



U.S. Supreme Court Clarifies When Debts Can Be Discharged In Bankruptcy

Michael A. Yoshida may@hawaiilawyer.com

May 14, 2013

On Monday, May 13, 2013, the U.S. Supreme Court clarified when certain debts can be discharged in bankruptcy. In *Bullock v. BankChampaign, NA*, No. 11-1518, the unanimous Court explained what the term “defalcation” means in section 523(a)(4) of the Bankruptcy Code.

In that case, Randy Bullock’s father established a trust for the benefit of Bullock and his siblings, making Bullock the trustee. Bullock borrowed money from the trust three times, and although each loan was repaid with interest and the court found no malicious intent, his siblings obtained a judgment against him for breach of his fiduciary duty as trustee. Bullock then filed for bankruptcy, seeking to discharge the debt. Generally speaking, debts such as money judgments may be discharged in bankruptcy unless the debt is a result of “fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny.” His siblings claimed the judgment was nondischargeable because although Bullock may not have acted with malicious intent, loaning money to himself from the trust could be characterized as objectively reckless. The bankruptcy court agreed, and held that the debt was non-dischargeable.

The Supreme Court disagreed, and concluded that the term “defalcation” includes “a culpable state of mind requirement” which involves knowledge of, or gross recklessness in respect to, the improper nature of someone’s conduct. In other words, since the lower courts had not found that Bullock had acted with ill intent or that he had caused the trust to lose principal, the judgment in favor of his siblings could be discharged in bankruptcy. The Court concluded:

“Thus, where the conduct at issue does not involve bad faith, moral turpitude, or other immoral conduct, the term requires an intentional wrong. We include as intentional not only conduct that the fiduciary knows is improper but also reckless conduct of the kind that the criminal law often treats as the equivalent.”

What this means is that an absence of actual knowledge that what someone is doing is wrong will not insulate that person from a finding of “defalcation,” but includes situations where that person consciously disregards or is willfully blind to the risk that his or her conduct will turn out to violate a fiduciary duty.

For more information, contact Michael at may@hawaiilawyer.com, or at (808) 531-8031.