
Bankruptcy Court for the Southern District of Florida Confirms Surety's Objection to Discharge Because of Breach of Trust Fund Provision in Indemnity Agreement

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The Bankruptcy Court for the Southern District of Florida recently issued an important decision about a surety's ability to object to an indemnitor's discharge of its debt to the surety based upon an alleged breach of the indemnity agreement's trust fund provision. In *Great American Ins. Co. vs. Michael Brandt*, Adv. Case No. 18-1351-RBR in the Bankruptcy Court for the Southern District of Florida, Great American filed an adversary complaint objecting to Brandt's discharge of his indemnity debt. Great American argued Brandt used bonded contract funds to pay for non-bonded obligations and personal expenses. Great American relied upon 11 U.S.C. § 523(a)(4) that exempts from discharge a debt incurred via "fraud or defalcation while acting in a fiduciary capacity."

Generally, federal and bankruptcy courts have held that a trustee of an express or technical trust acts in a fiduciary capacity as to the trust funds. However, state law is relevant to determine whether the elements necessary to create a trust exist. In *Brandt*, Great American argued the indemnity agreement's trust fund provision was sufficient to create a trust under Florida law, and that Brandt defalcated the trust funds by using them to pay for non-bonded obligations.

Brandt filed a motion to dismiss arguing Eleventh Circuit and Southern District of Florida precedent held that segregation of trust funds is a mandatory element of a trust. Brandt reasoned that because Great American did not allege Brandt had maintained the bonded contract funds in a separate, segregated account, no trust existed as a matter of law. Brandt relied heavily on *Quaif v. Johnson*, 4 F. 3d 950, 953 (11th Cir. 1993), *Hanft v. Church (In re Hanft)*, 315 B.R. 617 (S.D. Fla. 2002) *aff'd sub nom. Hanft v. Church*, 73 F. App'x 387 (11th Cir. 2003), and *Coosemans Miami, Inc. v. Arthur*, 2018 Bankr. LEXIS 2330 (Bankr. S.D. Fla. 2018). While these cases stated that segregation is one factor in determining whether a trust existed, Great American argued these cases were distinguishable.

Principally, Great American argued Brandt's reliance on these cases was misplaced because they all analyzed the existence of a fiduciary relationship arising under a statutory trust. A statutory trust arises automatically pursuant to a federal or state statute, and not pursuant to an express trust agreement. However, in *Brandt* Great American argued the indemnity agreement's trust fund provision was evidence of Brandt's express intent to create a trust. Further, Great American argued its Adversary Complaint alleged the elements necessary to create a trust under Florida law. Thus, Great American argued there was no need to look to whether Brandt segregated the trust assets to determine whether a trust existed. The *Brandt* Court agreed finding the indemnity agreement "is sufficient to establish an express trust [because it] provided for a trust corpus and an intent by the parties to create a fiduciary relationship." Accordingly, the Court denied Brandt's motion to dismiss.

This decision is important. If Brandt had prevailed, arguably a surety would have to demand that its indemnitors create separate accounts for each project as a condition to later enforcement of the indemnity agreement's trust fund provision. This puts the burden on the surety to act. Further, given the number of bonded projects and the fact that most bonded projects are completed without a bond claim, this would be impractical. Fortunately, the Bankruptcy Court agreed that the trust fund provision is sufficient to create a trust, and it is the indemnitor's obligation to comply with it.

In this case, the attorneys of Mills Paskert Divers secured a favorable result for Great American. If you have any questions or thoughts relating to surety and bankruptcy issues discussed in this post or would like to discuss a surety or bankruptcy issue facing you or your company, our attorneys are available to help.