The opinion below is hereby signed. Dated: January 5, 2006.

S. Martin Teel, Jr.
United States Bankruptcy Judge

UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF COLUMBIA

In re	)	
	)	
EDUARDO R. POTILLO,	)	Case No. 04-00146
	)	(Chapter 7)
Debtor.	)	
_____	)	
	)	
LONGFELLOW APARTMENTS, LLC, *et al.*,	)	
	)	
Plaintiffs,	)	
	)	
v.	)	Adversary Proceeding No. 04-10046
EDUARDO R. POTILLO,	)	
	)	
Defendant.	)	

OPINION AMENDING AND SUPPLEMENTING FINDINGS OF FACT AND CONCLUSIONS OF LAW ANNOUNCED ON NOVEMBER 23, 2005

The plaintiffs, Longfellow Apartments, LLC ("Longfellow"), Allison Apartments, LLC ("Allison"), and Randolph Apartments, LLC ("Randolph"), initiated this adversary proceeding to obtain a determination that amounts allegedly owed by the defendant Eduardo R. Potillo to Longfellow in the amount of $54,601.00, to Allison in the amount of $68,573.00, and to Randolph in the

amount of $71,872.00 were non-dischargeable pursuant to 11 U.S.C. §§ 523(a)(2), 523(a)(4), and 523(a)(6). A trial was held on November 22, 2005, and November 23, 2005, after which the court announced its findings of fact and conclusions of law from the bench. The court ruled that Potillo owes $43,295.00 to Longfellow, $68,573.00 to Allison, and $71,872.00 to Randolph. The court further ruled that these debts are non-dischargeable under 11 U.S.C. § 523(a)(4), and that the plaintiffs are entitled to interest on their judgments at the statutory rate of 6% per annum specified by D.C. Code § 28-3302. See Duggan v. Kato, 554 A.2d 1126 (D.C. 1989).[1] This opinion amends and supplements the court's earlier ruling.

I

The plaintiffs are three separate apartment complexes with a single owner. Potillo was the co-owner and principal of Washington & Jackson Investments, LLC ("W & J"). Potillo, operating through W & J, entered into management contracts with all three apartment complexes. (Pl. Ex. 1-3). Thereafter, Potillo managed the properties of the apartment complexes pursuant to the management agreements and District of Columbia law. In that capacity, Potillo was responsible for collecting all rents and maintaining them in an "Operating Account,"

[1] The court did not award attorneys' fees to the plaintiffs.

collecting all security deposits and maintaining those deposits in a separate account, paying all expenses of the apartment complexes out of the Operating Account, maintaining and leasing the properties, and handling the daily business of running the complexes in general.

The plaintiffs alleged numerous violations of Potillo's contractual and statutory obligations in managing the apartments at trial. They claimed that Potillo deposited tenant security deposits into W & J's Operating Account in contravention of District of Columbia law and then paid W & J operating expenses out of the intermingled funds, that W & J used these funds to pay not only expenses relating to the plaintiffs' buildings, but also other W & J business expenses, and that W & J continued to deposit rent checks received from the District of Columbia Housing Authority ("DCHA") into a W & J account for months after W & J terminated its management agreement with the plaintiffs. Longfellow also claimed that Potillo failed to file an insurance claim on a fire-damaged apartment in a timely manner, thereby causing six months of lost rent in that apartment, and allowed a personal acquaintance to stay in two apartments rent-free for a total of six months.

Potillo conceded at trial that he failed to keep tenant security deposits that he collected in a segregated account as required by D.C. law, that these funds were used to pay unrelated

W & J business expenses, and that this failure was a breach of his fiduciary duty to the plaintiffs. Longfellow, for its part, withdrew its claim based on the failure of Potillo to file an insurance claim on one fire-damaged apartment upon discovering at trial that rents from the apartment were received after the fire occurred.

The court, relying in part on a detailed "Accounting Reconciliation" prepared by Potillo (Pl. Ex. 7), concluded that Potillo owed Longfellow $30,103.11 for Operating Account assets used to pay other W & J business expenses plus another $9,352.00 for misused security deposits and $3,840.00 for lost rents created by Potillo's decision to allow an acquaintance to stay in Longfellow apartments rent-free for six months. The court further concluded that Potillo owed Allison $60,762.00 for misused Operating Account assets plus $7,811.00 for misused security deposits. Finally, the court concluded that Potillo owed Randolph $61,374.00 for misused Operating Account assets plus $10,498.00 for misused security deposits.

The court held that Potillo was not liable for unlawfully held DCHA deposits because there was no evidence that Potillo knew that these deposits were occurring at the time or profited from them. It also held that Potillo was not liable for any incidental expenses caused by the person who lived rent-free at Longfellow because there was no way to verify or quantify such

expenses. Finally, the court held that the debts owed by Potillo to the plaintiffs were non-dischargeable under 11 U.S.C. § 523(a)(4). It is this legal determination that the court amends and supplements below.

II

"Section 523(a)(4) of the Bankruptcy Code provides that a discharge under the Code does not discharge an individual debtor 'from any debt . . . for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny[] . . . .'" Old Republic Sur. Co. v. Richardson (In re Richardson), 193 B.R. 378, 380 (D.D.C. 1995). Potillo's actions constitute both a "defalcation while acting in a fiduciary capacity" and embezzlement within the meaning of § 523(a)(4). Consequently, the debts created by his malfeasance are not subject to discharge.

A. Defalcation by a Fiduciary

To prevail under the "defalcation" provision of § 523(a)(4), "[the p]laintiffs must prove that (1) the defendant was obligated to the plaintiff in a fiduciary capacity; (2) the defendant committed fraud or defalcation while acting in his fiduciary capacity; and (3) the plaintiff's debt resulted from such fraud or defalcation." Jacobs v. Mones (In re Mones), 169 B.R. 246, 255 (Bankr. D.D.C. 1994). As set forth in part I of this opinion, the court has already ruled that Potillo's debts to the

plaintiffs are a result of his misuse of funds in W & J's Operating Account and separate account for security deposits. The court will therefore not address the third prong of the standard employed in In re Mones.

Counsel for Potillo also acknowledged at trial that Potillo was a "fiduciary" for purposes of § 523(a)(4), and plaintiffs assumed that the identities of W & J and Potillo were one and the same in determining the extent of Potillo's liability--an assumption borne out by the evidence presented at trial. Potillo's waiver on this point renders consideration of the first prong of the In re Mones standard unnecessary. Nevertheless, out of an abundance of caution, the court will conduct its own inquiry into the nature of Potillo's relationship with the plaintiffs.

1. Fiduciary capacity

"For purposes of section 523(a)(4), the meaning of the term 'fiduciary capacity' is a question of federal law[,] which has held that the term applies only to technical trusts and not to fiduciary relationships which arise from equitable, implied[,] or constructive trusts or an agency relationship." In re Mones, 169 B.R. at 255. In other words, "the debtor must have been a trustee or fiduciary before the wrong and not a trustee ex maleficio." Id. "[T]he courts must look to non-bankruptcy law to determine whether there exist the elements of a trust

relationship as required by federal law for a fiduciary relationship to exist." Id.

Courts in the District of Columbia have adopted the definition of a trust set forth in the Restatement of Trusts. See Cabaniss v. Cabaniss, 464 A.2d 87, 91 (D.C. 1983). Applying the Restatement, the D.C. Court of Appeals held in Cabaniss that

> The elements of a trust, including an inter vivos trust created for the benefit of a third person, are the following: 1) a trustee, who holds the trust property and is subject to equitable duties to deal with it for the benefit of another; 2) a beneficiary, to whom the trustee owes equitable duties to deal with the trust property for his benefit; [and] 3) trust property, which is held by the trustee for the beneficiary.

Id.; see also Air Transport Ass'n of Am. v. Prof'l Air Traffic Controllers Org. (In re Prof'l Air Traffic Controllers Org. (PATCO)), 26 B.R. 337, 342 (Bankr. D.D.C. 1982) (defining a trust under District of Columbia law by reference to the Restatement of Trusts). While the Cabaniss court concluded that "[n]o particular form of words or conduct is necessary to manifest an intention to create a trust," id.,[2] the court regarded "the settlor's manifestation or external expression of his intention to create a trust" to be "[e]ssential to the creation of a

[2] See also In re Prof'l Air Traffic Controllers Org. (PATCO), 26 B.R. at 343 (discounting "mere fact that the terms 'trust' or 'trustee' were not specifically employed in the actual drafting" of a corporate resolution in holding that resolution created express trust).

trust . . . ." Id.

(a) Fiduciary capacity of W & J

In this case, Potillo's company, W & J, was a fiduciary to the plaintiffs by virtue of the management agreements between W & J and the plaintiffs. Each agreement specified that W & J would "establish a separate tracking Operating Account within [W & J's] system for the tracking of income and expenses" (Pl. Ex. 1 ¶ 3.a; Pl. Ex. 2 ¶ 3.a; Pl. Ex. 3 ¶ 3.a). Funds within the Operating Account "remain[ed] the property of the [plaintiffs] subject to disbursement of expenses by [W & J] as described" in the management agreement (id.). The management agreements also required W & J to "maintain all residential rental security deposits in an interest bearing account for tenants to whom interest shall accrue as required by law" (Pl. Ex. 1 ¶ 3.c; Pl. Ex. 2 ¶ 3.c; Pl. Ex. 3 ¶ 3.c).

The management agreements created express trusts between the apartment complexes and W & J. They required W & J (the trustee) to hold certain defined funds (the trust res) for a specified apartment complex (the beneficiary) and use those funds for certain clearly defined purposes and subject to certain clearly

defined restrictions.[3] This arrangement constituted an "express trust" under District of Columbia law and a trust creating a fiduciary relationship between W & J and the plaintiffs for purposes of § 523(a)(4). See Cabaniss, 464 A.2d at 91-92; see also In re Prof'l Air Traffic Controllers Org., 26 B.R. at 342-344.

(b) Fiduciary capacity of Potillo

Whether Potillo was himself a fiduciary with respect to the plaintiffs is a harder question. Arguably, Potillo owed a duty to care to the plaintiffs both as the principal of the plaintiffs' corporate fiduciary (W & J) and as a licensed property manager under District of Columbia law. The court examines the nature of these duties with respect to § 523(a)(4)

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[3] The benefit to the plaintiffs arising from this arrangement is less direct with respect to the security deposit account created by W & J only because the account was created (at least ostensibly) to hold funds belonging to and for the benefit of the tenants of the respective apartment complexes, not the complexes themselves. Under District of Columbia municipal regulations, however, it is the owner of a residential building (here, the plaintiffs) who is obligated to hold tenants' security deposits "in trust" in a District of Columbia financial institution, not the property manager. D.C. MUN. REG. § 14-308.3. W & J agreed to uphold this obligation on behalf of the plaintiffs pursuant to the management agreements, but it could not have relieved the plaintiffs of their fiduciary obligations to their tenants. Instead, W & J and the plaintiffs created what was in essence a "trust within a trust" through the management agreements in which the plaintiffs--trustees of the beneficiary tenants' security deposits under D.C. law--became the beneficiaries of a separate trust consisting of the same res (the tenants' security deposits) but maintained by a separate trustee (W & J).

in turn.

(i)

More than one court has held that the officer of a corporate fiduciary is not a fiduciary of the creditor for purposes of § 523(a)(4) even where the creditor was a guarantor of the corporation's debt. See, e.g., Barclays Am./Bus. Credit, Inc. v. Long (In re Long), 774 F.2d 875, 878-79 (8th Cir. 1985) (officer/guarantor "was not an express fiduciary because the document creating the trust named [the corporate debtor], rather than [the officer], as trustee"); Conn. Nat'l Bank v. Clark (In re Clark), 65 B.R. 306, 307-08 (Bankr. D. Conn. 1986) ("[E]ven where loan documents purportedly establish a fiduciary relationship between a creditor and a corporation, officers acting as guarantors of the corporate loan have not been deemed to be fiduciaries under § 523(a)(4) with respect to such third-party creditors."). The logic behind these decisions is fairly straightforward: corporate officers are usually charged with a corporation's fiduciary status only by virtue of local rule or statute, and should not be so charged absent an express provision, In re Long, 774 F.2d at 878; and imposing the fiduciary obligations of a corporation on an officer due to the officer's misconduct would create a trust ex maleficio, which does not constitute an "express trust" for purposes of § 523(a)(4). In re Clark, 65 B.R. at 308.

Other courts have reached the opposite conclusion. In Airlines Reporting Corp. v. Ellison (In re Ellison), 296 F.2d 266 (4th Cir. 2002), the Fourth Circuit concluded that a corporate officer could be considered a fiduciary under § 523(a)(4) where (1) the corporation breached a pre-existent fiduciary duty to a creditor, (2) the officer owed fiduciary duties to the corporation fiduciary under state law, and (3) the officer was responsible for the corporation's breach. Id. at 270-72. Similarly, the Sixth Circuit has concluded that a corporate officer can be considered a fiduciary under § 523(a)(4) where the officer had "full knowledge and responsibility for the handling of [the corporate fiduciary's] trust undertakings." Capitol Indemnity Corp. v. Interstate Agency, Inc. (In re Interstate Agency, Inc.), 760 F.2d 121, 125 (6th Cir. 1985).[4] And at least one bankruptcy court has concluded that corporate officers of fiduciary companies should be considered fiduciaries under § 523(a)(4) because "a director or officer of a corporate trustee 'is under a duty to the beneficiaries to use reasonable care in

[4] Accord Mostiler v. Couch, 100 B.R. 802, 808 (Bankr. E.D. Va. 1988) (majority shareholder and CEO of corporate fiduciary held to be a fiduciary to creditor under § 523(a)(4) as well because the "funds were entrusted to [the corporation] and also to [the CEO] through his absolute control of the corporate funds"); but see Commonwealth of Ky. v. Kinnard, 1 F.3d 1240 (6th Cir. 1993) (limiting In re Interstate Agency, Inc. to situations where statute imposes fiduciary obligations on corporate officer as well as corporation upon creation of a specific type of trust) (unpublished opinion), available at 1993 WL 300425.

the exercise of his powers and the performance of his duties as such director or officer.'" Global Express Money Orders, Inc. v. Davis (In re Davis), 262 B.R. 673, 683 (Bankr. E.D. Va. 2001)(quoting 4 Scott on Trusts § 326.3 at 307 (3d ed. 1967)) (emphasis in original).[5]

The common concern animating these decisions (and others like them) is the need to avoid

> a construction [of § 523(a)] so narrow as to eviscerate § 523(a)'s purpose of preventing debtors . . . from avoiding, through bankruptcy, the consequences of their wrongful conduct.

In re Ellison, 296 F.3d at 271.[6] For these courts, an individual officer of a corporation who assumes the responsibility of carrying out that corporations' fiduciary duties as a trustee acts in a fiduciary capacity towards the beneficiary of the trust. See In re Davis, 262 B.R. at 683. If an officer knowingly misuses the trust funds, that officer has engaged in defalcation while acting in a fiduciary capacity. In re Ellison, 296 F.3d at 271; see also Hemelt v. Pontier (In re Pontier), 165 B.R. 797, 798-99 (Bankr. D. Md. 1994) (officer is liable for

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[5] Accord Bellity v. Wolfington (In re Wolfington), 48 B.R. 920, 924 (Bankr. E.D. Pa. 1985) ("It is well established that corporate officers occupy a fiduciary relationship to the corporation and its creditors.").

[6] Accord In re Davis, 262 B.R. at 684; Wilcoxon Constr., Inc. v. Woodall (In re Woodall), 177 B.R. 517, 522 n.2 (Bankr. D. Md. 1995); Sun Life Ins. Co. of Am. v. Koszuth (In re Koszuth), 43 B.R. 104, 108 (Bankr. M.D. Fla. 1984).

corporate fiduciary's debts only if officer "specifically directed the particular act to be done, or participated or cooperated therein").

Although there is merit to both sides of this debate, the court finds the approach taken in In re Long and In re Clark to be more persuasive in light of the Supreme Court's ruling in Davis v. Aetna Acceptance Co., 293 U.S. 328 (1934). In Davis, the Court defined the term "fiduciary" in the Bankruptcy Act predecessor to § 523(a)(4) to mean only the fiduciary of an express trust. Id. The Court explained its ruling by pointing to the "unbroken continuity" of rulings over the prior century interpreting the term to refer only to express trusts. Id. As the Court explained:

> It is not enough that, by the very act of wrongdoing out of which the contested debt arose, the bankrupt has become chargeable as a trustee ex maleficio. He must have been a trustee before the wrong and without reference thereto.

Id. (emphasis added).

To be sure, there are legitimate grounds to question the applicability of the Davis decision to cases like the one before this court. Davis concerned an automobile dealer who converted funds; unlike this case, there was no express trust in existence at all. See id. at 333. Courts since Davis have held uniformly that technical trusts created by virtue of statute confer fiduciary status upon the trustee of such a trust for purposes of

§ 523(a)(4), see, e.g., Blyler v. Hemmeter (In re Hemmeter), 242 F.3d 1186, 1190 (9th Cir. 2001) ("[f]iduciary relationships imposed by statute may cause the debtor to be considered a fiduciary under § 523(a)(4)"), and several courts have held that statutes making officers and directors of a corporation fiduciaries of that corporation also make the officer and directors fiduciaries of the corporation for purposes of § 523(a)(4) even in the absence of a technical trust. See In re Bernard, 87 F.2d 705, 706-07 (2d Cir. 1937) (corporate officers and directors qualified as "fiduciaries" with respect to corporation under Bankruptcy Act predecessor to § 523(a)(4)); In re Whitlock, 449 F. Supp. 1383, 1390 (W.D. Mo. 1978).

These decisions have led some courts to conclude that the Court in Davis was actually concerned solely with the timing of the creation of the trust giving rise to fiduciary duties; i.e., that fiduciary relationships arising from or subsequent to fraud or defalcation do not fall within the scope of the § 523(a)(4) exception, but fiduciary relationships created before the debtor's wrongdoing qualify for the exception regardless of whether the relationship arises from a technical or express trust. See Cutter Realty Group, Inc. v. Schiraldi (In re Schiraldi), 116 B.R. 359, 361-62 (Bankr. D. Conn. 1990) (collecting cases). Under this reading of Davis, an officer of a corporate fiduciary could conceivably be considered a fiduciary

of the corporation's beneficiary under § 523(a)(4) because the officer's status as a fiduciary would arise from her pre-existent relationship to the corporate fiduciary, not as a result of the debtor's wrongdoing.

The problem with this argument is that, in the absence of an express agreement or a statute imposing, at a minimum, some type of fiduciary duties upon the officer with respect to a third-party beneficiary, there is no basis on which to conclude that the officer owes the third party any fiduciary duties at all except for equitable or constructive duties imposed by a court after the fact.[7] Even if this court adopted an interpretation of Davis focusing purely on the timing of the creation of the "fiduciary" relationship, it would still be forced to conclude that the officer of a corporate fiduciary is not a fiduciary to the third-party beneficiary within the meaning of § 523(a)(4) unless a fiduciary relationship was created beforehand by virtue of agreement or statute. As there was no such agreement or statute in place here, the court concludes that Potillo is not a fiduciary for purposes of § 523(a)(4) by virtue of his status as

[7] This was essentially the position taken by the Eighth Circuit in In re Long, and was also a point made by Judge Luttig in his dissenting opinion in In re Ellison. See In re Ellison, 296 F.3d at 274-75 (Luttig, J., dissenting); In re Long, 774 F.2d at 878.

the principal of W & J.[8] To the extent that a debt for defalcation can arise based on an innocent mistake,[9] this approach has the benefit of protecting corporate officers and other employees who engage in innocent, non-negligent defaults. To the extent that such officers or employees engage in a knowing defalcation, the debt will nevertheless likely escape discharge under § 523(a)(4) as a debt for embezzlement.

(ii)

Separate and apart from his status as the principal of a corporate fiduciary to the plaintiffs, Potillo owed special duties to the plaintiffs under District of Columbia law due to his status as a property manager. See D.C. CODE §§ 47-2853.141, 47-2853.195. This section of the D.C. Code imposes numerous "fiduciary" duties on a licensed "Property Manager" with respect to the owner of a property, including the duty to "[p]erform in

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[8] The court declines to follow the In re Davis and In re Wolfington courts in inferring some sort of common-law fiduciary status for corporate officers. While a corporate officer may have a basic duty to use "reasonable care in the exercise of his powers and the performance of his duties" with respect to the beneficiary of a corporate fiduciary, In re Davis, 262 B.R. at 683, that nominal obligation falls far short of the kind of responsibility contemplated by § 523(a)(4). As for In re Wolfington, the court in that case appears to have confused the special obligations of a corporate officer of an insolvent corporation to the corporation's creditors with the ordinary obligations of a corporate officer working for a healthy, solvent corporation. While understandable, the court's conclusion in that case is fundamentally flawed, and this court accordingly rejects it.

[9] See note 12, infra.

accordance with the terms of the property management agreement," D.C. CODE § 47-2853.195(1), the duty to "[e]xercise ordinary care" in the management of the property, id. at § 47-2853.195(2), the duty to "[d]isclose in a timely manner to the owner material facts of which the licensee has actual knowledge concerning the property," id. at § 47-2853.195(3), the duty to "[a]ccount[] for[,] in a timely manner, all money and property received in which the owner has or may have an interest," id. at § 47-2853.195(5), and the duty to "[c]omply with all requirements of [§ 47 of the D.C. Code], fair housing statutes and regulations, and all other applicable statutes and regulations . . . ." Id. at § 47-2853.195(6).

It is not enough, however, for a statute to label a duty "fiduciary" in nature to create such a relationship within the meaning of § 523(a)(4). Most courts require that the statute "(1) define[a] trust res; (2) identif[y] the fiduciary's fund management duties; and (3) impose[] obligations on the fiduciary prior to the alleged wrongdoing." In re Hemmeter, 242 F.3d at 1190.[10] Some courts have established narrow exceptions to this

[10] Accord Texas Lottery Comm'n v. Tran (In re Tran), 151 F.3d 339, 342-43 (5th Cir. 1998); Metropolitan Steel, Inc. v. Halversen (In re Halversen), 330 B.R. 291, 296-97 (Bankr. M.D. Fla. 2005); Duncan v. Neal (In re Neal), 324 B.R. 365, 370 (Bankr. W.D. Okla. 2005); Trustees of the Colo. Ironworkers Pension Fund v. Gunter (In re Gunter), 304 B.R. 458, 460-61 (Bankr. D. Colo. 2003); Griffith, Strickler, Lerman, Solymos & Calkins v. Taylor (In re Taylor), 195 B.R. 624, 629 (Bankr. M.D. Pa. 1996).

general rule for agents of an entity with special authority and discretion to manage important assets of the entity, such as the officer or director of a corporation, In re Bernard, 87 F.2d at 706-07, the ambassador of a sovereign nation, Republic of Rwanda v. Uwimana (In re Uwimana), 274 F.3d 806, 811 (4th Cir. 2001), or an agent vested with durable power of attorney giving the agent "unfettered control over the assets of a third party." BPS Guard Services, Inc. v. Myrick (In re Myrick), 172 B.R. 633, 636 (Bankr. D. Neb. 1994).

Assuming, arguendo, that the court embraced the exceptions carved out in In re Bernard, In re Uwimana, and In re Myrick, the statute at issue here still would not suffice to create a fiduciary relationship between Potillo and the plaintiffs. Unlike the situation in those cases, there is nothing in the D.C. Code conferring responsibilities and authority upon Potillo "tantamount to those of a trustee of an express trust." In re Myrick, 172 B.R. at 636. Indeed, the statute does not give Potillo any authority at all, much less the authority (and concomitant responsibility) to handle the plaintiffs' money. Those duties flow from the contractual arrangement between the parties, which, as the court has already discussed, created a trust relationship between the plaintiffs and W & J, not Potillo. Under any reading of § 523(a)(4), Potillo was not the fiduciary by virtue of a statutory trust.

(c) Piercing of the corporate veil

Nonetheless, the court concludes that in this instance Potillo's debt to the plaintiffs is that of a fiduciary. The court reaches this conclusion by piercing the corporate veil of W & J and attaching the status of the corporation as a fiduciary to Potillo. Under the veil-piercing doctrine, where the corporate form is "used to shield from scrutiny a sham transaction, . . . 'the courts will not permit themselves to be blinded or deceived by mere forms of law but, regardless of fictions, will deal with the substance of the transaction involved as if the corporate agency did not exist as the justice of the case may require.'" Christacos v. Blackie's House of Beef, Inc., 583 A.2d 191, 196 (D.C. 1990).[11] As even the dissent in In re Ellison acknowledged, the doctrine can be used to attach the non-dischargeable liability of a corporation (in this case, W & J) to one of its principals (in this case, Potillo) if "there is reason to disregard the corporate form." In re Ellison, 296 F.3d at 275 (Luttig, J., dissenting).

"Generally speaking, an individual will not be liable personally for the debts of a corporate entity unless it is 'proved by affirmative evidence that there is (1) unity of ownership and interest, and (2) use of the corporate form to

[11] District of Columbia law governs the question of whether the court should pierce the corporate veil. Diamond Chem. Co. v. Atofina Chemicals, Inc., 268 F. Supp. 2d 1, 7 (D.D.C. 2003).

perpetrate fraud or wrong.'" Simon v. Circle Associates, Inc., 753 A.2d 1006, 1011 (D.C. 2000) (quoting Bingham v. Goldberg, Marchesano, Kohlman, Inc., 637 A.2d 81, 93 (D.C. 1994) (internal quotation omitted)). As the D.C. Court of Appeals explained in a recent opinion,

> [t]his determination in turn requires the consideration of a range of factors, including whether corporate formalities have been observed; whether there has been any commingling of corporate and shareholder funds, staff, and property; whether a single shareholder dominates the corporation; whether the corporation is adequately capitalized; and, especially, whether the corporate form has been used to effectuate a fraud.

Meshel v. Ohev Sholom Talmud Torah, 869 A.2d 343, 363 (D.C. 2005).

While there are many factors available for the court to consider, "[n]o single factor is dispositive, and 'considerations of justice and equity may justify piercing the corporate veil.'" Lawlor v. D.C., 758 A.2d 964, 975 (D.C. 2000) (quoting Bingham, 637 A.2d at 93). Finally, "the decision to pierce will be influenced by considerations of who should bear the risk of loss and what degree of legitimacy exists for those claiming the limited liability protection of the corporation." Vuitch v. Furr, 482 A.2d 811, 816 (D.C. 1984). "The inquiry ultimately turns on whether the corporation is, in reality, 'an alter ego or business conduit of the person in control.'" Lawlor, 758 A.2d at

975 (quoting Labadie Coal Co. v. Black, 672 F.2d 92, 97 (D.C. Cir. 1982)).

All of the factors delineated above support the piercing of the corporate veil in this case. There is no question that Potillo owed and breached fiduciary duties to W & J and that W & J owed and breached fiduciary duties to the plaintiffs. Ordinarily, the plaintiffs could have sued W & J directly for its breach, and, if W & J had been anything more than a front for Potillo and his partner Michael Minor, the company could have sued Potillo and obtained a non-dischargeable judgment against him under § 523(a)(4). But the plaintiffs could not have sued W & J in this instance because the company was run into the ground and then dissolved by Potillo and Minor, and the company, being a mere sham, would never have sued its owners.

Potillo used funds owned by the plaintiffs and held in trust by W & J to pay incidental personal expenses, and even hid the accreting debts of the plaintiffs from them by providing the plaintiffs with an accounting balance that Potillo knew to be false. Under these circumstances, the fiction of W & J's existence--and, to be sure, the company was about as fictional as one could imagine--should not insulate Potillo from the consequences of his own misconduct. The court will pierce the corporate veil in this instance and attach W & J's liability as a fiduciary for purposes of § 523(a)(4) to Potillo.

2. Defalcation

Potillo's actions also constitute a "defalcation" within the meaning of § 523(a)(4). "'Defalcation is not a synonym for fraud, embezzlement, or misappropriation, but has a broader meaning relative to the failure of a fiduciary to account for money received in a fiduciary capacity as a result of misconduct.'" BCCI Holdings (Luxembourg), S.A. v. Clifford, 964 F. Supp. 468, 484 (D.D.C. 1997) (quoting B. Weintraub & M. Resnick, Bankruptcy Law Manual ¶ 3.09[4], at 3-35 (1980)). The test used by most courts to determine whether a fiduciary has engaged in defalcation is "essentially a recklessness standard." Schwager v. Fallas (In re Schwager), 121 F.3d 177, 185 (5th Cir. 1997); accord Meyer v. Rigdon, 36 F.3d 1375, 1384-85 (7th Cir. 1997); Carlisle Cashway, Inc. v. Johnson (In re Johnson), 691 F.2d 249, 257 (6th Cir. 1982); Cent. Hanover Bank & Trust Co. v.

Herbst, 93 F.2d 510, 512 (2d Cir. 1937).[12]

Potillo's actions went far beyond the realm of recklessness. According to his own testimony, Potillo, along with his partner Michael Minor, intentionally used security deposits and Operating Account funds to pay for W & J expenses that had nothing to do with the plaintiffs' buildings even though Potillo knew that these actions violated the management agreements between W & J and the plaintiffs and, in the case of tenants' security deposits, District of Columbia law. Potillo's self-composed "Accounting Reconciliation" details the amounts lost through this deliberate misappropriation and misuse of funds. Moreover,

[12] The standard is by no means universal. The First Circuit, for example, has held that "a defalcation requires some degree of fault, closer to fraud, without the necessity of meeting a strict specific intent requirement." Rutanen v. Baylis (In re Baylis), 313 F.3d 9, 18-19 (1st Cir. 2002). The Fourth, Eighth, and Ninth Circuits stand at the opposite end of the spectrum, having held that an innocent mistake can give rise to a defalcation. See In re Uwimana, 274 F.3d at 811 ("even an innocent mistake [that] results in misappropriation or failure to account" satisfies standard for defalcation); Tudor Oaks Ltd. P'ship v. Cochrane (In re Cochrane), 124 F.3d 978, 984 (8th Cir. 1997) (defalcation "includes the innocent default of a fiduciary who fails to account fully for money received") (internal quotation omitted); Lewis v. Scott (In re Lewis), 97 F.3d 1182, 1186 (9th Cir. 1996) (same). Finally, the Bankruptcy Appellate Panel for the Tenth Circuit has adopted a negligence standard. See Antlers Roof-Truss & Builders Supply v. Storie (In re Storie), 216 B.R. 283, 288 (B.A.P. 10th Cir. 1997) (concluding that defalcation is "a fiduciary-debtor's failure to account for funds that have been entrusted to it due to any breach of a fiduciary duty, whether intentional, wilful, reckless, or negligent"). In any event, the disagreement between these courts is irrelevant to this case because Potillo's conduct satisfies any of the definitions listed above.

Potillo admitted in a letter faxed to the owner of the plaintiffs that his misconduct was "grounds for the commencement of legal action." (Pl. Ex. 4). Potillo's conduct was intentional and deliberate. His actions constitute a defalcation within the meaning of § 523(a)(4).

B. Embezzlement

Even if Potillo was not a defalcating fiduciary for purposes of § 523(a)(4), his debts to the plaintiffs would still be non-dischargeable because the debts are the product of embezzlement. Embezzlement for purposes of § 523(a)(4) is "the fraudulent appropriation of property of another by a person to whom such property has been entrusted or into whose hands it has lawfully come." Moore v. United States, 160 U.S. 268, 269 (1885).[13] "A creditor proves embezzlement by showing that he entrusted his property to the debtor, the debtor appropriated the property for a use other than that for which it was entrusted, and the circumstances indicate fraud." Brady v. McAllister (In re Brady), 101 F.3d 1165, 1173 (6th Cir. 1996); accord Transamerica Commercial Fin. Corp. v. Littleton (In re Littleton), 942 F.2d 551, 555 (9th Cir. 1991).

The plaintiffs entrusted Potillo, as an officer of W & J,

[13] Accord Miller v. J.D. Abrams Inc. (In re Miller), 156 F.3d 598, 602 (5th Cir. 1998); Belfry v. Cardozo (In re Belfry), 862 F.2d 661, 662 (8th Cir. 1988) (quoting In re Schultz, 46 B.R. 880, 889 (Bankr. D. Nev. 1985)); Spinoso v. Heilman (In re Heilman), 241 B.R. 137, 171 (Bankr. D. Md. 1999).

with the management of their funds pursuant to the management agreements entered into by the plaintiffs and W & J. Potillo used (or permitted Minor to use) the funds to pay his own company's operating expenses (as well as some incidental personal expenses) instead.[14] Over an extended period of time, Potillo then concealed the consequences of this ongoing misappropriation from the plaintiffs. Moreover, Potillo knew that his conduct was in breach of contract and unlawful when he engaged in that conduct. Potillo's actions present a textbook case of embezzlement.

III

For the reasons set forth from the bench on November 23, 2005, the court will enter final judgment in favor of Longfellow in the amount of $43,295.00, final judgment in favor of Allison in the amount of $68,573.00, and final judgment in favor of Randolph in the amount of $71,872.00, all with prejudgment interest from May 24, 2003, at 6% per annum. Per the request of the plaintiffs, the court will enter separate judgments for each award. Furthermore, for the reasons set forth from the bench as amended and supplemented in this opinion, the court concludes (and the final judgments for each plaintiff will reflect) that

[14] The court has found, however, that Potillo did not permit Minor's use of the DCHA rent checks deposited after W & J terminated its management agreement with the plaintiffs, and accordingly Potillo owes no debt in that regard.

Potillo’s debts are non-dischargeable pursuant to 11 U.S.C. § 523(a)(4).

Separate judgments follow.

[Signed and dated above.]

Copies to: All counsel of record.