreover, notice, knowledge or consent of the beneficiary to the creation of a trust is not required for the validity of the trust.[34] Nor is acceptance or assent to the trust by the beneficiary required to create a valid trust.[35]

The party seeking to establish the existence of a trust bears the burden of proving the creation of the trust.[36] In some jurisdictions, the burden of proof for establishing any trust, whether express or implied, requires a heightened standard of proof.[37] In other jurisdictions, the heightened standard of proof is reserved for constructive and resulting trusts.[38] For example, in Illinois, the Court has held that, "[i]n fulfilling the burden of proof of establishing a resulting trust, the proof provided, whether circumstantial or direct, must be clear, strong, unequivocal and beyond reasonable doubt."[39] Moreover, while it is generally recognized that a trust may be created orally in personal property,[40] proof of such trusts must be of an "extraordinary degree" variously described as "clear," "cogent," "convincing," and "such as to leave no room for a reasonable doubt" as to the existence and terms of such a trust.[41]

C. ELEMENTS OF A VALID EXPRESS TRUST

The description of the elements required to create a valid trust vary from state to state, but it can generally be stated that the requisite elements are:

1. a declaration creating the trust, or manifestation of an intention of the settlor to create a trust;
2. a trust res;
3. a trustee with active duties;
4. designated beneficiaries;
5. a trust purpose; and
6. if required, delivery of the trust property to the trustee.[42]

The authors of the Restatement define the elements of an express trust as follows: "[i]n the strict, traditional sense, a trust involves three elements: (1) a trustee, who holds the trust property and is subject to duties to deal with it for the benefit of one or more others; (2) one or more

beneficiaries, to whom and for whose benefit the trustee owes the duties with respect to the trust property; and (3) trust property, which is held by the trustee for the beneficiaries."[43]

Courts in a variety of jurisdictions echo these elements as requirements for the establishment of a valid trust. For example, under Pennsylvania and Kentucky law, the elements of an express trust are: (1) an express intent to create a trust; (2) an ascertainable res; (3) a sufficiently certain beneficiary; and (4) a trustee who owns and administers the res for the benefit of another (the beneficiary).[44] Under Michigan law the requisite elements of an express trust are simply stated as: (1) the existence of a clearly defined res; (2) an unambiguous trust relationship; and (3) specific affirmative duties undertaken by the trustee.[45] While under Florida law, the elements of an express trust are spelled out in more detail as: (1) a person competent to create the trust; (2) indication of intention to create the trust; (3) property to which the trust may and does pertain; (4) a definite and complete present disposition of that property; (5) a provision, at least by implication, for the office of trustee; and (6) a person capable of holding the equitable interest in the property as beneficiary.[46] In some jurisdictions, the elements of an express trust are defined by statute.[47]

1. Intent

One of the fundamental requirements for the creation of a trust is the intent of the settlor to create a trust.[48] "A trust is created only if the settlor properly manifests an intention to create a trust relationship."[49] The intent to create a trust must be clear and unequivocal.[50] Such intent must be manifested in some external expression of written or spoken words or conduct.[51] The intention of the settlor may be ascertained by a consideration of their words and conduct in the light of surrounding circumstances.[52] In the case of written trusts, courts will look first and foremost to the language of the trust document and attempt to interpret that document to determine and effectuate the intent of the settlor.[53] In addition to the words of a written trust document, to determine the intention of the settlor the Restatement identifies the following circumstances, among others, which may be considered:

(1) the imperative or precatory character of the words used;
(2) the definiteness or indefiniteness of the property;
(3) the definiteness or indefiniteness of the beneficiaries or of the extent of their interests;
(4) the relations between the parties;
(5) the financial situation of the parties;
(6) the motives which may reasonably be supposed to have influenced the settlor in making the disposition;
(7) whether the result reached by construing the transaction as a trust or not a trust would be such as a person in the situation of the settlor would naturally desire to produce.[54]

2. Trust Property

As noted above, one of the basic elements of any trust is the existence of the trust property or "res." The trust property can consist of any type of transferrable property.[55] The Restatement defines the type of property that can be the subject of a trust as follows:

> Trust property may be real or personal, tangible or intangible. It may consist of such diverse rights as undivided interests, terms of years, contingent future interests, and *choses in action*, even *choses* with respect to things that are not specifically ascertainable at the time the trust is created, or with respect to things that are not owned by the settlor or in existence at that time.[56]

Generally, the trust property cannot be property that the settlor has a mere future expectancy or hope of acquiring an interest in at some later date without a present right, interest or consideration.[57] The settlor must clearly identify the trust property so that it is defined, definite and reasonably ascertainable.[58]

3. Beneficiaries

Another basic element of any valid and enforceable trust is the identification of beneficiaries of the trust. A beneficiary can be any party that has capacity to take and hold property.[59] Individuals, corporations (municipal or private), including non-profit corporations, unincorporated associations and the government can all be beneficiaries of a trust.[60] In addition, a class or group may be designated as beneficiaries.[61] However, the beneficiaries must be sufficiently identifiable, definite or ascertainable for a trust to be valid.[62] While the beneficiaries must be ascertainable, they need not be specifically named in the terms of the trust, but can be designated by class terminology or by description. Further, the beneficiaries do not necessarily need to be known at the time the trust is created and in such circumstances the title to the trust property remains in the trustee until such time as the beneficiaries have been ascertained.[63] A class is not indefinite merely because the class consists of a changing or shifting group, the number of whose members may increase or decrease.[64] Persons who may only incidentally benefit in some manner from the performance of the trust are not beneficiaries of the trust and cannot enforce the trust unless they were specifically intended to be beneficiaries.[65]

4. Trustees

Finally, perhaps the defining aspect of a trust is the existence of a trustee to hold the trust property. A trustee may be any party that can hold title to property. The trustee holds mere legal title to the trust property for the benefit of the beneficiaries with certain powers and subject to certain duties imposed by the terms of the trust, equitable jurisprudence and statute.[66] Thus, corporations and unincorporated associations may serve as trustees.[67] It is generally recognized that a trust will not fail for want of a trustee, because a court of equity can appoint a trustee or take steps to effectuate the purpose of a trust in the event of a failure of the trustee.[68] In order for the trust to be valid, the trustee must have affirmative powers and duties with respect to the trust property.[69] A designated trustee may accept or decline the role and such action can be either by words or conduct.[70] Under certain circumstances, acceptance can be deemed by the trustee's silence. Moreover, if one accepts the role of trustee one can later resign and a trustee can also be removed either by the terms of the trust or court action.[71]

Courts will look to the terms of the trust, its purpose and the intent of the settlor to determine the powers of a trustee with respect to the trust.[72] It has been stated that the trustee has all powers necessary or appropriate to effectuate the purpose of the trust except for those that are specifically denied to the trustee in the trust itself or prohibited by law.[73] The trustee is obligated to exercise the powers conferred in accordance with the fiduciary obligations as discussed below.

With respect to the duties of a trustee, the terms of the trust and applicable law will control. Upon acceptance of the role of trustee, the trustee has the affirmative duty to administer the trust diligently and in good faith, in accordance with the terms of the trust and applicable law.[74] The trustee's duties are referred to as "fiduciary duties" and include the obligation to administer the trust as a "prudent" person would with "reasonable, care, skill, and caution."[75] Further, the trustee owes a duty of loyalty to the beneficiaries and must administer the trust solely in the interest of and for the benefit of the beneficiaries in furtherance of the purposes of the trust.[76] "The duty of loyalty is, for trustees, particularly strict even by comparison to the standards of other fiduciary relationships."[77] In this regard, the Supreme Court has observed:

> Under principles of equity, a trustee bears an unwavering duty of complete loyalty to the beneficiary of the trust, to the exclusion of the interests of all other parties. To deter the trustee from all temptation and to prevent any possible injury to the beneficiary, the rule against a trustee dividing his loyalties must be enforced with 'uncompromising rigidity.'[78]

As part of the trustee's duties, the trustee is obligated to keep records and provide information regarding the trust.[79] Finally, the trustee is under a duty to identify and segregate trust property.[80] The Restatement provides, "[t]he trustee has a duty to see that trust property is designated or identifiable as property of the trust, and also a duty to keep the trust property separate from the trustee's own property and, so far as practical, separate from other property not subject to the trust."[81] The bar against the comingling of trust property with non-trust property is strictly applied and arises from the trustee's duty of loyalty and prohibition against creating potentially conflicting interests and/or self-dealing.[82] However, the fact that a trustee does not in fact segregate the trust property from other property, while a breach of duty, does not render the trust invalid.[83] "Trust funds do not lose their character as such because they are commingled with those of the trustee. Once a trust is created, it cannot be destroyed by the action, wrongful or innocent, of the trustee, in the absence of the intervening right of a purchaser for value without notice."[84] However, while the trust may not be held invalid the ability to recover the trust property will be impaired or even extinguished if the trust property cannot be traced.

III. EXPRESS CONSTRUCTION TRUST FUNDS

In the construction industry, trusts can arise in three primary ways: (1) by contractual agreement, whether in the prime contract, a subcontract or in the indemnity agreement; (2) by statute, through a construction trust fund act or similar legislation or (3) by implication from the law as in the case of a constructive or resulting trust.

A. STATUTORY TRUST FUND PROVISIONS

Many jurisdictions have some form of construction trust fund legislation that may be applicable to a bonded project. However, while many states have such statutes a majority of states do not. Accordingly, the surety must first determine if the applicable jurisdiction has such a statute. The following is a list of states that *did not* have any applicable construction trust fund legislation as of the date of a comprehensive survey performed in 2004[85]:

Alabama	Kentucky	North Carolina
Alaska	Louisiana	North Dakota
California	Maine	Ohio
Connecticut	Massachusetts	Oregon
District of Columbia	Mississippi	Pennsylvania
Florida	Missouri	Rhode Island
Hawaii	Montana	Tennessee
Idaho	Nebraska	Utah
Indiana	Nevada	Virginia
Iowa	New Hampshire	West Virginia
Kansas	New Mexico	Wyoming

The following is a list of states that *did* have some form of construction trust fund legislation as of the date of a comprehensive survey performed in 2004[86]:

Arizona – Ariz. Rev. Stat. § 33-1005	Arkansas – Ark. Code Ann. § 18-44-132
Colorado – Colo. Rev. Stat. Ann. §38-22-127	Delaware – Del Code Ann. Tit. 6, § 3502
Georgia – Ga. Code Ann. § 16-8-15	Illinois – 770 ILCS 60/21.02
Maryland – Md. Code Ann., Real Prop. § 9-201	Michigan – Mich. Comp. Laws Ann. § 570.151
Minnesota – Minn. Stat. Ann. § 514.01	New Jersey – N.J. Stat. Ann. § 2A:44-148 and N.J. Stat. Ann. § 2A:29A
New York – N.Y. Lien Law § 70-79	Oklahoma – Okla. Stat. tit. 42 § 152
South Carolina – So. Carolina Code § 29-7-10	South Dakota – S.D. Codified Laws § 44-9-13
Texas – Tex. Prop. Code Ch. 162	Vermont – Vt. Stat. Ann. Tit. 9, § 4003 (Prompt Pay)
Washington – Wash. Rev. Code § 60.28.010	Wisconsin – Wis. Stat. § 779.02(5)(private projects) and Wis. Stat. § 779.16 (public projects)

If the particular jurisdiction does have some form of trust fund statute, the surety must still carefully explore a number of issues to determine if the applicable legislation can be useful to the surety. Initially, the scope of the applicable provision must be analyzed. For example, some of the trust fund statutes are limited to private projects and would not apply to governmental projects where most significant bonding arises.[87] Other statutes are limited to residential construction projects which are typically not bonded.[88] Still other statutes are limited to criminal penalties and may not give rise to enforcement or recovery by the surety or even permit a private right of action.[89] Such statutes may not constitute a trust at all. Moreover, some statutes only permit recovery by a limited classification of persons which may not include the surety.[90] Finally, some statutes have exceptions which may preclude or limit the use of the statute by the surety. For example, the Colorado Construction Trust Statute has an exception which excuses the operation of the trust if the party holding the funds has furnished a payment or performance bond.[91] Finally, the mere fact that a statute might require certain contract funds to be held may not give rise to a valid and enforceable trust in all circumstances, research into the specific statutory provision and the particular jurisdiction's interpretation of that provision is required.

B. TRUST FUND PROVISIONS IN THE GENERAL AGREEMENT OF INDEMNITY

As a part of the underwriting process, at a minimum, a typical surety will require the principal and one or more individual officers, owners and/or directors and their respective spouses to execute a General Agreement of Indemnity ("indemnity agreement"). The Maryland Court of Appeals has observed that:

> In the construction industry, it is standard practice for surety companies to require contractors for whom they write bonds to execute indemnity agreements by which principals and their individual backers agree to indemnify sureties against any loss they may incur as a result of writing bonds on behalf of principals. *See generally The Surety's Indemnity Agreement - Law & Practice* (Marilyn Klinger, *et al., eds.*, Am. Bar Assoc. 2002).[92]

Indemnity agreements are common and are uniformly sustained and upheld by the courts.[93] The primary purpose of the indemnity agreement is to define the terms and conditions upon which the surety will agree to provide bonds. In addition, such agreements provide the surety with a wide variety of rights and remedies and impose a wide variety of duties and obligations on the indemnitors so that the surety can recover any damages or losses that the surety may incur by reason of having issued bonds for the principal. Among the duties and obligations generally imposed on the indemnitors is the obligation to hold bonded contract funds in trust for the benefit of the surety and the subcontractors, materialmen, suppliers and labors that performed work on the bonded project. One example of a well-known, large surety's trust fund provision in its indemnity agreement provides as follows ("Example A"):

> **Trust Fund.** If a Bond is executed in connection with the performance of any contract, the entire contract price shall be dedicated to the satisfaction of the conditions of that bonded contract. All money paid, or any securities, warrants, checks or evidences of debt, plus any proceeds thereof, given under that bonded contract shall be impressed with a trust in the hands of the Indemnitors in favor of Surety for the purpose of satisfying the conditions of that bonded contract and shall be used for no other purpose until such conditions have been fully satisfied. On demand, Indemnitors shall establish a trust account with a bank, acceptable to Surety, and shall thereafter deposit all monies from said bonded contracts into said trust account. The trust account shall be a restricted account requiring the signature of an authorized representative of Surety on all checks drawn against said account. Such trust shall not terminate until the Indemnitors' obligations under all Bonds issued hereunder and under this Agreement have been fully discharged to Surety's satisfaction.

Another example of a trust fund provision from another surety's indemnity agreement provides as follows ("Example B"):

> If any of the bonds are executed in connection with a contract which by its terms or by law prohibits assignment of contract proceeds, or any part thereof, the Indemnitors covenant and agree that all payments received for or on account of said contract shall be held as a trust fund in which the Surety has an interest, for the payment of obligations incurred in the performance of the contract and for labor, materials, and services furnished in the prosecution of the work provided in said contract or any authorized extension or modifications thereof; and, further it is expressly understood and declared that all monies due or to become due under any contract or contracts covered by the bonds are trust funds, whether in the possession of the Indemnitors or otherwise, for the benefit of and for the payment of all such obligations in connection with any such contract or contracts for which the Surety would be liable under any of said bonds, which said trust also inures to the benefit of the Surety for any liability or loss it may have or sustain under any of said bonds, and this Agreement and declaration shall also constitute notice of such trust.[94]

Whether the trust fund provision of the indemnity agreement constitutes an express trust and operates to provide a surety with enforceable interests must be determined under state law. Because the law of trusts for each state varies, often in important respects, and because the terms of the indemnity agreements vary, the surety must measure the specific indemnity agreement against the relevant trust law of the jurisdiction where the matter is at issue to determine if the trust fund provision of the indemnity agreement meets the required elements of a valid trust.

As discussed, above the typical elements of a valid express trust include:

1. a declaration creating the trust, or manifestation of an intention of the settlor to create a trust;
2. a trust res;
3. a trustee with active duties;
4. designated beneficiaries;
5. a trust purpose; and
6. required, delivery of the trust property to the trustee.[95]

The declaration of a trust and intention to create a trust as well as its purpose is readily apparent from the language of the trust fund provisions of the indemnity agreements set forth above. Clearly, where the language of the trust fund provision explicitly sets forth the exact nature of the trust relationship and the purpose of the trust, the intention to create a trust should be held to be established.

With respect to the trust property or res, the indemnity agreements identify the bonded contract funds as constituting the trust property. Example A identifies the trust property as, "[a]ll money paid, or any securities, warrants, checks or evidences of debt, plus any proceeds thereof, given under that bonded contract shall be impressed with a trust in the hands of the Indemnitors." Example B identifies the trust property as, "all payments received for or on account of said contract

shall be held as a trust fund in which the Surety has an interest, . . . it is expressly understood and declared that all monies due or to become due under any contract or contracts covered by the bonds are trust funds, whether in the possession of the Indemnitors or otherwise . . ."

While the trust property is clearly identified for purposes of satisfying the elements of a valid trust, a significant issue arises with respect to whether the trust property is in existence at the time that the trust is created. Some courts have held that if the bonded contract funds are not in existence at the time the indemnity agreement is executed a valid trust cannot be created.[96] Other courts and commentators have held and observed that the mere fact that the trust property would be created later is not fatal to the establishment of the trust.[97] A contract to create a trust for a future res when acquired is appropriate if the settlor receives sufficient consideration. In the typical circumstance, the surety's issuance of the bonds for the principal as settlor of the trust in reliance upon the agreement of indemnity and its provisions should constitute fair and adequate consideration.[98] Supported by this consideration, the agreement of indemnity should be construed as a contract to hold the property (the contract funds) in trust when acquired and as giving the beneficiaries equitable rights in such property from the moment of its acquisition.[99]

The trust fund provision of the example indemnity agreements also clearly set forth the trust's beneficiaries and identifies a trustee. Example A provides that the bonded contract funds shall be impressed with a trust in the hands of the indemnitors, "in favor of Surety for the purpose of satisfying the conditions of that bonded contract . . ." Example B provides that the bonded contract funds are to be held in trust and that the, "[s]urety has an interest, for the payment of obligations incurred in the performance of the contract and for labor, materials, and services furnished in the prosecution of the work provided in said contract . . . which said trust also inures to the benefit of the Surety." From these provisions, the specific identity of the beneficiaries may be ascertained. Moreover, the settlor of the trust, in this case the principal, can be identified as the trustee from the language of the trust fund provisions.

With respect to the requirement of delivery of the trust property, some courts hold that in order to create a completed and enforceable trust of personalty, such as the contract funds, there must be delivery, or the equivalent of delivery, of the trust res to the trustee.[100] Other courts hold that delivery is not required if the settlor declaring a trust is also the trustee.[101] "[Where] there is a written trust declaration…. delivery is not necessary to constitute a valid trust. The owner has declared that he, himself, holds the property in trust for the person designated. A writing creating a trust, kept by the donor without delivery to anyone, will be given effect as such by the courts."[102] Logically, once the contract funds are paid to the principal, any delivery requirement has been satisfied and the contract funds must be held in trust.

Courts in a variety of jurisdictions under a variety of facts and circumstances have held that the trust fund provisions of the surety's indemnity agreement operate to create a valid and enforceable trust.[103] Courts in other jurisdictions have refused to hold that the indemnity agreement creates a valid trust.[104]

C. TRUST FUND PROVISIONS IN CONTRACTS

In addition to creation of trusts by statute and in indemnity agreements, trusts can also arise from the terms of the underlying contract, whether it's the prime contract between an owner and general contractor or a subcontract between a general contractor and a subcontractor or supplier or

a lower tier sub-subcontract. It is not uncommon for the parties to provide for the creation of a trust with respect to monies paid to provide a measure of protection and responsibility with respect to the contract funds.

Although the surety is not a party to prime contracts or subcontracts on most construction projects, the surety can still take advantage of such trust provisions through its equitable rights of subrogation. In addition, in some jurisdictions where the bond incorporates the underlying contract by reference courts have held that surety's are bound by the terms of the underlying contract. In such jurisdictions the surety might be able to argue that it is entitled to seek enforcement of the provision even if the surety may not be a specific beneficiary of the trust. Moreover, such provisions in the underlying contract when combined with the provisions in the indemnity agreement and any applicable trust fund statute create a powerful implication that the contract funds are impressed with a trust and that the surety is entitled to enforce such a trust or benefit from such a trust.[105] At the very least the combination of such provisions should provide a strong argument for the imposition of a constructive or resulting trust in the proper circumstances. Accordingly, it is important for the surety to investigate the trust fund provisions of the applicable underlying contracts to determine if any rights or benefits can be obtained.

Obviously construction contracts vary widely and are often negotiated heavily. However, the following examples of some of the typical contract trust provisions from some national and regional construction industry players provides a glimpse of the nature and substance of such provisions which the surety may encounter. A Fortune 500 Owner's standard General Conditions provides as follows:

> **9.7.3 Payments in Trust.** Any funds that Contractor receives in payment for services or Work performed by a Subcontractor shall constitute assets of a trust, which trust funds shall, . . . be used for the exclusive benefit of the Subcontractor for the purpose of discharging Contractor's financial obligations on account of labor, services, materials or equipment furnished to the Project by the Subcontractor, provided that such labor, services, materials or equipment were performed in accordance with the Contract Documents, were included in an Application for Payment to the Owner, and were paid by the Owner to Contractor. Contractor shall be the trustee of the trust and shall be required to deal with the trust assets for the benefit of the Subcontractor. Contractor shall not be a beneficiary of the trust. Nothing herein shall be construed as an intent to require that Contractor maintain trust funds in separate bank accounts, specifically designate any third party as a beneficiary of the trust created herein, or otherwise give rise to any cause of action against the Owner by any third party beneficiary of the trust created herein.

A Fortune 500 general contractor's standard subcontract agreement provides:

> Use of Payments by Subcontractor: Subcontractor shall use the sums paid to it pursuant to this Subcontract solely for the purpose of fulfilling its responsibilities and obligations under this

> Subcontract. Any and all funds paid to Subcontractor hereunder constitute trust funds in the hands of Subcontractor to be applied before application to any other purpose to the payment of the following costs incurred by Subcontractor pursuant to this Subcontract:
>
> (a) Sub-subcontractors, laborers, suppliers, materialmen or other persons employed by Subcontractor;
> (b) Utilities furnished and taxes imposed;
> (c) Premiums on surety bonds, other bonds and insurance required by the Attachments to this Subcontract;
> (d) Any indemnity obligations of Subcontractors;
> (e) Union or association dues, assessments and fringe benefits; and
> (f) All other costs of Subcontractor's performance of its responsibilities and obligations under this Subcontract.

A large regional specialty subcontractor's standard sub-subcontract agreement provides:

> **5.4 CONSTRUCTION CONTRACT TRUST FUND**
> The parties agree and expressly declare that all funds payable to the Subcontractor under this Contract are trust funds, whether in possession of the Contractor or Subcontractor, for the benefit and payment of all persons to whom the Subcontractor incurs obligations in the performance of the Work. If the Contractor discharges any such obligation, it shall be entitled to assert the claim of such person to the trust funds. The Contractor, at its sole option, in implementation of the trust hereby created, may open an account, or accounts, with a bank or similar depository. Such account, or accounts, shall be trust accounts for the deposit of such trust funds and Contractor may deposit therein all monies earned by the Subcontractor pursuant to the Subcontract. Withdrawal from such accounts shall be by check or similar instrument signed by both parties. Said trust or trusts shall terminate on the payment of all obligations of the Subcontractor for the payment of which the trust or trusts are hereby created or upon the expiration of twenty years from the date hereof, whichever shall first occur.

The example provisions are very detailed and clearly spell out the necessary elements of valid express trusts by identifying the trust property, trustee, beneficiaries, intent and purpose of the trust. Courts have routinely upheld trusts formed in such construction contracts.[106] In contrast to the clear and specific terms cited above, the AIA A-201 (1997) General Conditions are much less clear as to whether a trust is intended. The applicable provision states:

> Unless the Contractor provides the Owner with a payment bond in the full penal sum of the Contract sum, payments received by the Contractor for work properly

> performed by Subcontractors and Suppliers shall be held by the Contractor for those Subcontractors and Suppliers who performed work or furnished materials, or both, under the contract with the Contractor for which payment was made by the Owner. Nothing contained herein shall require money to be placed in a separate account and not commingled with money of the Contractor, shall create a fiduciary duty or tort liability on the part of the Contractor for breach of trust or shall entitle any person or entity to an award of punitive damages against the Contractor for breach of the requirements of this provision.[107]

Although the A-201 provision speaks of holding the contract payments for work performed by subcontractors and suppliers, the provision also seems to reject some of the indicia of a valid trust by providing that there is no intent to create a "fiduciary duty" on the part of the would be trustee – the contractor, and that there is "no tort liability on the part of the contractor for breach of trust." These provisions seem to conflict with an intent to create a trust.

However, the Washington Court of Appeals has held that §9.6.7 indeed creates a valid trust.[108] Relying on the Restatement and general trust law precedent, the *Westview Investments* Court held that provisions limiting the trustee's liability are permissible so long as they do not offend public policy.[109] The Court also noted that the Minnesota Legislature had adopted a progress payment trust statute modeled on §9.6.7, which the Minnesota court held created a valid trust and found that the limitation of liability language did not negate the trust.[110]

IV. IMPLIED TRUSTS

A. CONSTRUCTIVE TRUSTS

Constructive trusts have been defined as:

> [A] trust by operation of law which arises contrary to intention and in invitum, against one who, by fraud, actual or constructive, by duress or abuse of confidence, by commission of wrong, or by any form of unconscionable conduct, artifice, concealment, or questionable means, or who in any way against equity and good conscience, either has obtained or holds the legal right to property which he ought not, in equity and good conscience, hold and enjoy. It is raised by equity to satisfy the demands of justice.[111]

A constructive trust is not actually a trust, but rather a common-law remedy, developed in equity, for unjust enrichment.[112] Constructive trusts are raised or "imposed" by equity in respect of property which has been acquired by fraud, or where, though acquired originally without fraud, it is against equity that it should be retained by the one who holds it.[113] "Equity declares the trust in order that it may lay its hand on the thing and wrest it from the possession of the wrongdoer."[114]

Such trusts arise purely by construction of equity, independently of any actual or presumed intention of the parties to create a trust, and are generally thrust on the trustees for the purpose of working out the remedy.[115] A constructive trust arises only when "a court declares the party in possession of wrongfully acquired property as constructive trustee of that property."[116] Once a constructive trust is declared, the limited duties of the constructive trustee are to transfer property to the rightful owner, account for the handling of such property and pay over any damages

associated with the wrongful retention of the property.[117] Although the trust arises when ordered by the court, it is deemed to relate back to the date of the wrongful acquisition.[118]

Because a constructive trust is an equitable remedy there are no firmly established elements for imposing such a trust. Such trusts arise out of consideration of all the relevant facts and circumstances. Even where a particular jurisdiction has established elements of a constructive trust they are typically general in nature and often not strictly adhered to. Nevertheless, the elements for a constructive trust are variously stated as including: (1) obtaining property or retaining property; (2) through actual or constructive fraud, a breach of a fiduciary duty, duress, coercion or mistake or other wrongful conduct; (3) causing unjust enrichment of the wrongdoer.[119] Some courts also require that the party seeking the relief be able to trace to an identifiable res.[120] Other courts require an existing confidential or fiduciary relationship between the parties.[121] Although it has been stated that fraud is an essential element in the creation or existence of a constructive trust, fraud is not always required.[122] "As has been well said, a court of equity would be of little value, if it could suppress only positive frauds, and leave mutual mistakes, innocently made, to work intolerable mischiefs, contrary to the real intention of the parties. It would be to allow an act, originally innocent, to operate ultimately as a fraud, by enabling the party who receives the benefit of the mistake, to resist the claims of justice, under the shelter of statutes framed to promote it."[123] A mere "breach of contract alone is not sufficient and does not qualify as the type of wrongful act or fraud which would warrant the imposition of a constructive trust."[124]

Finally, the party seeking to establish the constructive trust bears the burden of proof by "clear and convincing evidence."[125] It should be noted that a constructive trust will generally not be imposed unless there is no relief at law or such relief is inadequate.

B. RESULTING TRUSTS

A resulting trust is "an implied trust which rests upon the presumed intention of the parties."[126] It is an equitable remedy designed to prevent unjust enrichment and ensure that legal formalities do not frustrate the original intent of the transacting parties.[127] Such trusts are implied by law from the acts and conduct of the parties and the facts and circumstances which surround the transaction out of which the trust arises.[128] Resulting trusts have been defined as: "[a] reversionary, equitable interest implied by law in property that is held by a transferee, in whole or in part, as trustee for the transferor or the transferor's successors in interest."[129]

A resulting trust arises in three situations: (1) where an express trust fails in whole or in part; (2) where an express trust is fully performed without exhausting the trust estate; and (3) where a person furnished the money to purchase property in the name of another, with both parties intending at the time that the legal title be held by the named grantee for the benefit of the unnamed purchaser of the property.[130]

Some courts hold that to establish a resulting trust there must be evidence of intent to separate beneficial and legal ownership of the property by words or by the circumstances of the transaction.[131] In contrast to a constructive trust, "a resulting trust, like an express trust, comes into being independent of any judicial action," and it arises, if at all, at the time that legal title vests.[132] "A resulting trust, unlike a constructive trust, seeks to carry out a donative intention rather than to thwart a wicked scheme."[133] The party seeking to establish a resulting trust bears the burden of proof by clear and convincing evidence.[134]

V. USE OF TRUST FUND RIGHTS IN BANKRUPTCY

Every surety has had to wade into the waters of bankruptcy to protect its rights to bonded contract funds, seek recovery of losses and damages, fend-off a bankruptcy trustee seeking to assert its rights in the debtor's property or spar with the IRS or a secured lender over bonded contract funds. The surety's subrogation rights are a powerful weapon in the context of bankruptcy and are useful in a variety of contexts within the Bankruptcy Code. However, with an understanding of the general nature of trusts in hand, the question becomes what rights flow from the existence of a trust in bankruptcy that can supplement the surety's subrogation rights? The drafters of the Bankruptcy Code recognized the special nature of trusts and the special duties flowing from the role of the trustee of trusts and crafted specific provisions to address trusts. These provisions of the Bankruptcy Code can be used by the surety as a beneficiary of a trust or through subrogation to the rights of a beneficiary of a trust. The following sections of this paper will first discuss in general terms the nature of bankruptcy and the automatic stay and then focus on some specific uses the trust can play in bankruptcy.

A. THE COMMENCEMENT OF THE BANKRUPTCY CASE.

The principal[135] may commence a voluntary case in bankruptcy by the filing of a petition with the bankruptcy court.[136] The voluntary case may be filed under either chapter 7 or chapter 11 of the Bankruptcy Code. The principal then becomes the debtor.

Under chapter 7 of the Bankruptcy Code, a Trustee is appointed for the debtor's estate. The Trustee is charged with certain duties,[137] including the collection and reduction to money of the property of the debtor's estate, the investigation of the debtor's financial affairs, the examination of the Proofs of Claim of the various creditors, and the closing of the debtor's estate upon making any distributions of the property of the debtor's estate to the debtor's creditors.

Under chapter 11 of the Bankruptcy Code, the debtor attempts to reorganize its business in order to continue its operations as a principal/contractor. Unless the bankruptcy court, on request of a party in interest and after a notice and hearing, orders otherwise, the debtor may continue to operate its business as a "debtor-in-possession."[138] Ultimately, the debtor proposes a plan of reorganization,[139] prepares and disseminates a disclosure statement and solicits acceptances of the plan of reorganization,[140] and, hopefully, confirms the plan of reorganization at a confirmation hearing.[141] Assuming that the debtor complies with its obligations under the plan of reorganization, the debtor may continue in business as a reorganized debtor.[142]

B. THE AUTOMATIC STAY - SECTION 362 OF THE BANKRUPTCY CODE.

Section 362 of the Bankruptcy Code provides that the filing of a petition and the commencement of the bankruptcy case operates as a stay, applicable to all entities, including the surety, of many actions.[143] Upon the commencement of the debtor's bankruptcy case, a surety may not enforce its claims against the bonded contract funds without risking a violation of the automatic stay. The automatic stay remains in effect until the bonded contract funds are no longer the property of the debtor's estate.

A surety may seek relief from the automatic stay in order to enforce its rights against the bonded contract funds. After notice and a hearing, the bankruptcy court may provide such relief, such as by terminating, annulling, modifying or conditioning the automatic stay, for the following reasons: (1) for cause, including the debtor's lack of adequate protection of the surety's interest in the bonded contract funds;[144] or (2) with respect to a stay of any act against the property of the debtor's estate, if the debtor does not have any equity in the bonded contract funds, and such funds are not necessary to an effective reorganization.[145]

It is the surety's burden of proof on the issues of cause, or whether the debtor has any equity in the bonded contract funds.[146] A party willfully violating the automatic stay may be liable to the debtor for actual damages, including costs and attorneys' fees, and possibly punitive damages in the appropriate circumstances.[147]

C. PROPERTY OF THE ESTATE - SECTION 541 OF THE BANKRUPTCY CODE.

Section 541 of the Bankruptcy Code provides that the commencement of a case under the Bankruptcy Code creates an estate.[148] The debtor's estate is comprised of certain defined property, wherever it is located and by whomever it is held. Specifically, the property of the debtor's estate includes all of the debtor's legal or equitable interests in property as of the commencement of the case.[149] Property of the estate includes proceeds or profits of or from property of the estate.[150] There are certain limitations on what may be property of the debtor's estate. For example, property in which the debtor holds only legal title and not an equitable interest becomes property of the estate only to the extent of the debtor's legal title to such property, but not to the extent of any equitable interest in such property that the debtor does not hold.[151]

The Bankruptcy Code provides at §541(d):

> Property in which the debtor holds, as of the commencement of the case, only legal title and not an equitable interest, such as a mortgage secured by real property, or an interest in such a mortgage, sold by the debtor but as to which the debtor retains legal title to service or supervise the servicing of such mortgage or interest, becomes property of the estate under subsection (a)(1) or (2) of this section only to the extent of the debtor's legal title to such property, but not to the extent of any equitable interest in such property that the debtor does not hold.[152]

As noted earlier in the general discussion of trusts, a trustee holds only bare legal title to the trust property while the beneficiaries of the trust hold equitable title.[153] Thus, in circumstances where the debtor is holding property in trust as a trustee at the time of commencement of or during the pendency of the bankruptcy, such trust property is subject to the debtor's legal title only and the beneficiaries of the trust property hold the equitable title.[154] Although the question of whether a debtor's interest in property constitutes "property of the estate" is a federal question to be decided by federal law, courts must look to the applicable state law to determine the extent of the debtor's legal or equitable interest in the property including whether a valid trust exists.[155] If there is valid trust property held by the debtor at the time of the filing of the petition, such trust property is not part of the bankruptcy estate.[156] In *Begier v. IRS*,[157] the Supreme Court citing to § 541(d) concluded that "because the debtor does not own an equitable interest in property which he holds in

trust for another, that interest is not 'property of the estate.'"[158] Accordingly, the trust property "can only be distributed to trust beneficiaries, and not to the creditors of the bankruptcy estate."[159] Indeed, it has been held that the debtor's "sole permissible administrative act" upon receipt of the trust funds is to pay the trust funds to the beneficiaries of the trust.[160] Some courts dispute the assertion that trust property is excluded entirely from the estate.[161] The *Maxon Engineering* Court held that property in which the debtor holds only legal title also becomes part of the bankruptcy estate, but only to the extent of the debtor's legal title.[162] "Thus, it follows that the contract proceeds regarded as in trust are included within the estate, but subject to the equitable lien" of the beneficiaries of the trusts.[163] And the *Maxon Engineering* Court went on to note that the debtor might well hold an equitable interest in some portion of the contract funds to the extent such funds might also include compensation for the debtor's overhead expenses exclusive of labor and materials, which is further basis for treating the funds as part of the bankruptcy estate.[164]

The debtor's rights and interests in property are determined as of the date of the commencement of the case.[165] Section 541 of the Bankruptcy Code does not vest the debtor's estate with any greater rights than those held by the debtor.[166] Thus, to the extent that the legal or equitable interests in the debtor's property included in the estate under section 541(a)(1) of the Bankruptcy Code are limited in the debtor's hands, they are generally limited to the same extent in the hands of any bankruptcy trustee because the Bankruptcy trustee acquires only the rights that the debtor has and nothing more.[167] Stated differently, the debtor gets no better interest in property after filing the bankruptcy case than the debtor had prior to filing the bankruptcy case.[168]

When property of the estate is alleged to be held in trust, the burden rests upon the claimant to establish the original trust relationship. Some Courts hold that the claimant must: (1) establish title; (2) identify the trust fund or property; and (3) trace the property in the event the trust fund or property has been mingled with the general property of the debtor.[169] When the trust funds have been commingled to such an extent that tracing of the funds is not possible, some courts employ the "lowest intermediate balance test" to determine what remaining property is trust property[170] Other courts hold that if trust funds cannot be traced the trust is destroyed and the beneficiaries become mere unsecured creditors.

Under the lowest intermediate balance test, the court will follow the trust fund and decree restitution where the amount of the deposit has at all times since the intermingling of funds equaled or exceeded the amount of the trust fund. But where, after the appropriation and mingling, all of the moneys are withdrawn, the equity of the beneficiary is lost, although moneys from other sources are subsequently deposited in the same account. In the intermediate case where the account is reduced to a smaller sum than the trust fund, the latter must be regarded as dissipated, except as to the balance, and funds subsequently added from other sources cannot be subject to the equitable claim of the beneficiary. If new money is deposited before the balance is reduced, the reduction should be considered to be from the new money and not from the monies held in trust.[171]

1. Section 541 and Trusts Established by Contract

As discussed above, the contract between the obligee and the debtor, or the subcontract between the general contractor and the subcontractor debtor, frequently contains a trust fund provision in the contract or subcontract that requires the debtor to hold all contract funds in trust for the benefit of the debtor's subcontractors and suppliers on the contract or subcontract.[172] Some courts have held that such contract provisions are sufficient to create a valid and enforceable trust

for purposes of bankruptcy law and that such funds to the extent of the equitable interest of the beneficiaries of the trust are not part of the debtor's bankruptcy estate.[173]

In *In re Gonzales*,[174] the Bankruptcy Appellate Panel of the Ninth Circuit affirmed the bankruptcy court's ruling that the terms of the underlying subcontracts created a valid trust for purposes of the Bankruptcy Code. In *Gonzales* each subcontract provided that all money received by the subcontractor from the contractor immediately became and constituted a trust fund for the benefit of "persons and firms supplying labor [and] materials . . . . for the benefit of said persons and firms, and shall not in any instance be diverted by Subcontractor to any other purpose until all obligations arising hereunder have been fully discharged and all claims arising therefrom have been fully paid."[175] The Court concluded that the trust fund clause of the subcontract agreement created an express trust whereby Gonzales held funds received from the contractor in trust for the benefit of laborers and materialmen.[176]

In *T & B Scottdale Contractors, Inc. v. United States*,[177] the Eleventh Circuit held that certain funds were not part of a subcontractor's bankruptcy estate because the general contractor paid those monies into a joint bank account for the sole purpose of paying the subcontractor's materialmen.[178] The general contractor T & B and the subcontractor R & R entered into a contract requiring T & B to create and control a bank account in R & R's name for the sole purpose of paying the subcontractor's suppliers. Relying upon § 541 of the Bankruptcy Code, the court held that R & R held these funds in trust for its materialmen and therefore, those funds were not part of the bankruptcy estate.[179] While these cases did not involve a surety, through its subrogation rights, a surety could seek to enforce trusts in the manner noted above to its advantage.

In contrast, the Sixth Circuit Court of Appeals in *In re Hughes-Bechtol, Inc.*[180] held that even if the contract language did create a valid express trust, which the court held it did not, such a trust would still be part of the estate. Relying on *In re William Cargile Contractor, Inc.*,[181] the *Hughes-Bechtol* court agreed that a debtor's estate should be interpreted broadly under § 541(a) to facilitate the rehabilitation of the debtor's business and that *all* the debtor's property must be included in the reorganization plan. The Court held, "[t]hus, even if a trust exists, the money may be subject to inclusion in the bankrupt's estate, because [debtor] had a legal and beneficial interest in any trust. Contract proceeds that [debtor] ultimately earned by completing performance on the contracts are part of the bankrupt's estate."[182]

2. Section 541 and Trusts Established in the Indemnity Agreement

As noted above, indemnity agreements frequently contain a trust fund provision.[183] If a valid express trust is created by the trust fund provision in the agreement of indemnity, those trust rights will be protected under the Bankruptcy Code.

In re Alcon Demolition, Inc.,[184] the court found that the four elements for the establishment of an express trust under New Jersey law were met by the trust fund provision in the agreement of indemnity, thus establishing a valid and enforceable trust under New Jersey law.[185] The indemnity agreement at issue in *Alcon Demolition* provided in relevant part:

> It is expressly understood and declared that all monies due or to become due under any contract or contracts covered by the Bonds are trust funds, whether in the possession of [debtor] or otherwise for the benefit of and for payment of all such

> obligations in connection with any such contract or contracts for which [Surety] would be liable under any of said Bonds, for which said trust also inures to the benefit of [Surety] for any liability of loss it may have to sustain under any said Bonds, and this Agreement and Declaration shall also constitute notice of such trust.

The Court noted that the language of the indemnity agreement expressly states that a trust is to be created, that the trust *res* will consist of "all monies due or to become due" for any bonded contracts, that the materialmen and laborers, along with the surety are the beneficiaries of the trust and that the debtor was the trustee.[186] The *Alcon Demolition* Court concluded that pursuant to § 541 the debtor had no beneficial interest in the contract funds to the extent of the payments made by the surety, and the debtor was bound by its fiduciary duty to pay the contract funds to the surety as the beneficiary of the trust under the trust fund provision of the agreement of indemnity.[187] Courts in other jurisdictions have similarly found that the surety's indemnity agreement creates a valid trust for purposes of the Bankruptcy Code.[188]

However, there is a split of authority as to whether the standard surety indemnity agreement creates a valid trust for purposes of the Bankruptcy Code when applicable state law is applied. In *In re Construction Alternatives, Inc.*,[189] the court held that the trust fund provision of the surety's agreement of indemnity did not have the necessary language to create a valid, express trust under Ohio law because the debtor was not required to keep any portion of the progress payments in a separate trust fund, nor did the debtor actually keep the progress payments in a separate account. Therefore, since there was no trust property held by the debtor, no trust was created.[190] Courts in other jurisdictions have held that the sureties' indemnity agreements do not create valid trusts for purposes of the Bankruptcy Code.[191]

3. Section 541 and Trusts Established by Statute

As noted above, many states have trust fund statutes that give subcontractors and suppliers a trust interest in any contract funds paid by an owner to a contractor or by a contractor to a subcontractor. In *Universal Bonding Insurance Co. v. Gittens & Sprinkle Enterprises, Inc.*,[192] the debtor contractor, Gittens & Sprinkle Enterprises ("Gittens") filed for bankruptcy protection and attempted, as debtor in possession, to collect outstanding contract balances due from state, municipal and federal agencies, for the purposes of reorganizing and using such funds as capital in new ventures. The surety objected and argued that the contract balances constituted statutory trusts for the benefit of laborers and materialmen and therefore could not become part of debtor's general estate under § 541. Both the bankruptcy court and the district court rejected the surety's arguments and held that contract balances belonged to the bankrupt's estate free of any liens of laborers and materialmen. The Third Circuit Court of Appeals vacated the lower court holding and held that funds paid by state and municipal agencies were statutory trust funds for the benefit of laborers and materialmen.

The New Jersey Trust Fund Act provided in relevant part:

> all money paid by the State of New Jersey or by any agency commission or department thereof, or by any county, municipality or school district in the state, to any person pursuant to the provisions of any contract for any public improvement . . . shall constitute a trust fund in the hands of such person . . . until all claims for

> labor, materials and other charges incurred in connection with the performance of such contract shall have been fully paid.[193]

The court found that the contract balances were subject to the New Jersey Trust Fund Act and that Gittens as debtor-in-possession was required to hold those funds subject to the statutory trust.[194] The court, citing § 541(d) noted that "property in which the debtor holds only legal title, and does not hold an equitable interest, such as trust funds, is included in the bankrupt's estate only to the extent of the debtor's legal title to the property and not to the extent of any interest in the property that the debtor does not hold."[195] Whether Gittens received the contract balances either before or after the filing of its bankruptcy case, the court determined that there was no difference in the trust fund nature of the contract balances. Finally, the court went on to hold that "when and if [the surety] pays Gittens' indebtedness to laborers or materialmen, it may pursue the statutory remedies of the laborers or materialmen by proceeding against such trust funds."[196]

Other courts have expressly held that the various state trust fund statutes create enforceable trusts and that the beneficial interests in subcontractors and materialmen in the trust property are not property of the debtor or of the bankruptcy estate pursuant to § 541.[197]

The practical applications of the use of an express trust under § 541 should not be underestimated. If the argument can be made that a trust exists and that the bonded contract funds at issue are, therefore, not property of the bankruptcy estate the surety, as a direct beneficiary or through subrogation, can prevail over the bankruptcy trustee's "strong-arm powers"[198] because those powers do not prevail over the funds that are not property of the estate pursuant to § 541(d).[199] Similarly, if the bonded contract funds can be deemed to be trust funds, then under § 541(d) the surety can prevail over the bankruptcy trustees preference actions under § 547.[200] Further, the surety can seek to use § 541 affirmatively to force the bankruptcy trustee or debtor in possession to release trust funds to the proper beneficiaries because such funds are not property of the estate.

D. CASH COLLATERAL – SECTION 363 OF THE BANKRUPTCY CODE.

Under certain limited circumstances the surety may wish to treat the bonded contract funds in the possession of the debtor as property constituting cash collateral of the debtor. For example, a situation may arise where at the time of the filing of bankruptcy the debtor is in possession of significant bonded contract funds which the surety could assert are trust funds held for the benefit of the surety. If the debtor is not able to use those funds to continue to operate its business it may default on other bonded projects and fail to complete which could give rise to wider losses or bond exposure to the surety. In such a case, rather than claim those funds, the surety may want to allow the debtor to use those funds under certain specified conditions. Under this scenario the existence of the trust may give rise to a sufficient interest in the funds to constitute cash collateral of the debtor as provided in § 363 of the Bankruptcy Code.[201]

Section 363 of the Bankruptcy Code concerns the debtor's use of the property of the bankruptcy estate. If the business of the debtor is authorized to be operated, the debtor may use property of the estate, other than cash collateral, in the ordinary course of business without notice to the creditors or a hearing and approval by the bankruptcy court.[202] "Cash collateral" is defined as cash in which the debtor's estate and an entity other than the debtor's estate have an interest.[203] If the bonded contract funds are deemed to be property of the debtor's estate, the debtor's receipt of

the funds would be property in which the debtor has an interest. To the extent that the surety, as an entity other than the debtor, can show it has an interest in the bonded contract funds, through its trust fund rights, those funds would then become "cash collateral."

While § 363(a) of the Bankruptcy Code defines cash collateral using the term "interest," the Bankruptcy Code does not define that word as it is used in § 363(a). However, the term "security interest" is defined in § 101(51) of the Bankruptcy Code as a "lien created by an agreement." In reviewing § 363(a), it is clearly apparent that the word "interest" is more inclusive than a mere "security interest" as the "interest" which the entity other than the estate must have includes certain proceeds, etc. which may be "subject to a security interest." Section 361 of the Bankruptcy Code concerning adequate protection under § 363 was intended to extend to equitable interests as well as perfected secured interests.[204] Therefore, the "interest" described in section 363(a) may include rights other than rights granted under a security interest, including any rights the surety may obtain utilizing trust funds.

If the bonded contract funds are "cash collateral" the debtor may not use such funds unless: (1) the surety consents to the debtor's use of the funds;[205] or (2) the bankruptcy court, after notice and a hearing, authorizes the debtor's use of the funds.[206]

It is the debtor's duty under § 363(c)(2) of the Bankruptcy Code to forebear from using cash collateral unless it has consent or a proper order from the court.[207] Typically issues regarding the use of cash collateral are determined in conjunction with the debtor through negotiation or a debtor filed motion. However, the surety may also request that the bankruptcy court, with or without a hearing, prohibit or condition the debtor's use of the cash collateral as is necessary to provide adequate protection to the surety.[208] At any hearing under § 363 of the Bankruptcy Code, the surety would have the burden of proof on the issue of the validity, priority or extent of the surety's interest in the bonded contract funds.[209] The debtor has the burden of proof on the issue of providing adequate protection for the surety asserting an interest in the bonded contract funds.[210]

E. NON-DISCHARGEABILITY – SECTION 523 OF THE BANKRUPTCY CODE.

Section 523(a)(4) of the Bankruptcy Code provides that a debtor in bankruptcy is ***not*** discharged from any debt "for fraud or defalcation while acting in a fiduciary capacity, embezzlement or larceny."[211] The purpose of § 523 is to remove from the debtor's capacity the ability to discharge certain debts arising from practices Congress deemed so pernicious that bankruptcy should not be able to insulate the debtor from their payment.[212] This section reflects Congress' conclusion that creditors' interest in recovering full payment of the types of debts identified outweighs the debtors' interest in a complete fresh start.[213] Because of the important nature of fiduciary relationships in general Congress deemed the violation of such relationship to be of such high significance that a discharge should not be allowed. However, § 523(a)(4), as with all other exceptions to discharge, is to be narrowly construed to further the fundamental purpose of the Bankruptcy Code to grant a debtor a fresh start.[214]

The surety can use § 523(a)(4) to its potential advantage if it can establish: (1) the existence of a fiduciary relationship on the part of the debtor to the surety and (2) some defalcation of that relationship.[215] The party seeking to establish non-dischargeability bears the burden of establishing the necessary requirements by a preponderance of the evidence.[216] If a defalcation has occurred, only that portion of the trust *res* inappropriately expended becomes nondischargeable.[217]

1. Fiduciary Capacity Under Section 523 of the Bankruptcy Code

The meaning of the term "fiduciary capacity" as used in § 523 is a question of federal law.[218] It has been defined as:

> [a] relation subsisting between two persons in regard to a business, contract, or piece of property,…of such a character that each must repose trust and confidence in the other and must exercise a corresponding degree of fairness and good faith. Out of such a relation, the law raises the rule that neither party may…take selfish advantage of his trust, or deal with the subject matter of the trust in such a way as to benefit himself or prejudice the other except in the exercise of the utmost good faith and with full knowledge and consent of that other.[219]

Most courts have limited the term to express or technical trust relationships.[220] The debt alleged to be non-dischargeable must arise from a breach of trust obligations imposed by law, separate and distinct from any breach of contract.[221] In addition, the requisite trust relationship must exist prior to and without reference to the act of wrongdoing.[222] This requirement eliminates constructive, resulting or implied trusts as a basis for creating the necessary fiduciary relationship as well as trusts which arise *ex-maleficio*.[223]

Although the concept of "fiduciary" in the dischargeability context is a narrowly defined question of federal law, courts look to state law to determine whether the requisite trust relationship exists.[224] If state law creates an express or technical trust relationship between the debtor and another party and imposes trustee status upon the debtor, the debtor will be a fiduciary under section 523(a)(4).[225]

2. Defalcation Under Section 523 of the Bankruptcy Code

"Defalcation" has been defined as the "failure to meet an obligation" or "a nonfraudulent default."[226] It has also been defined as the "misappropriation of trust funds or money held in any fiduciary capacity" or even the "failure to properly account for such funds."[227] To constitute defalcation for purposes of § 523 an act need not rise to the level of embezzlement, intentional fraud or any other intentional wrongdoing.[228] Thus, negligence or even an innocent mistake which results in misappropriation or failure to account can be sufficient.[229] With respect to fiduciary duties arising out of trust relationships, "[a] failure to apply funds entrusted to a fiduciary in accordance with the terms of the trust is a defalcation, whether intentional or not."[230] Thus, it has been widely held that, "the mere act of using the trust fund for any purpose other than the purpose for which the trust was created that constitutes misuse or misappropriation of the trust fund which is a defalcation committed by the fiduciary."[231] A question exists as to whether mere negligence is enough to constitute defalcation.[232] The Sixth and Seventh Circuits hold that mere negligence is not enough, while most bankruptcy and district courts find negligence sufficient to establish defalcation.[233]

3. Section 523 and Trusts Established by Indemnity Agreement

In two recent cases, the courts held that the trust relationship created in the indemnity agreement between the surety and the indemnitors created a sufficient express trust for § 523 non-

dischargeability and that under the facts of the cases a defalcation occurred.[234] In *Favre v. Lyndon Property Insurance Co.*,[235] the Court held that payments made from bonded contract funds by the debtor to himself and two other individuals as "loan repayments" were a breach of fiduciary duty which made the debt non-dischargeable.[236] The Court held that the indemnity agreement between the surety and the debtor created a valid express trust under applicable state law.[237] The indemnity agreement at issue in *Favre* provided in relevant part:

> The Principal and each of the Indemnitors agree and hereby expressly declare that notwithstanding any other provision, option, right or obligation contained in this Agreement and whether or not all funds earned or unearned, due or to become due under any contract covered by a bond issued by the Surety, as well as any funds loaned or advanced to the Principal and/or any proceeds from any advance or loan guaranteed by the Surety, are and shall at all times be and constitute trust funds, whether in the possession of the Principal or another, for the benefit and payment of all persons to whom the Principal incurs obligations in the performance of such contract and for which the Surety would be liable under the Bond, or any applicable law, statute, ordinance or regulation applicable to the Bond. Nothing contained in this Agreement shall be construed so as to enlarge or broaden the obligation of the Surety with respect to any bond written by it.[238]

The bond issued by the surety in *Favre* also provided that "all contract proceeds payable to the Principal . . . are acknowledged by the Obligee, the Principal and the Claimants, . . . to be trust funds . . ."[239] The Court found that the existence of the express trust created a fiduciary duty on the part of the debtor with respect to the contract funds and that payment of those funds to persons who were not the intended beneficiaries of the trust satisfied the requirements of § 523.[240] In so holding the Court rejected the debtor's argument that there was no breach of fiduciary duty because the surety was aware of the payments it made, finding insufficient evidence.[241]

In *Safeco Insurance Company of America v. Hastings (In re Hastings)*[242] the Bankruptcy Court for the Northern District of Alabama entered partial summary judgment in favor of the surety finding the portion of the trust property inappropriately expended by the debtor to be non-dischargeable under §523.[243] The Court held that the indemnity agreement created an express trust in favor of the surety and that such trust gave rise to a fiduciary duty on the part of the general contractor debtor sufficient for purposes of § 523 of the Bankruptcy Code.[244] The indemnity agreement entered into between the surety and the debtor provided that all moneys earned by the debtor are "trust funds . . . for payment of Contractor's obligations for, labor, material, and supplies furnished to Contractor in performance of such Contract for which surety would be liable under any Bond on such Contract."[245] The surety in *Hastings* sustained a loss of over $1,000,000 which it alleged was directly attributable to the debtor's failure to remit payments to subcontractors and suppliers after it was paid by the owner. The Court held that any use of the bond funds to pay expenses for which the surety was not liable, even if those expenses were otherwise legitimate business expenses for the project constituted a defalcation under § 523.[246]

4. Section 523 and Trusts Established by Statute

As noted above, the type of fiduciary relationship that is required to trigger § 523 is generally agreed to be narrowly defined as arising from an "express or technical trust relationship." In the context of trusts imposed by statute, like the construction trust fund statutes, courts disagree

as to whether such trusts are sufficient to give rise to the fiduciary relationship required by § 523. Some courts hold that a technical trust is one that is created based upon the intentions of the parties, through a formal document or agreement.[247] Under this view, trusts imposed by statute, which arise irrespective of the parties' intentions, are implied in law and fall short of the requirement of § 523. Other courts hold that a technical trust is, "a trust that is imposed by law and may arise either by statute or common law."[248] On this issue, the Fifth Circuit Court of Appeals has observed:

> Most courts today . . . recognize that the "technical" or "express" trust requirement is not limited to trusts that arise by virtue of a formal trust agreement, but includes relationships in which trust-type obligations are imposed pursuant to statute or common law. . . . Thus, the trust obligations necessary under section 523(a)(4) can arise pursuant to a statute, common law or a formal trust agreement.[249]

Illustrative of the broad view of § 523 the Tenth Circuit Court of Appeals in *In re: Siegfried*[250] held that the Colorado construction lien statute creates an express trust for purposes of § 523. Section 38-22-127(1) of the Colorado Revised Statutes provides:

> All funds disbursed to any contractor or subcontractor under any building, construction, or remodeling contract or on any construction project shall be held in trust for the payment of the subcontractors, laborer or material suppliers, or laborers who have furnished laborers, materials, services, or labor, who have a lien, or may have a lien, against the property, or who claim, or may claim, against a principal and surety under the provisions of this article and for which such disbursement was made.

The *Siegfried* Court stated that the statute plainly creates a fiduciary relationship and it does not permit the contractor to carve out a portion of the trust fund for its own expenses to the detriment of subcontractors.[251] The Court observed that, "[i]n the absence of a showing that *all* the trust funds were used to pay subcontractors or to satisfy the owner's obligations on the project, the insufficiency of the funds to meet the contractor's expenses is not a defense."[252] In *Siegfried* the debtor received two payments from the purchaser's lender and used some of those funds for its operating expenses and other funds to reimburse itself for the real property the project was constructed upon. The Court held such use of the trust funds constituted a defalcation for § 523 rending such debts non-dischargeable. Several courts have held that a statutory trust was an express trust for purposes of § 523.[253]

The narrow view of § 523 is best espoused by the Maryland Bankruptcy Court in *In re Holmes*,[254] where the Court held that Maryland's Construction Trust Statute did not give rise to a non-dischargeable debt under § 523. The Maryland statute provides in relevant part:

> *Moneys to be held in trust*. -- Any moneys paid under a contract by an owner to a contractor, or by the owner or contractor to a subcontractor for work done or materials furnished, or both, for or about a building by any subcontractor, shall be held in trust by the contractor or subcontractor, as trustee, for those subcontractors who did work or furnished materials, or both, for or about the building, for purposes of paying those subcontractors.[255]

The *Holmes* Court stated that in order for a debt to be nondischargeable under § 523 arising from a breach of fiduciary duty, the debtor must have been acting as a trustee under an express or technical trust which is one created in fact and not implied by law.[256] The Court defined "technical trust" as "a formal fiduciary relationship whose creation is based upon the intentions of a settlor and/or a beneficiary. A formal trust document is executed which establishes the rights and duties of the parties to the trust."[257] In contrast, the Court found that the Maryland statute imposes a trust upon the performance of an act i.e.: the payment of funds, irrespective of the intentions of the parties and therefore it is a trust implied in law.[258] The Court held that the Maryland Construction Trust Statute did not create an express trust sufficient to deny dischargeability of a debt incurred by the debtor's breach of fiduciary duty.[259]

VI. CONCLUSION

As the economic uncertainties facing the construction industry continue the surety will more and more find itself heading to the bankruptcy court to protect its interest in bonded contract funds and to recover losses and damages incurred by reason of having issued bonds. One of the many tools and weapons that the surety must have in its arsenal is a solid appreciation of the law of trusts and how such trusts can help the surety in the bankruptcy context.

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[3] Agatha Christie

[4] Robert F. Carney & Adam Cizek, *Payment Provisions in Construction Contracts and Construction Trust Fund Statutes: A Fifty State Survey* (paper presented at the Fifteenth Annual Northeast Surety and Fidelity Claims Conference on Sept. 30, 2004); Kim McNaughton, Mary Paty Lynn Jetton, & J. Michael Franks, *Surety's Rights to Contract Funds Under Trust Fund Provisions in Indemnity Agreements and Trust Fund Statutes* paper submitted at the Surety Claims Institute Annual Meeting on June 24,1999); Justin Melkus, *Trusts and the Commercial Surety* (paper presented at the Surety Claims Institute Annual Meeting on June 20-21, 2007); Armen Shahinian & James P. Ferrucci, *Use of Construction Trust Fund Statutes and the Misapplication of Funds Doctrine in Defense of Payment Bond Claims* (paper submitted at the Fourteenth Annual Northeast Surety and Fidelity Claims Conference in Sept. 2003).

[5] *Schumann-Heink v. Folsom*, 159 N.E. 250 (Ill. 1927).

[6] *Id. at 252.*

[7] *See* 1 Perry on Trusts §28 (5th ed. 1899).

[8] RESTATEMENT (THIRD) OF TRUSTS CH. 1 (2003).

[9] *In re Schnitz*, 52 B.R. 951 (Bankr. W.D. Mo. 1985), *McDaniel Title Co. v. Lemons*, 626 S.W.2d 686, 690 (Mo. App. 1981); *Yang v. Qin (In re Qin)*, 285 B.R. 292, 297 (Bankr. N.D. Iowa 2002).

[10] *Moore v. Moore,* 189 S.W.3d 627, 636 (Mo. App. 2006).

[11] GEORGE G. BOGERT & GEORGE T. BOGERT, THE LAW OF TRUSTS AND TRUSTEES § 1 (rev. 2d ed. 1984).

[12] *Milholland v. Whalen*, 89 Md. 212, 213-14, 43 A. 43, 43-44 (1899). *From the Heart Church Ministries, Inc. v. African Methodist Episcopal Zion Church*, 370 Md. 152, 181-182 (2002), *cert. denied*, 537 U.S. 1171 (2003).

[13] *In re Penn Central Transp. Co.*, 486 F.2d 519, 524 (3d Cir. 1973) (quoting RESTATEMENT (SECOND) OF TRUSTS § 2 (1959)).

[14] *Farris v. Boyke*, 936 S.W.2d 197, 200 (Mo. Ct. App. 1996); *Blue Ridge Ins. Co. v. Stanewich*, 142 F.3d 1145, 1150 (9th Cir. 1998); *Bracken v. Harris & Zide, L.L.P.*, 219 F.R.D. 481 (N.D. Calif. 2004); *Coverdell v. Mid-S. Farm Equip. Ass'n, Inc.*, 335 F.2d 9 (6th Cir. 1964) *Limouze v. M.M.&P. Mar. Advancement, Training, Educ. & Safety Program*, 397 F. Supp. 784 (D. Md. 1975).

[15] *Pelt v. Utah*, 104 F.3d 1534 (10th Cir. 1996); *U.S. v. Kingsley*, 851 F.2d 16, 20-21 (1st Cir. 1988); *Coleman v. Golkin, Bomback & Co.*, 562 F.2d 166, 168-69 (2d Cir. 1977); *Dennett v. Kuenzli*, 936 P.2d 219 (Idaho App. 1997).

[16] RESTATEMENT (THIRD) OF TRUSTS § 3(1) (2003).

[17] William F. Fratcher, *Scott on Trusts* § 156.3 (4th ed. 1987); *see also Lehman v. Comm'r of Internal Revenue*, 109 F.2d 99 (2d Cir. 1940); *In re Green Valley Fin. Holdings*, 32 P.3d 643 (Colo. Ct. App. 2001).

[18] *Times of Trenton Publ'g. Corp. v. Lafayette Yard Comm. Dev. Corp.*, 846 A.2d 659 (N.J. App. Div. 2004), *see also* RESTATEMENT (THIRD) OF TRUSTS § 3(3) (2003).

[19] RESTATEMENT (THIRD) OF TRUSTS § 3(4) (2003).

[20] Under the doctrine of merger, if the equitable title and legal title are held by the same person the property is free of the trust and the property holder has full and complete title. *See* RESTATEMENT (THIRD) OF TRUSTS § 69 (2003).

[21] *Levin v. Sec. Fin. Ins. Corp.*, 230 A.2d 93, 98 (Md. 1967) (citing *Sieling v. Sieling*, 135 A. 376, 381 (Md. 1926)).

[22] ARIZ. REV. STAT. § 33-1005; COLO. REV. STAT. § 38-22-127; 770 DEL. CODE ANN. tit. 6, § 3502 *et seq.*; ILL. COMP. STAT. ANN. 60/21.02; MD. CODE ANN., REAL PROP. §9-201 *et seq.*; MICH. COMP. LAWS SERV. § 570.151 *et seq.*; MINN. STAT. ANN. § 514.02; N.Y. LIEN LAW § 70; OKLA. STAT. ANN. tit. 42, § 152 *et seq.*; TENN. CODE ANN. § 66-34-304; WIS. STAT. § 799.02.

[23] *From the Heart Church Ministries, Inc. v. African Methodist Episcopal Zion Church*, 803 A.2d 548 (Md. 2002); *Springer v. Springer*, 125 A. 162, 166-67 (Md. 1924). Implied trusts are discussed in greater detail *infra*

[24] *Mattson v. U.S. Ensilage Harvester Co.*, 213 N.W. 893, 895 (Minn. 1927).

[25] *Negley v. Ingleman*, 166 N.E. 477 (Ill. 1929); *McCartney v. Ridgway*, 43 N.E. 826 (Ill. 1895).

[26] *Peal v. Luther*, 97 S.E.2d 668, 669 (Va. 1957); *Broaddus v. Gresham*, 26 S.E.2d 33, 35 (Va. 1943).

[27] *Broaddus*, 26 S.E.2d at 35; *see also Old Republic Nat. Title Ins. Co. v. Tyler (In re Dameron)*, 155 F.3d 718, 722 (4th Cir. 1998); *Schloss v. Powell*, 93 F.2d 518, 519 (4th Cir. 1938); *In re: Southstar Funding, LLC*, 2008 Bankr. LEXIS 3883 (Bankr. N.D. Ga. 2008); *Woods v. Stull*, 30 S.E.2d 675, 682 (Va. 1944).

[28] RESTATEMENT (THIRD) OF TRUSTS § 5 cmt. (a) (2003).

[29] *Id.*.

[30] *Mid-Atl. Supply, Inc. of Va. v. Three Rivers Aluminum Co.*, 790 F.2d 1121 (4th Cir. 1986) (quoting *Broaddus v. Gresham*, 26 S.E.2d 33, 35 (Va. 1943)).

[31] *Becker v. Dutton*, 168 N.E. 804 (Mass. 1929); *see also In re H&A Constr. Co.*, 65 B.R. 213 (Bankr. D. Mass. 1986).

[32] RESTATEMENT (THIRD) OF TRUSTS § 15 (2003).

[33] *Id*. at cmt. (a) .

[34] *Bongaards v. Millen*, 768 N.E.2d 1107 (Mass. App. Ct. 2002), *aff'd* 793 N.E.2d 335 (Mass. 2003).

[35] *Morsman v. Comm'r of I.R.S.*, 90 F.2d 18 (8th Cir. 1937).

[36] *Official Comm. of Unsecured Creditors of Columbia Gas Transmission Corp. v. Columbia Gas Sys. (In re Columbia Gas Sys.)*, 997 F.2d 1039, 1063 (3d Cir. 1993); *Georgia Pac. Corp. v. Sigma Serv. Corp.*, 712 F.2d 962, 969 (5th Cir. 1983); *Mayfield v. Kansas City Life Ins. Co.*, 158 F.2d 331 (7th Cir. 1946); *In re K.I. Liquidation, Inc.*, 2007 Bankr. LEXIS 4235 (Bankr. D.N.J. 2007); *In re M&T Electrical Contractors, Inc.*, 267 B.R. 434 (Bankr. D.D.C. 2001); *Webster v. Webster*, 184 N.E.2d 897 (Ind. App. 1962).

[37] *Kelley v. Kelley*, 13 A.2d 529, 533 (Md. 1940) (clear and convincing evidence); *Masters v. Masters*, 89 A.2d 576, 582 (Md. 1952); *Gibson v. The Resolution Trust Corporation*, 750 F. Supp. 1565 (S.D. Fla. 1990) ("For the purpose of proving the trust relationship, the evidence must be clear and unmistakable both as the intent to create the trust and as to the execution of that intent. The acts or words relied on must be unequivocal."); *Hill v. Irons*, 113 N.E.2d 243, 248 (Ohio 1953); *Fed. Ins. Co. v. Fifth Third Bank*, 867 F.2d 330 (6th Cir. 1989) (clear and convincing).

[38] *Lawton v. Nyman*, 327 F.3d 30 (1st Cir. 2003); *Gomez v. Cecena*, 15 Cal.2d 363, 366-367 (1940); *Viele v. Curtis*, 101 A. 966 (Me. 1917).

[39] *Hill v. Berger*, 134 N.E. 721 (Ill. 1922).

[40] *In re Snider Bros., Inc.*, 12 B.R. 87 (Bankr. D. Mass. 1981); *Peterson v. Teodosio*, 297 N.E.2d 113 (Ohio 1973).

[41] *Ambruster v. Ambruster*, 31 S.W.2d 28 (Mo. 1930); *Pitts v. Weakley*, 55 S.W. 1055 (Mo. 1900).

[42] 76 AM. JUR. 2D *Trusts* § 40 (2005).

[43] RESTATEMENT (THIRD) OF TRUSTS § 2 cmt. (f) (2003).

[44] *In re Verrone*, 277 BR 66, 72 (Bankr. W.D. Pa. 2002); *In re Smith*, 238 BR 664 (Bankr. W.D. Ky. 1999) *In re Desiderio*, 213 B.R. 99, 103 (Bankr. E.D. Pa. 1997); *In re McCormick*, 283 B.R. 680 (Bankr. W.D. Pa. 2002); *Sherwin v. Oil City National Bank*, 229 F.2d 835, 838 (3d Cir. 1965) *Frazier v. Hudson*, 279 Ky. 334, 130 S.W.2d 809, 810 (1939).

[45] *Kitchen v. Boyd (In re Newpower)*, 229 B.R. 691, 705 (Bankr. W.D. Mich. 1999) (citation omitted), *aff'd in part and rev'd in part on other grounds*, 233 F.3d 922 (6th Cir. 2000); *E. Concrete Paving Co. v. Jacob's Elec. Constr., Inc.*, 293 B.R. 704 (Bankr. E.D. Mich. 2003).

[46] *In re Smith*, 73 B.R. 211, 212 (Bankr. N.D. Fla. 1986); *Maurer v. Maurer (In re Maurer)*, 267 B.R. 639 (Bankr. M.D. Fla. 2001).

[47] In the Georgia Code, "Express trusts - (b) An express trust shall have each of the following elements, ascertainable with reasonable certainty: (1) An intention by a settlor to create a trust; (2) Trust property; (3) A beneficiary; (4) A trustee; and (5) Active duties imposed on the trustee, which duties may be specified in the writing or implied by law." GA. CODE ANN. § 53-12-20.

[48] *In re Kulzer Roofing, Inc.*, 139 B.R. 132, 139 (Bankr. E.D. Pa.) *aff'd*, 150 B.R. 134 (E.D. Pa. 1992); *Mory v. Michael*, 18 Md. 227, 240-41 (1862); *Pierowich v. Metro. Life Ins. Co.*, 275 N.W. 789, 790 (Mich. 1937).

[49] RESTATEMENT (THIRD) OF TRUSTS § 13 (2003).

[50] *Smith v. Williams*, 698 F.2d 611 (3d Cir. 1983); *Hoyle v. Dickinson*, 746 P.2d 18 (Ariz. App. 1987); *Succession of Stoneman*, 490 So.2d 333 (La. App. 1986).

[51] *In re Iowa R.R.*, 840 F.2d 535, 544 (7th Cir. 1988); *Cabaniss v. Cabaniss*, 464 A.2d 87, 91 (D.C. 1983); *Stern v. J. Nichols Produce Co.*, 486 A.2d 84 (D.C. App. 1984).

[52] *Fed. Ins. Co. v. Fifth Third Bank*, 867 F.2d 330, 333 (6th Cir. 1989) (quoting *Guardian Trust Co. v. Kirby*, 199 N.E. 81, 83 (Ohio App. 1935)); *Townsend v. Gordon*, 14 N.W.2d 57, 61 (Mich. 1944); *Eastern Concrete Paving Co. v. Jacob's Elec. Constr., Inc.*, 293 B.R. 704 (Bankr. E.D. Mich. 2003); *Ulmer v. Fulton*, 195 N.E. 557 (Ohio 1935).

[53] *Wachovia Bank of Ga. v. Namik*, 593 S.E.2d 35 (Ga. App. 2003); *In re Trust by Dumaine*, 781 A.2d 999 (N.H. 2001).

[54] RESTATEMENT (SECOND) OF TRUSTS § 25 cmt. (b) (1959).

[55] RESTATEMENT (THIRD) OF TRUSTS § 40 (2003); 76 AM. JUR. 2D *Trusts* § 248 (2005).

[56] RESTATEMENT (THIRD) OF TRUSTS § 40 cmt. (b) (2003).

[57] *Fisher v. Donovan*, 77 N.W. 778 (Neb. 1899).

[58] *Begier v. IRS*, 496 U.S. 53 (1990); *In re Stefanoff*, 97 B.R. 607 (Bankr. N.D. Okla. 1989); *Eychaner v. Gross*, 779 N.E.2d 1115 (Ill. 2002).

[59] RESTATEMENT (THIRD) OF TRUSTS § 43 (2003).

[60] *Id.* at cmt. (a).

[61] *McLemore v. McLemore*, 675 So.2d 202 (Fla. App. 1996).

[62] *McLemore, supra.; Hubbard v. Shankle*, 138 S.W. 3d 474 (Tex. App. 2004).

[63] *Senfour Inv. Co. v. King County*, 401 P.2d 319 (Wash. 1965).

[64] RESTATEMENT (THIRD) OF TRUSTS § 45 cmt. (a) (2003).

[65] *Id.* at § 48.

[66] *Reinecke v. Smith*, 289 U.S. 172 (1933).

[67] RESTATEMENT (THIRD) OF TRUSTS § 33 (2003).

[68] *Kelley, Glover, & Vale, Inc. v. Kramer (In re V-I-D, Inc.)*, 198 F.2d 392 (7th Cir. 1952); *Bisbee v. Sec. Nat. Bank & Trust Co.* (*In re Bisbee)*, 754 P.2d 1135 (Ariz. 1988).

[69] 76 AM. JUR. 2D *Trusts* § 51 (2005)

[70] RESTATEMENT (THIRD) OF TRUSTS § 35 cmt. (b) (2003).

[71] *Id.* at §§ 36-37.

[72] *In re Trust of Brooke*, 697 N.E. 2d 191 (Ohio 1998); *Sorrel v. Sorrel*, 1 S.W. 3d 867 (Tex. App. 1999).

[73] RESTATEMENT (SECOND) OF TRUSTS § 186(b) (1959); RESTATEMENT (THIRD) OF TRUSTS § 70 cmt. (a) (2003); *see also Petition of First Interstate Bank of Denver, N.A.*, 767 P.2d 792 (Colo. App. 1988).

[74] RESTATEMENT (THIRD) OF TRUSTS § 76 (2003) .

[75] *Id.* at § 77.

[76] *Id.* at § 78.

[77] *Id.* at § 78 cmt. (a).

[78] *NLRB* v. *Amax Coal Co.*, 453 U.S. 322, 329-332 (1981).

[79] RESTATEMENT (THIRD) OF TRUSTS §§ 82-83 (2003).

[80] *Wagner v. Coen*, 23 S.E. 735 (W.Va. 1895); *Tyler v. California*, 134 Cal. App. 3d 973 (1982); *Frontier Excavating, Inc. v. Sovereign Constr. Co.*, 294 N.Y.S.2d 994, 998 (1968); *Engstrom v. Larson*, 44 N.W.2d 97, 109 (N.D. 1950); *Winger v. Chicago City Bank & Trust Co.*, 67 N.E.2d 265, 277 (Ill. 1946); George G. BOGERT & GEORGE T. BOGERT, THE LAW OF TRUSTS AND TRUSTEES § 596, at 458 (2d ed. 1980).

[81] RESTATEMENT (THIRD) OF TRUSTS § 84 (2003).

[82] *Id.* at cmt. (b)

[83] *West Virginia v. Blue Cross and Blue Shield of West Virginia, Inc.*, 638 S.E.2d 144 (W.Va. App. 2006); *Bell v. Killian*, 93 So. 2d 769, 778 (Ala. 1957); *Hurst v. Hurst*, 405 P.2d 913, 917 (Ariz. Ct. App. 1965); *Chambers v. Williams*, 132 S.W.2d 654, 656 (Ark. 1939); *Elliott v. Elliott*, 231 Cal. App. 2d 205, 41 Cal.Rptr. 686, 688 (1964); *Cotting v. Berry*, 114 P. 641, 643 (Colo. 1911); *Curran v. Smith-Zollinger Co.*, 151 A. 217 (Del. Ch. 1930); *Myers v. Matusek*, 125 So. 360, 366 (Fla. 1929); *Adler v. Hertling*, 451 S.E.2d 91, 97 (Ga. Ct. App. 1994); *In re Possession & Control of the Comm'r of Banks & Real Estate of Independent Trust Corp.*, 764 N.E.2d 66, 100 (Ill. App. Ct. 2001); *Ross v. Thompson*, 146 N.E.2d 259, 266 (Ind. 1957); *State v. Hawkeye Oil Co.*, 110 N.W.2d 641, 648 (Iowa 1961); *In re Miller's Estate*, 594 P.2d 167, 170 (Kan. 1979); *Farmers' Bank of White Plains v. Bailey*, 297 S.W. 938, 939 (Ky. 1927); *D.T. & A.T. Lee v. First Nat'l Bank*, 139 So. 63, 65 (La. Ct. App. 1932); *Brown v. Coleman*, 566 A.2d 1091, 1097 (Md. 1989); *Feeney v. Feeney*, 140 N.E.2d 642, 645 (Mass. 1957); *Blair v. Trafco Prods., Inc*., 369 N.W.2d 900, 903 (Mich. Ct. App. 1985); *Petersen v. Swan*, 57 N.W.2d 842, 846 (Minn. 1953); *Holliman v. Demoville*, 138 So. 2d 734, 736 (Miss. 1962); *In re Myers Estate*, 376 S.W.2d 219, 222 (Mo. 1964); *Bennett v. Glacier Gen. Assur. Co.*, 259 Mont. 430, 857 P.2d 683, 685 (Mont. 1993); *In re Estate of Redpath*, 402 N.W.2d 648, 651 (Neb. 1987); *Div. of Employment Sec. v. Pilot Mfg. Co.*, 199 A.2d 78, 81 (N.J. 1964); *Daughtry v. Int'l Bank of Commerce*, 134 P. 220, 221 (N.M. 1913); *Gen. Motors Acceptance Corp. v. Norstar Bank, N.A.*, 532 N.Y.S.2d 685, 687 (1988); *Mich. Nat'l Bank v. Flowers Mobile Homes Sales, Inc*., 217 S.E.2d 108, 111 (N.C. Ct. App. 1975); *Engstrom v. Larson*, 44 N.W.2d 97, 109 (N.D. 1950); *In re Graham's Estate*, 98 N.E.2d 104, 111 (Ohio Prob. Ct. 1950); *Boroughs v. Whitley*, 363 P.2d 150, 152 (Okla. 1961); *Montgomery v. U.S. Nat'l Bank of Portland*, 349 P.2d 464, 473 (Ore. 1960); *In re Paxson Trust I*, 893 A.2d 99, 129 (Pa. 2006); *Want v. Alfred M. Best Co.*, 105 S.E.2d 678, 701 (S.C. 1958); *Farmers' Sav. Bank v. Bergin*, 216 N.W. 597, 599 (S.D. 1927); *State ex rel. Robertson v. Thomas W. Wrenne & Co.*, 92 S.W.2d 416, 418 (Tenn. 1936); *Flournoy v. Wilz*, 201 S.W.3d 833 (Tex. Ct. App.); *Tooele County Bd. of Educ. v. Hadlock*, 11 P.2d 320, 324 (Utah 1932); *First Nat'l Bank v. Commercial Bank & Trust Co.*, 175 S.E. 775, 779 (Va. 1934); *Westview Invs., Ltd. v. U.S. Bank Nat'l Ass'n*, 138 P.3d 638, 644 (Wash. Ct. App. 2006); *Simonson v. McInvaille*, 166 N.W.2d 155, 159 (Wis. 1969); *City of Casper v. Joyce*, 88 P.2d 467, 470 (Wyo. 1939).

[84] *West Virginia v. Blue Cross and Blue Shield of West Virginia, Inc.*, 638 S.E.2d 144 (W.Va. App. 2006), (quoting *Henson v. Lamb*, 199 S.E. 459 (W. Va. 1938)).

[85] *See* Robert F. Carney & Adam Cizek, *Payment Provisions in Construction Contracts and Construction Trust Fund Statutes: A Fifty State Survey* (paper presented at the Fifteenth Annual Northeast Surety and Fidelity Claims Conference on Sept. 30, 2004).

[86] *Id.*

[87] MICH. COMP. LAWS ANN. §570.151; *Air Prods. & Chems., Inc. v. J.F. Cavanaugh Co.*, 311 N.W.2d 731, 733 (Mich. 1981) ("The act applies only to private construction contracts."); OKLA. STAT. tit. 42 § 152.

[88] *See* ARIZ. REV. STAT. § 33-1005 (only applies to owner occupied residential construction).

[89] *See* ARK. CODE ANN. § 18-44-132; GA. CODE ANN. § 16-8-15.

[90] Of course, the surety may still be able to pursue recovery through its subrogation rights, but it must be subrogated to the proper class of person.

[91] COLO. REV. STAT. § 38-22-127(3) (1973); *see also In re W. Urethanes, Inc.*, 61 B.R. 243 (Bankr. D. Colo. 1986).

[92] *A. Contracting & Material Co. v. Ulico Cas. Co.*, 844 A.2d 460, 468 (Md. 2004).

[93] *See Com'l Ins. Co. of Newark v. Pacific-Peru Consrt.*, 558 F.2d 948, 953 (9th Cir. 1977); *Transamerica Ins. Co. v. Bloomfield*, 401 F.2d 357, 362-63 (6th Cir. 1968); *Engbrock v. Fed. Ins. Co.*, 370 F.2d 784, 786 (5th Cir. 1967); *Am. Sur. Co. of New York v. Inmon*, 187 F.2d 784, 786 (5th Cir. 1951); *U.S. Fid. & Guar.Co. v. Jones*, 87 F.2d 346, 348 (5th Cir. 1937); *Carroll v. Nat'l Sur. Co.*, 24 F.2d 268, 270-71 (D.C. Cir. 1928); *Nat. Sur. Corp. v. Peoples Milling Co.*, 57 F. Supp. 281, 282-83 (W.D. Ky. 1944); *Martin v. Lyons*, 558 P.2d 1063, 1066 (Idaho 1977); *Mass. Bonding & Ins. Co. v. Gautieri*, 69 R.I. 70, 30 A.2d 848, 850 (1943); *Cent. Sur. & Ins. Corp. v. Martin*, 224 S.W.2d 773, 779 (Tex. Civ. App. 1949).

[94] This exact indemnity agreement provision was held valid in *In re Wright*, 266 B.R. 848, 851 (Bankr. E.D. Ark. 2001). However, in *In re Marques*, 358 B.R. 188 (Bankr. E.D. Pa. 2006), the Court interpreted the first clause of the paragraph as creating a condition precedent to the application of the trust fund provision and refused to apply the trust fund provision because the surety in that case failed to prove that the condition had been satisfied.

[95] 76 AM. JUR. 2D *Trusts* § 40 (2005).

[96] *Acuity, A Mut. Ins. Co. v. Planters Bank, Inc.*, 362 F. Supp. 2d 885 (W.D. Ken. 2005).

[97] *Fed. Ins. Co. v. Fifth Third Bank*, 867 F.2d 330, 334 (6th Cir. 1989); *In re Smith*, 238 B.R. 664 (Bankr. W.D. Ky. 1999); RESTATEMENT (SECOND) OF TRUSTS § 26 (1959); GEORGE G. BOGERT & GEORGE T. BOGERT, THE LAW OF TRUSTS AND TRUSTEES Ch. 7 § 112 (rev. 2d ed. 1984).

[98] *In re Smith*, 238 B.R. 664 (Bankr. W.D. Ky. 1999).

[99] *Id.*

[100] *In re Suprema Specialties, Inc.*, 370 B.R. 517 (S.D.N.Y. 2007), *aff'd, In re Suprema Specialties, Inc. v. Bank of Am. N.A.*, 2009 U.S. App. LEXIS 3359 (2d Cir. 2009).

[101] *In re Eljay JRS., Inc.*, 106 B.R. 775 (Bankr. S.D.N.Y. 1989), *aff'd* 123 B.R. 961 (S.D.N.Y. 1991); *Coleman v. Golkin, Bomback & Co., Inc.*, 562 F.2d 166, 69 n. 5 (2d Cir. 1977).

[102] *In re Mackintosh's Estate*, 249 N.Y.S. 534, 536 (N.Y. Sur. Ct. 1931); RESTATEMENT (SECOND) OF TRUSTS § 17 cmt. a (1959); A.W. SCOTT & W.F. FRATCHER, THE LAW OF TRUSTS § 32.5, at 369 (4th ed. 1987).

[103] *Favre v. Lyndon Prop. Ins. Co.*, 2008 WL 3271100 (S.D.Miss. Aug. 6, 2008); *Safeco Ins. Co. of Am. v. Hastings (In re Hastings)*, 2008 WL 5383586 (Bankr. N.D.Ala. Dec. 23, 2008); *In re Fox*, 357 B.R. 770 (Bankr. E.D. Ark. 2006); *In re: Maxon Eng'g Servs., Inc.*, 332 B.R. 495 (Bankr. D.P.R. 2005); *In re McIntosh*, 320 B.R. 22 (Bankr. M.D. Fla. 2005); *In re McCormick*, 283 B.R. 680 (Bankr. W.D. Penn. 2002); *In re Herndon*, 277 B.R. 765 (Bankr. E.D. Ark. 2002); *In re Wright*, 266 B.R. 848, 851 (Bankr. E.D. Ark. 2001); *Cumberland Sur. Ins. Co. v. Smith (In re Smith)*, 238 B.R. 664, 672 (Bankr. W. D. Ky. 1999); *In re Alcon Demolition, Inc.*, 204 B.R. 440 (Bankr. D.N.J. 1997); *Gillespi v. Jenkins (In re Jenkins)*, 110 B.R. 74, 76-77 (Bankr. M.D. Fla. 1990).

[104] *In re Suprema Specialties, Inc.*, 370 B.R. 517 (S.D.N.Y. 2007), *aff'd, In re Suprema Specialties, Inc. v. Bank of Am. N.A.*, 2009 U.S. App. LEXIS 3359 (2d Cir. 2009); *In re Constr. Alternatives*, 2 F.3d 670, 676-677 (6th Cir. 1993); *In re Wm. Cargile Contractor, Inc.*, 151 Bankr. 854, 859-860 (Bankr. S.D. Ohio 1993); *Acuity, A Mut. Ins. Co. v. Planters Bank, Inc.*, 362 F. Supp. 2d 885 (W.D. Ken. 2005); *E. Concrete Paving Co. v. Jacob's Elec. Constr., Inc.*, 293 B.R. 704 (E.D. Mich. Bankr. 2003).

[105] Bankruptcy courts have described the trust fund nature of the contract funds arising from construction contracts. The bankruptcy courts generally acknowledge that the contract funds are encumbered with the rights of others, including the obligees, unpaid subcontractors and suppliers, and/or the surety. As such, the Contract Funds are, in essence, trust funds to be held by the debtor for the protection of others as beneficiaries. *In re RAM Constr. Co., Inc.*, 32 B.R. 758 (Bankr. W.D. Pa. 1983). The *RAM* court reasoned:

"RAM could not transfer to Equibank rights in these payments, which are greater than RAM possesses. *See Prairie State Bank v. United States*, 164 U.S. 227, 240 (1896). RAM's claim to these monies is encumbered first by the owners, then by its unpaid subcontractor, et al., and if unpaid, by its surety. By express contract with the surety and with the owner, RAM is subordinated first to the owner's claim, second to the subcontractors, et al. and then to the surety. Judge Marsh in *Atlantic Refining Co. v. Continental Casualty Co.*, 183 F. Supp. 478 (W.D. Pa. 1960) recognized the trust nature of these funds until the job is complete and these parties paid. The Supreme Court in *Martin v. National Surety Co.*, 300 U.S. 588 (1937), read into the contract the bond and considered a default under the bond as a default under the contract and imposed an equitable trust upon the funds over the contractor's assignee." *Id.* at 760. *See also In re Glover Constr. Co., Inc.*, 30 B.R. 873, 878 (Bankr. W.D. Ky. 1983), in which the court reviewed Sixth Circuit precedent "outlining the fundamental reasons for treating contractor monies as a trust fund held for the benefit of materialmen claimants," *citing Selby v. Ford Motor Co.*, 590 F.2d 642 (6th Cir. 1979) and *Parker v. Klochko Equipment Rental Co., Inc.*, 590 F.2d 649 (6th Cir. 1979) *See also In re Pacific Marine Dredging and Constr.*, 79 B.R. 924, 928 (Bankr. D. Or. 1987) ("In an unbroken line of decisions, the courts have held that when a surety executes a bond with a general contractor on a public contract, in favor of the owner, there arises, in the surety's favor, an equitable right to or lien on funds the owner properly withholds from the contractor. These funds are in the nature of a trust to reimburse the surety who is forced to pay on its bond."); *In re Alliance Properties, Inc.*, 104 B.R. 306, 312 (Bankr. S.D. Cal. 1989) ("The fund is analogous to the corpus of a trust held by the estate for the benefit of the subcontractors and/or the surety.").

[106] *In re Gonzales*, 22 B.R. 58 (B.A.P 9th Cir. 1982); *In re Marrs-Winn Co.*, 103 F.3d 584 (7th Cir. 1996); *Fed. Ins. Co. v. Fifth Third Bank*, 867 F.2d 330 (6th Cir. 1989).

[107] AIA A-201 § 9.6.7 (1997).

[108] *Westview Invs., Ltd. v. U.S. Bank Nat'l Ass'n*, 138 P.3d 638 (Wash. App. 2006).

[109] RESTATEMENT (SECOND) OF TRUSTS § 222 (1959); *Washington v. Comer*, 28 P.2d 1027 (Wash. 1934).

[110] *See* Minn. Stat. Ann. §514.02 subdiv. 1(a); *State v. Bren*, 704 N.W.2d 170 (Minn. 2005).

[111] *Ferguson v. Owens*, 459 N.E.2d 1293 (Ohio 1984); *In re Team America, Inc.*, 2009 U.S. Dist. LEXIS 32562 (S.D. Ohio 2009), *see also Superior Glass Co., Inc. v. First Bristol County Nat'l Bank*, 394 N.E.2d 972 (Mass. App. 1979), *aff'd*, 406 N.E.2d 672 (Mass. 1980); *Kelly v. Kelly*, 260 N.E.2d 659 (Mass. 1970); *In re H&A Constr. Co., Inc.*, 65 B.R. 213 (Bankr. D. Mass. 1986).

[112] *In re McCafferty*, 96 F.3d 192, 196 (6th Cir. 1996); *Am. Nat'l Bank & Trust Co. of Rockford v. U.S.*, 832 F.2d 1032, 1035 (7th Cir. 1987); *Dunham v. Kisak*, 1998 U.S. Dist. LEXIS 22660 (S.D. Ill. 1998) ("A constructive trust, under Illinois law, is an equitable remedy to prevent unjust enrichment, not a real trust."); *Yetter Well Serv., Inc. v. Cimarron Oil Co.*, 841 P.2d 1068, 1070 (Colo. App. 1992); *Syfrett v. Pullen*, 2008 Colo. App. LEXIS 2174 (Colo. App. 2008).

[113] *Hartsock v. Strong*, 318 A.2d 237 (Md. 1974); *Am. Nat'l Bank v. FDIC*, 710 F.2d 1528, 1541 (11th Cir. 1983); *Barnett Bank of Tallahassee v. Applegate*, 379 So. 2d 1284, 1287 (Fla. Dist. Ct. App. 1978); *Reaves v. Hembree*, 330 So. 2d 747, 749 (Fla. Dist. Ct. App. 1976); *U.S. Fid. & Guar. Co. v. Ernest Constr.Company*, 854 F. Supp. 1545 (M.D. Fla. 1994); *Flanigan v. Munson*, 175 N.J. 597, 818 A.2d 1275, 1281 (N.J. 2003); *In re Monnig's Dep't Stores, Inc.*, 929 F.2d 197, 201 (5th Cir. 1991) (quoting *Omohundro v. Matthews*, 341 S.W.2d 401, 405 (Tex. 1960)); *see also Hudspeth v. Stoker*, 644 S.W.2d 92, 94 (Tex. Ct. App.1982*); In re N.S. Garrott & Sons*, 772 F.2d 462, 467 (8th Cir. 1985); *Horton v. Koner*, 671 S.W.2d at 238 (Ark. Ct. App. 1984); *Andres v. Andres*, 613 S.W.2d 404 (Ark. Ct. App. 1981).

[114] *Hartsock v. Strong*, 318 A.2d at 240.

[115] *Id;, see also NPF IV, Inc. v. Transitional Health Servs.*, 922 F. Supp. 77 (S.D. Ohio 1996).

[116] *Suttles v. Vogel*, 533 N.E.2d 901, 904 (Ill. 1988); *Dunham v. Kisak*, 1998 U.S. Dist. LEXIS 22660 (S.D. Ill. 1998)**.**

[117] 76 AM.JUR.2D *Trusts* § 171 (2005); *Dunham v. Kisak*, 1998 U.S. Dist. LEXIS 22660 (S.D. Ill. 1998); *Meyer v. Kneip*, 457 N.W.2d 463 (S.D. 1990).

[118] *Johnson v. Graff*, 23 N.W.2d 166, 168 (S.D. 1946); *City of Centerville v. Turner County*, 126 N.W. 605 (S.D. 1910); *Stianson v. Stianson*, 167 N.W. 237, 238 (S.D. 1918); *Pioneer Annuity Life Ins. Co. v. Nat'l Equity Life Ins. Co.*, 765 P.2d 550 (Ariz. App. 1988); *Andre v. Morrow*, 680 P.2d 1355 (Idaho 1984).

[119] *Dunham v. Kisak*, 1998 U.S. Dist. LEXIS 22660 (S.D. Ill. 1998); *Thompson v. City of Atl. City*, 901 A.2d 428, 438 (N.J. App. Div. 2006), *aff'd as modified*, 921 A.2d 427 (N.J. 2007); *In re Monnig's Dep't Stores, Inc.*, 929 F.2d at 201; *see also, Burkhart Grob Luft und Raumfahrt GmbH & Co. K.G. v. E-Systems, Inc.*, 257 F.3d 461, 469 (5th Cir. 2001); *In re: K.I. Liquidation, Inc.*, 2008 U.S. Dist. LEXIS 97522 (D.N.J. 2008).

[120] *In re Monnig's Dep't Stores, Inc.*, 929 F.2d at 201; *see also Burkhart Grob Luft und Raumfahrt GmbH & Co. K.G. v. E-Systems, Inc.*, 257 F.3d 461, 469 (5th Cir. 2001).

[121] *In re Am. Motor Club, Inc.*, 109 B.R. 595, 599 (Bankr. E.D.N.Y. 1990); *see also In re Vichele Tons, Inc.*, 62 B.R. at 790; *In re Fagan*, 166 B.R. 531 (Bankr. E.D. N.Y. 1993); *In re Koreag, Controle et Revision, S.A.*, 961 F.2d 341 (2d Cir. 1992) (citations omitted); *In re Branch Motor Exp. Co.*, 51 B.R. 146, 148 (Bankr. S.D.N.Y. 1986).

[122] *Hartsock v. Strong*, 318 A.2d 237 (Md. App. 1974); *Meadows v. Bierschwale*, 516 S.W.2d 125 (Tex. 1974); *Underwriters Group, Inc. v. Clear Creek Indep. School Dist.*, 2006 U.S. Dist. LEXIS 47907 (S.D. Tex. 2006).

[123] *Bailiff v. Woolman*, 906 A.2d 409 (Md.App. 2006).

[124] *Presten v. Sailer*, 542 A.2d 7, 15 (N.J. App. Div. 1988); *see Del. River & Bay Auth. v. York Hunter Constr., Inc.*, 781 A.2d 1126, 1131 n.5 (N.J. Super. Ct. 2001); *In re K.I. Liquidation, Inc.*, 2008 U.S. Dist. LEXIS 97522 (D.N.J. 2008).

[125] *Univ. Hosps. of Cleveland v. Lynch*, 772 N.E.2d 105 (Ohio 2002); *Kelley v. Kelley*, 13 A.2d 529, 533 (Md. 1940); *Bottenfield v. Wood*, 573 S.W.2d 307, 309 (Ark. 1978); *Robertson v. Robertson*, 317 S.W.2d 272, 274 (Ark. 1958); *Viele v. Curtis*, 101 A. 966 (Me. 1917).

[126] *Levin v. Levin*, 405 A.2d 770 (Md. App. 1979); *see also Taylor v. Mercantile-Safe Deposit & Trust Co.*, 307 A.2d 670 (Md. 1973); *Fitch v. Double "U" Sales Corp.*, 129 A.2d 93 (Md. 1957); *Fasman v. Pottashnick*, 51 A.2d 664 (Md. 1947); *Frain v. Perry*, 609 A.2d 379 (Md.App. 1992).

[127] 76 AM.JUR.2D *Trusts* §135 (2005).

[128] *Id.*

[129] [129] RESTATEMENT (THIRD) OF TRUSTS § 7 (2003).

[130] *Steinhardt v. Steinhardt*, 445 So. 2d 352 (Fla. Dist. Ct. App. 1984)*; Taylor v. Mercantile-Safe Deposit & Trust Co.*, 307 A.2d 670, 674-75 (Md. 1973); *Rector v. Episcopal Church*, 620 A.2d 1280, 1283 (Conn. 1993); *In re Snider Bros., Inc.*, 12 B.R. 87 (Bankr. D. Mass. 1981).

[131] *Smigliani v. Smigliani*, 260 N.E. 2d 917 (Mass. 1970); *Frank v. Frank*, 162 N.E. 2d 781 (Mass. 1959); *Moat v. Moat*, 17 N.E.2d 710 (Mass. 1938); and *Browdy v. Browdy*, 145 N.E. 868 (Mass. 1925).

[132] *First Nat'l Bank & Trust Co. of Rockford v. Illinois Nat'l Bank & Trust Co. of Rockford*, 167 N.E.2d 223, 225 (Ill. 1960).

[133] *Am. Nat'l Bank & Trust Co. of Rockford, Ill. v. U.S.*, 832 F.2d 1032, 1035 (7th Cir. 1987).

[134] *Siemiesz v. Amend*, 237 Md. 438, 206 A.2d 723 (1965).

[135] For the purposes of this article, the principal is a corporate principal/contractor, not an individual. Therefore, this article will not discuss the rights of a surety against an individual principal who may file a voluntary case under chapter 13 of the Bankruptcy Code.

[136] 11 U.S.C. § 301.

[137] 11 U.S.C. § 704.

[138] 11 U.S.C. § 1108. With limited exceptions, a "debtor-in-possession" has the same rights, powers and duties as a trustee. *See* 11 U.S.C. § 1107. These powers are enumerated in the Bankruptcy Code.

[139] 11 U.S.C. §§ 1121-1124.

[140] 11 U.S.C. §§ 1125, 1126.

[141] 11 U.S.C. §§ 1128, 1129.

[142] 11 U.S.C. §§ 1141-1144.

[143] 11 U.S.C. § 362(a) provides that the automatic stay prohibits creditors from taking the following actions against a debtor or its property: (1) the commencement or continuation, including the issuance or employment of process, of a judicial, administrative, or other action or proceeding against the debtor that was or could have been commenced before the commencement of the case under this title, or to recover a claim against the debtor that arose before the commencement of the case under this title; (2) the enforcement, against the debtor or against property of the estate, of a judgment obtained before the commencement of the case under this title; (3) any act to obtain possession of property of the estate or of property from the estate or to exercise control over property of the estate; (4) any act to create, perfect, or enforce any lien against property of the estate; (5) any act to create, perfect, or enforce against property of the debtor any lien to the extent that such lien secures a claim that arose before the commencement of the case under this title; (6) any act to collect, assess, or recover a claim against the debtor that arose before the commencement of the case under this title; (7) the setoff of any debt owing to the debtor that arose before the commencement of the case under this title against any claim against the debtor; and (8) the commencement or continuation of a proceeding before the United States Tax Court concerning the debtor.

[144] 11 U.S.C. § 362(d)(1).

[145] 11 U.S.C. § 362(d)(2).

[146] 11 U.S.C. § 362(g)(1).

[147] 11 U.S.C. § 362(h).

[148] 11 U.S.C. § 541(a).

[149] 11 U.S.C. § 541(a)(1).

[150] 11 U.S.C. § 541(a)(6).

[151] 11 U.S.C. § 541(d).

[152] The statute has been read and applied generally. *Begier v. I.R.S.*, 496 U.S. 53, 59 (1990); *City Nat'l Bank of Miami v. Gen. Coffee Corp. (In re Gen. Coffee Corp.)*, 828 F.2d 699 (11th Cir. 1987). Thus, the italicized language does not limit the operation of the section to a real estate mortgage or to a mortgage to which a debtor retains legal title for servicing purposes. *Belisle v. Plunkett*, 877 F.2d 512 (7th Cir. 1989).

[153] *See* Section II(A) and note 9, *supra.*

[154] *Universal Bonding Ins. Co. v. Gittens & Sprinkle Enters., Inc.*, 960 F.2d 366, 371 (4th Cir. 1992); *Ga. Pac. Corp. v. Sigma Serv. Corp.*, 712 F.2d 962 (5th Cir. 1983); *In re Alcon Demolition, Inc.*, 204 B.R. 440 (Bankr. D.N.J. 1997); *In re W. Urethanes, Inc.*, 61 B.R. 243 (Bankr. D. Colo. 1986).

[155] *In re Yonikus*, 996 F.2d 866 (7th Cir. 1993); *see Butner v. U.S.*, 440 U.S. 48, 55 (1979) ("Property interests are created and defined by state law."); *UNR Indus., Inc. v. Continental Cas. Co*., 942 F.2d 1101, 1103 (7th Cir. 1991) ("State law controls the determination of assets in a bankrupt estate, unless federal interests require a different result."); *In re Dameron*, 155 F.3d 718 (4th Cir. 1998); *In re B.I. Fin. Servs. Group, Inc.*, 854 F.2d 351, 354 (9th Cir. 1988); *Elliott v. Bumb*, 356 F.2d 749, 753 (9th Cir. 1966); *In re Darby*, 226 B.R. 126 (Bankr. M.D. Ala. 1998).

[156] *In re B.I. Fin. Servs. Group, Inc.*, 854 F.2d at 354 (citing *U.S. v. Whiting Pools, Inc.*, 462 U.S. 198, 205 n. 10 (1983)); *Official Comm. of Unsecured Creditors v. Columbia Gas Systems, Inc. (In re Columbia Gas Systems, Inc.)*, 997 F.2d 1039 at 1059 (3d Cir. 1993); *Universal Bonding Ins. Co. v. Gittens and Sprinkle Enters., Inc.*, 960 F.2d 366, 371 (3d Cir. 1992); *City of Farrell v. Sharon Steel Corp.*, 41 F.3d 92, 95 (3d Cir. 1994); *Bank of Marin v. England*, 385 U.S. 99 (1966); *In re Wyatt*, 6 B.R. 947 (Bankr. E.D. N.Y. 1980); *In re Snider Bros., Inc.*, 12 B.R. 87 (Bankr. D. Mass. 1981).

[157] 496 U.S. 53, 59 (1990).

[158] *Id.*

[159] *In re Marrs-Winn Company, Inc.*, 103 F.3d 584, 590 (7th Cir. 1996); *In re Butts*, 46 B.R. 292, 295 (D.N.D. 1985) ("legal title alone has been held to be of no value to the estate and the debtor will be required to reconvey the property or its substitute to the beneficial owner.").

[160] *In Mid-Atl. Supply, Inc. of Va. v. Three Rivers Aluminum Co.*, 790 F.2d 1121, 1126 (4th Cir. 1986), the court held that: "[I]f a trust, whether express, statutory, or constructive is established over property in the possession of the trustee or debtor-in-possession, the 'sole permissible administrative act' of the trustee or debtor-in-possession is to pay over or endorse over the property to the beneficiary or beneficiaries of the trust." *See also Ga. Pac. Corp. v. Sigma Serv. Corp.*, 712 F.2d 962 (5th Cir. 1983).

[161] *In re Maxon Eng'g Servs., Inc.*, 332 B.R. 495 (Bankr. D.P.R. 2005); *In re Glover Constr. Co., Inc.*, 30 B.R. 873 (Bankr. W.D. Ky. 1983); *In re Hughes-Bechtol, Inc.*, 2000 U.S. App. LEXIS 18741 (6th Cir. 2000).

[162] *In re Maxon Eng'g Servs., Inc.*, 332 B.R. at 500.

[163] *Id.*

[164] *Id.*; *see also In re Glover Constr. Co., Inc.*, 30 B.R. 873 (Bankr. W.D. Ky. 1983).

[165] *In re Julien Co.*, 44 F.3d 426, 429 (6th Cir. 1995); *In re Turner*, 190 B.R. 836, 840 (Bankr. S.D. Ohio 1996); *In re Roberge*, 181 B.R. 854, 856 (Bankr. E.D. Va. 1995), *rev'd on other grounds*, 188 B.R. 366 (E.D. Va. 1995), *aff'd*, 95 F.3d 42 (4th Cir. 1996); *In re Deblock*, 11 B.R. 51, 53 (Bankr. N.D. Ohio 1981).

[166] *In re Brown*, 734 F.2d 119, 124 (2d Cir. 1984); *In re TTS, Inc*., 158 B.R. 583, 585 (D. Del. 1993); *In re Auto-Train Corp., Inc.*, 53 B.R. 990, 994 (D.D.C. 1985), *rev'd on other grounds*, 810 F.2d 270 (D.C. Cir. 1987); *In re Psychotherapy & Counseling Ctr., Inc.*, 195 B.R. 522, 532 (Bankr. D.D.C. 1996); *In re DuBose*, 174 B.R. 260, 262 (Bankr. N.D. Ohio 1994); *In re Pupura*, 170 B.R. 202, 208 (Bankr. E.D.N.Y. 1994); *In re Joseph B. Dahlkemper Co., Inc.*, 165 B.R. 149, 155 (Bankr. W.D. Pa. 1994); *In re Coombs*, 86 B.R. 314, 317 (Bankr. D. Mass. 1988); *In re Lemons & Assocs*., 67 B.R. 198, 208 (Bankr. D. Nev. 1986).

[167] *Creasy v. Coleman Furniture Corp.*, 763 F.2d 656, 662 (4th Cir. 1985); *Integrated Solutions, Inc. v. Serv. Support Specialties, Inc.*, 193 B.R. 722, 729 (D.N.J. 1996); *In re Home Builders, Inc.*, 213 B.R. 475, 477 (Bankr. E.D. Va. 1997); *In re Alpha Ctr., Inc.*, 165 B.R. 881, 883 (Bankr. S.D. Ill. 1994); *In re Royal Bus. Sch., Inc.*, 157 B.R. 932, 942 (Bankr. E.D.N.Y. 1993); *In re Southwest Citizens' Org. for Poverty Elimination*, 91 B.R. 278 (Bankr. D.N.J. 1988).

[168] *Universal Bonding Ins. Co. v. Gittens & Sprinkle Enters., Inc*., 960 F.2d 366, 372-73 (3d Cir. 1992); *Old Stone Bank v. Tycon I Bldg. Ltd. P'ship*, 946 F.2d 271, 275 (4th Cir. 1991); *In re Pupura*, 170 B.R. 202, 208 (Bankr. E.D.N.Y. 1994); *Aetna Cas. & Sur. Co. v. Gamel*, 45 B.R. 345, 347 (N.D.N.Y. 1984).

[169] *In re H&A Constr. Co., Inc.*, 65 B.R. 213 (Bankr. D. Mass. 1986) (citing *Ga. Pac. Corp. v. Sigma Serv. Corp.*, 712 F.2d 962, 969 (5th Cir. 1983)); *Conn. Gen. Life Ins. Co. v. Universal Ins. Co.*, 838 F.2d 612, 618 (1st Cir 1988); *Am. Serv. Co. v. Henderson*, 120 F.2d 525, 531 (4th Cir. 1941); *In re K.I. Liquidation, Inc.*, 2007 Bankr. LEXIS 4235 (D.N.J. Bankr. 2007); *Official Comm. of Unsecured Creditors of the Columbia Gas Transmission Corp. v. Columbia Gas Sys. Inc. (In re Columbia Gas Sys. Inc.)*, 997 F.2d 1039, 1063 (3d Cir. 1993); *In re K.I. Liquidation, Inc.*, 2008 U.S. Dist. LEXIS 97522 (D.N.J. 2008); *In re Trafalgar Assocs.*, 53 B.R. 693 (Bankr. S.D.N.Y. 1985); *In re St. Theresa Props., Inc.*, 152 B.R. 852 (Bankr. S.D.N.Y. 1993); *In re U.S. Lines, Inc.*, 79 B.R. 542, 544-48 (Bankr. S.D.N.Y. 1987).

[170] *Official Comm. of Unsecured Creditors of the Columbia Gas Transmission Corp. v. Columbia Gas Sys. Inc. (In re Columbia Gas Sys. Inc.)*, 997 F.2d 1039, 1054 (3d Cir. 1993); *In re Trafalgar Assocs.*, 53 B.R. 693 (Bankr. S.D.N.Y. 1985); *In re K.I. Liquidation, Inc.*, 2007 Bankr. LEXIS 4235 (Bankr. N.D.N.J. 2007).

[171] *In re: Nat'l Century Fin. Enters., Inc.*, 310 B.R. 580 (Bankr. S.D. Ohio 2004).

[172] *Fed. Ins. Co. v. Fifth Third Bank*, 867 F.2d 330 (6th Cir. 1989); *In re Gonzales*, 22 B.R. 58 (B.A.P. 9th Cir. 1982).

[173] *See n.156 supra.*

[174] *In re Gonzales*, 22 B.R. 58 (B.A.P. 9th Cir. 1982).

[175] *Id.* at 59.

[176] *Id.*

[177] *T & B Scottdale Contractors, Inc. v. U.S.*, 866 F.2d 1372 (11th Cir. 1989).

[178] *Id.* at 1376.

[179] *Id.*

[180] *In re Hughes- Bechtol, Inc.*, 2000 U.S. App. LEXIS 18741 (6th Cir. 2000).

[181] *In re Wm. Cargile Contractor, Inc.*, 151 B.R. 854, 859-60 (Bankr. S.D. Ohio 1993).

[182] 2000 U.S. App. LEXIS 18741 at *29-31 (clarification added).

[183] *See generally*, Robert L. Lawrence, et al., *The Agreement of Indemnity - The Surety's Handling of Contract Bond Problems: Enforcement of the Surety's Rights Against the Principal and the Indemnitors Under the Agreement of Indemnity*, in THE AGREEMENT OF INDEMNITY - PRACTICAL APPLICATIONS BY THE SURETY (George J. Bachrach ed., 1990); Kim McNaughton, Mary Paty Lynn Jetton, & J. Michael Franks, *Surety's Rights to Contract Funds Under Trust Fund Provisions in Indemnity Agreements and Trust Fund Statutes* paper submitted at the Surety Claims Institute Annual Meeting on June 24,1999).

[184] *In re Alcon Demolition, Inc.*, 204 B.R. 440 (Bankr. D.N.J. 1997).

[185] *Id.* at 448.

[186] *Id.* at 448-449.

[187] *Id.* at 449.

[188] *Favre v. Lyndon Prop. Ins. Co.*, 2008 U.S. Dist. LEXIS 105334 (S.D.Miss. August 6, 2008); *Safeco Ins. Co. of Am. v. Hastings (In re Hastings)*, 2008 Bankr. LEXIS 3507 (Bankr. N.D.Ala. December 23, 2008); *In re Fox*, 357 B.R. 770 (Bankr. E.D. Ark. 2006); *In re Herndon*, 277 B.R. 765 (Bankr. E.D. Ark. 2002); *In re McCormick*, 283 B.R. 680 (Bankr. W.D. Penn. 2002); *In re Wright*, 266 B.R. 848, 851 (Bankr. E.D. Ark. 2001); *In re McIntosh*, 320 B.R. 22 (Bankr. M.D. Fla. 2005); *In re Maxon Eng'g Serv's, Inc.*, 332 B.R. 495 (Bankr. D.P.R. 2005); *Cumberland Sur. Ins. Co. v. Smith (In re Smith)*, 238 B.R. 664, 672 (Bankr. W. D. Ky. 1999); *Gillespi v. Jenkins (In re Jenkins)*, 110 B.R. 74, 76-77 (Bankr. M.D. Fla. 1990).

[189] *Ind. Lumbermens Mut. Ins. Co. v. Constr. Alternatives, Inc. (In re Constr. Alternatives)*, 2 F.3d 670 (6th Cir. 1993).

[190] *Id.* at 677, *see also Capitol Indem. Corp. v. Mount Vernon Sch. Dist.*, 41 F.3d 320 (7th Cir. 1994); *In re Foam Sys. Co.*, 92 B.R. 406 (B.A.P. 9th Cir. 1988).

[191] *Capitol Indem. Corp. v. U.S.*, 41 F.3d 320 (7th Cir. 1994); *In re Constr. Alternatives*, 2 F.3d at 676-677; *Acuity, A Mut. Ins. Co. v. Planters Bank, Inc.*, 362 F. Supp. 2d 885 (W.D. Ken. 2005); *Int'l Fid. Ins. Co. v. Marques (In re Marques)*, 358 B.R. 188 (Bankr. E.D. Pa. 2006); *E. Concrete Paving Co. v. Jacob's Elec. Constr., Inc.*, 293 B.R. 704 (E.D. Mich. Bankr. 2003); *In re Wm. Cargile Contractor, Inc.*, 151 B.R. 854, 859-860 (Bankr. S.D. Ohio 1993); *In re: Suprema Specialties, Inc.*, 370 B.R. 517 (S.D.N.Y. 2007), *aff'd, In re Suprema Specialties, Inc. v. Bank of Am. N.A.*, 2009 U.S. App. LEXIS 3359 (2d Cir. 2009).

[192] *Universal Bonding Ins. Co. v. Gittens & Sprinkle Enters.*, 960 F.2d 366 (3d Cir. 1992).

[193] N.J.STAT. ANN. 2A:44-148.

[194] *Universal Bonding Ins. Co.*, 960 F.2d at 371.

[195] *Id*.

[196] *Id.* at 373-74.

[197] *In re Kennedy & Cohen, Inc.*, 612 F.2d 963, 965 (5th Cir. 1980); *Selby v. Ford Motor Co.*, 590 F.2d 642, 645, 649 (6th Cir. 1979); *In re Casco Elec. Corp.*, 28 B.R. 191, 193-194 (Bankr. E.D.N.Y. 1983), *aff'd*, 35 B.R. 731, 732 (E.D.N.Y. 1983); *In re: Dunwell Heating & Air Conditioning Contractors Corp.*, 78 B.R. 667 (Bankr. E.D.N.Y. 1987).

[198] 11 U.S.C. § 544 (providing the trustee or the debtor with the status of a judicial lienholder, a creditor with an unsatisfied execution, and a bona fide purchaser of real property).

[199] In *In re General Coffee Corp.*, 828 F.2d 699, 706 (11th Cir. 1987), the court found no difficulty in ruling in favor of the party seeking to enforce its rights under a constructive trust and against the claim of the trustee. The court stated: "We believe, however, that for purposes of priority in bankruptcy a constructive trust beneficiary should have the same rights to the trust assets that a beneficiary of an express trust would have. An express trust beneficiary clearly has priority to trust assets over a judicial lienholder or execution creditor." *Id*. at 706. *See also In re Quality Holstein Leasing*, 752 F.2d 1009, 1013 (5th Cir. 1985).

[200] *Selby v. Ford Motor Co.*, 590 F.2d 642 (6th Cir. 1979); *In re Short*, 818 F.2d 693, 695 (9th Cir. 1987).

[201] *See, e.g., In re Glover Constr. Co., Inc.*, 30 B.R. 873, 882 (Bankr. W.D. Ky. 1983).

[202] 11 U.S.C. § 363(c)(1) and (c)(2).

[203] 11 U.S.C. § 363(a).

[204] H.R. REP. NO. 95-595, at 338-40 (1977).

[205] 11 U.S.C. § 363(c)(2)(A).

[206] 11 U.S.C. § 363(c)(2)(B).

[207] Prior to obtaining the entity's consent or the bankruptcy court's approval for the debtor's use of "cash collateral," the debtor must segregate and account for any "cash collateral" in the debtor's possession, custody or control. 11 U.S.C. § 363(c)(4). Upon the debtor's filing of its bankruptcy case, the surety should file a notice in the bankruptcy case concerning the surety's interests and rights in the Contract Funds, stating that the surety does not consent to the debtor's use of the Contract Funds as "cash collateral," and serve the notice on the debtor's counsel and any other interested parties. The surety may also want to file a motion to sequester, segregate and account for the Contract Funds as "cash collateral."

[208] 11 U.S.C. § 363(e). Section 361 of the Bankruptcy Code discusses when adequate protection is required under sections 362, 363 and 364 of the Bankruptcy Code. Section 361 focuses on the financial protection granted to an entity with an interest in the "cash collateral" for the debtor's use of that "cash collateral." The bankruptcy court is allowed to grant other relief to such an entity that results "in the realization by such entity of the indubitable equivalent of such entity's interest in such property." 11 U.S.C. § 361(3).

[209] 11 U.S.C. § 363(o)(2).

[210] 11 U.S.C. § 363(o)(1).

[211] 11 U.S.C. § 523(a)(4).

[212] *Stackhouse v. Hudson (In re Hudson),* 859 F.2d 1418, 1423 (9th Cir. 1988); *Century 21 Balfour Real Estate v. Menna (In re Menna),* 16 F.3d 7, 9 (1st Cir. 1994).

[213] *Cohen v. de la Cruz,* 523 U.S. 213 (1998).

[214] *In re Delisle*, 281 B.R. 457, 466 (Bankr. D. Mass. 2002); *In re Verrone*, 277 BR 66 (Bankr. WD Pa. 2002); *In re Cohn*, 54 F.3d 1108, 1113 (3d Cir. 1995); *In re James N. McCormick*, 283 B.R. 680 (W.D. Pa. 2002).

[215] *In re Montgomery*, 236 B.R. 914, 922 (D.N.D. 1999).

[216] *Grogan v. Garner,* 498 U.S. 279 (1991) (adopting preponderance-of-the-evidence standard for all exceptions to discharge under 11 U.S.C. § 523(a)).

[217] *See generally In re Thomas,* 729 F.2d 502 (7th Cir. 1984); *In re Fox,* 357 B.R. 770 (Bankr. E.D. Ark. 2006).

[218] *Davis v. Aetna Acceptance Co.*, 293 U.S. 328, 333 (1934); *Tudor Oaks Limited P'ship v. Cochrane (In re Cochrane),* 124 F.3d 978, 984 (8th Cir. 1997); *In re Fox,* 357 B.R. 770 (Bankr. E.D. Ark. 2006); *Runnion v. Pedrazzini (In re Pedrazzini),* 644 F.2d 756, 758 (9th Cir. 1981); *In re Runge*, 226 BR 298, 304 (Bankr. D.N.H. 1998).

[219] *In re Humphrey*, 350 B.R. 657, 659 (E.D. La. 2006); *Angelle v. Reed,* 610 F.2d 1335, 1338 (5th Cir. 1980).

[220] *Davis v. Aetna Acceptance Corp.*, 293 U.S. 328, 333 (1934); *Ragsdale v. Haller,* 780 F.2d 794, 796 (9th Cir. 1986).

[221] *In re Johnson*, 691 F.2d 249, 251 (6th Cir. 1982).

[222] *Ragsdale,* 780 F.2d at 796. The circuits which have addressed statutes imposing only criminal or other penalties on a general contractor have refused to find a fiduciary relationship within the scope of § 523 and its predecessor, § 17(a)(4) of the Bankruptcy Act because in such statutes the trust generally arises only upon the act of misappropriation and cannot be said to exist prior to the wrong and without reference to it even though a technical or express trust may exist at that time. *Johnson,* 691 F.2d at 253; *Pedrazzini,* 644 F.2d at 759; *Angelle,* 610 F.2d at 1341. *See also In re Dloogoff,* 600 F.2d 166 (8th Cir. 1979).

[223] *In re Short*, 818 F.2d 693, 695 (9th Cir. 1987).

[224] *Ragsdale*, 780 F.2d at 796-97; *In re Johnson*, 691 F.2d at 251; *Runnion v. Pedrazzini*, 644 F.2d 756 (9th Cir. 1981); *Angelle v. Reed,* 610 F.2d 1335 (5th Cir. 1980).

[225] *Ragsdale*, 780 F.2d at 796-97.

[226] *In re Uwimana*, 274 F.3d 806, 811 (4th Cir. 2001) (quoting BLACK'S LAW DICTIONARY 427 (7th ed. 1999)); *In re James N. McCormick*, 283 B.R. 680 (W.D. Pa. 2002).

[227] *Tudor Oaks Limited P'ship v. Cochrane (In re Cochrane),* 124 F.3d at 984.

[228] *Uwimana* 274 F.3d at 811 (quoting *In re Ansari*, 113 F.3d 17, 20 (4th Cir. 1997)); *Cent. Hanover Bank & Trust Co. v. Herbst*, 93 F.2d 510, 512 (2nd Cir. 1937); *Tudor Oaks Limited P'ship*, 124 F.3d at 984; *In re Sigler*, 196 B.R. 762, 764 (Bankr. W.D. Ky. 1996); *In re Garver*, 116 F.3d 176, 178-80 (6th Cir. 1997); *Quaif v. Johnson*, 4 F.3d 950(11th Cir. 1993); *Holmes v. Kraus*, 37 B.R. 126 (Bankr. E.D. Mich. 1984).

[229] *Uwimana*, 274 F.3d at 811; *In re James N. McCormick*, 283 B.R. 680 (W.D. Pa. 2002).

[230] *In re Herndon*, 277 B.R. at 769, *see also In re Wright*, 266 B.R. at 851("[A]lthough something more than mere negligence or an innocent mistake is required, ignorance of the fiduciary responsibilities is not an excuse to defalcation if that ignorance leads to a fiduciary default."); *In re: Fox*, 357 B.R. 770 (bankr. E.D. Ark. 2006).

[231] *In re Matheson*, 10 B.R. 652, 656 (Bankr. Ala. 1981). *See, e.g., In re Reeves*, 124 B.R. 5, 8 (Bankr. D.N.H. 1990); *In re Boshell*, 108 B.R. 780, 784 (Bankr. N.D. Ala. 1989); *In re Guy*, 101 B.R. 961, 992 (Bankr. N.D. Ind. 1988); *In re Ardito*, 1988 Bankr. LEXIS 2273 (Bankr. E.D.N.Y. 1988); *In re Gans*, 75 B.R. 474, 490 (Bankr. S.D.N.Y. 1987).

[232] 3 WILLIAM L. NORTON, JR., BANKRUPTCY LAW AND PRACTICE §47:29 (2d ed. 2006); *Meyer v. Rigdon*, 36 F.3d 1375 (7th Cir. 1994); *In re Johnson*, 691 F.2d 249 (6th Cir. 1982).

[233] *Meyer*, 36 F.3d at 1384.

[234] *Favre v. Lyndon Prop. Ins. Co.*, 2008 U.S. Dist. LEXIS 105334 (S.D. Miss. Aug. 6, 2008); *Safeco Ins. Co. of Am. v. Hastings (In re Hastings)*, 2008 Bankr. LEXIS 3507 (Bankr. N.D.Ala. Dec. 23, 2008).

[235] *Favre*, 2008 U.S. Dist. LEXIS 105334 (S.D. Miss. August 6, 2008).

[236] *Id.* at *17.

[237] *Id.* at *12-13.

[238] *Id.* at *12-13 n. 5.

[239] *Id.* at *14 n. 5.

[240] *Id.* at *16-17.

[241] *Id.*

[242] *Safeco Ins. Co. of Am. v. Hastings (In re Hastings)*, 2008 Bankr. LEXIS 3507 (Bankr. N.D.Ala. Dec. 23, 2008).

[243] *Id.* at *5-6.

[244] *Id.* at *3.

[245] *Id.* at *2.

[246] *Id.* at *4.

[247] *In re Holmes*, 117 B.R. 848, 852 (Bankr. D. Md. 1990).

[248] *In re Runge*, 226 B.R. at 305 (Bankr. Dist. N.H. 1998); *In re Mccormick*, 2002 Bankr. LEXIS 1059 (Bankr. W.D. Pa. 2002); *In re Bennett*, 989 F.2d 779 (5th Cir. 1993); *In re Romero*, 535 F.2d 618, 621 (10th Cir. 1976).

[249] *In re Bennett*, 989 F.2d at 784-85.

[250] *Mangum v. Siegfried (In re Seigfried)*, 2001 U.S. App. LEXIS 3907 (10th Cir. Mar. 14, 2001).

[251] *Id.* at 6-7.

[252] *Id.* at *12-13.

[253] *In re Twitchell*, 91 B.R. 961 (D. Utah 1988); *In re Kawczynski*, 442 F. Supp. 413 (W.D. N.Y. 1977); *In re Ketchum*, 409 F. Supp. 743 (S.D. N.Y. 1975); *In re Specialized Installers, Inc.*, 12 B.R. 546 (Bankr. D. Colo. 1981).

[254] *In re Holmes*, 117 B.R. 848 (Bankr. D. Md. 1990).

[255] MD. CODE ANN., REAL PROP. ART. § 9-201 *et seq.* (1996).

[256] *In re Holmes*, 117 B.R. at 852.

[257] *Id.*

[258] *Id.*

[259] *Id.* at 855.