

2014

# The Challenges of the New Defalcation Standard

Jonathon S. Byington

*Alexander Blewett III School of Law at the University of Montana*, [jonathon.byington@umontana.edu](mailto:jonathon.byington@umontana.edu)

Follow this and additional works at: [http://scholarship.law.umt.edu/faculty\\_lawreviews](http://scholarship.law.umt.edu/faculty_lawreviews)



Part of the [Bankruptcy Law Commons](#)

---

## Recommended Citation

Jonathon S. Byington, *The Challenges of the New Defalcation Standard*, 88 Am. Bankr. L.J. 3 (2014),  
Available at: [http://scholarship.law.umt.edu/faculty\\_lawreviews/97](http://scholarship.law.umt.edu/faculty_lawreviews/97)

This Article is brought to you for free and open access by the Faculty Publications at The Scholarly Forum @ Montana Law. It has been accepted for inclusion in Faculty Law Review Articles by an authorized administrator of The Scholarly Forum @ Montana Law.

# The Challenges of the New Defalcation Standard

by

Jonathon S. Byington\*

*The crux of bankruptcy law is giving debtors a fresh start by discharging their debts. Yet society has recognized that some debts should not be discharged because they either have a high level of societal importance or derive from a debtor's culpable conduct. One of these exceptions from discharge is for defalcation while acting in a fiduciary capacity. The legal meaning of defalcation has been unclear for 172 years, ranging from a breach of trust by one who has charge of money to the misappropriation of money in one's keeping. A three-way federal circuit split developed on whether a state of mind was required for defalcation and if so, how culpable. In May 2013, the U.S. Supreme Court resolved the circuit split in *Bullock v. BankChampaign* by establishing a new, heightened mental standard based on the Model Penal Code's definition of "recklessly." *Bullock's* holding is significant because it did not adopt any of the tests from the circuit split. *Bullock's* new test is challenging for three reasons. First, applying a Model Penal Code culpability to civil fiduciary law is awkward because the various sources of fiduciary duties rarely contain a mental state requirement. Second, the Model Penal Code's recklessly definition is abstract and difficult to apply. For example, instead of focusing on the breach of a fiduciary duty, it concentrates on the risk that a fiduciary duty will be breached. Further, some elements of recklessly must be evaluated from a subjective standard while others require an objective one. Finally, in delineating the new recklessly test, *Bullock* parenthetically grafted in the separate criminal law doctrine of willful blindness. This synthesis of recklessness and willful blindness, which are two completely different tests, results in a seemingly unworkable standard that does not make sense. This Article explores each element of the new recklessly standard and identifies pitfalls to avoid. It also suggests an approach to reconcile the troubling analytical problems resulting from combining recklessness and willful blindness. This Article concludes by establishing an analytical framework to apply *Bullock's* new test.*

---

\*Assistant Professor, University of Montana School of Law. I am grateful for the insightful comments and suggestions from Professor Michelle Bryan Mudd and Professor Larry Howell. I also thank Benjamin L. Keller and Rachel Wanderscheid for their research.

- I. Introductions ..... 5
- II. Background ..... 7
  - A. *Pre-Bullock* Circuit Split: The Spectrum of Standards Constituting Defalcation ..... 7
    - 1. Fiduciary Status Regardless of State of Mind ..... 8
    - 2. Objective Recklessness ..... 8
    - 3. Extreme Recklessness or Scierter ..... 9
  - B. The Broadening Scope of a “Fiduciary Capacity” in Section 523(a)(4) ..... 10
  - C. The Basics of *Bullock* ..... 13
    - 1. *Bullock* Factual Background ..... 13
    - 2. *Bullock* Procedural Background ..... 13
    - 3. *Bullock* Supreme Court Decision ..... 15
- III. Analysis of *Bullock*: Implications and Precautions ..... 18
  - A. The Awkwardness of Applying the Model Penal Code’s Definition of “Recklessly” to Civil Fiduciary Law ..... 18
  - B. Difficulties When Applying the Model Penal Code’s Definition of “Recklessly” ..... 20
    - 1. Objective and Subjective Standards in the Determination of Recklessly ..... 20
      - i. The Difference Between Objective and Subjective Standards ..... 21
      - ii. Objective and Subjective Standards in the Tort Restatements ..... 22
      - iii. The Objective and Subjective Aspects of the Model Penal Code’s Definition of Recklessly ... 25
    - 2. Substantial and Unjustifiable Risk ..... 25
      - i. Substantial Risk ..... 26
      - ii. Unjustifiable Risk ..... 27
      - iii. The Nature and Degree of the Risk ..... 27
    - 3. The Debtor Consciously Disregarded the Risk ..... 28
      - i. Conscious Disregard ..... 28
      - ii. Gross Deviation ..... 28
      - iii. Law-Abiding Person ..... 29
  - C. The Analytical Problems Arising From *Bullock*’s Infusion of “Willfully Blind” Into The Model Penal Code’s Definition of Recklessly ..... 32
  - D. Additional Implications That May Arise from *Bullock*. 36
  - E. The New Analytical Structure of Determining Defalcation While Acting in a Fiduciary Capacity ..... 37
- IV. Conclusion ..... 38

## I. INTRODUCTION

One of the primary purposes of bankruptcy law is to provide debtors a fresh start.<sup>1</sup> This is done through the discharge<sup>2</sup> of debts and ensuing injunction<sup>3</sup> barring creditor efforts to collect discharged debts. The fresh start policy, however, has limits.<sup>4</sup> Not all debts and debtors are equal.

Society has demanded a fresh start be withheld for certain types of debts, such as those relating to taxes,<sup>5</sup> domestic-support obligations,<sup>6</sup> government fines,<sup>7</sup> educational loans,<sup>8</sup> and orders of restitution in criminal cases.<sup>9</sup> The very nature of these debts is significant enough to outweigh<sup>10</sup> both the public<sup>11</sup> and private interest in providing debtors a fresh start.

In addition to withholding a discharge based on the nature or type of debt, there is no discharge of debt arising from certain types of reprehensible conduct by a debtor. For example, there is no discharge for debts obtained by false pretenses or actual fraud,<sup>12</sup> embezzlement,<sup>13</sup> larceny,<sup>14</sup> willful and malicious injury by the debtor to another,<sup>15</sup> or death or injury caused by the

---

<sup>1</sup>Marrama v. Citizens Bank of Mass., 549 U.S. 365, 367 (2007) (noting that “[t]he principal purpose of the Bankruptcy Code is to grant a fresh start to the honest but unfortunate debtor”); Local Loan Co. v. Hunt, 292 U.S. 234, 244 (1934) (stating the fresh start policy is a “public as well as private interest, in that it gives to the honest but unfortunate debtor who surrenders for distribution the property which he owns at the time of bankruptcy, a new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of pre-existing debt”).

<sup>2</sup>Even though it is not a fundamental right, see *Grogan v. Garner*, 498 U.S. 279, 286 (1991) (noting that “a debtor has no constitutional or ‘fundamental’ right to a discharge in bankruptcy”) (citing *United States v. Kras*, 409 U.S. 434, 445-46 (1973)), § 524(a) prevents waiver of a discharge and § 524(c) contains significant restrictions and requirements for post-petition reaffirmation of debt.

<sup>3</sup>11 U.S.C. § 524(a)(2).

<sup>4</sup>See generally 11 U.S.C. § 523(a); *Cohen v. de La Cruz*, 523 U.S. 213, 222 (1998) (stating that “[t]he various exceptions to discharge in § 523(a) reflect a conclusion on the part of Congress that the creditors’ interest in recovering full payment of debts in these categories outweigh[s] the debtors’ interest in a complete fresh start”); *Bruning v. United States*, 376 U.S. 358, 361 (1964) (noting that the predecessor to § 523(a) “[was] not a compassionate section for debtors” because “it demonstrate[d] congressional judgment that certain problems . . . override the value of giving the debtor a wholly fresh start”).

<sup>5</sup>11 U.S.C. § 523(a)(1).

<sup>6</sup>11 U.S.C. § 523(a)(5).

<sup>7</sup>11 U.S.C. § 523(a)(7).

<sup>8</sup>11 U.S.C. § 523(a)(8).

<sup>9</sup>11 U.S.C. § 523(a)(13).

<sup>10</sup>*Grogan*, 498 U.S. at 287 (stating that “Congress evidently concluded that the creditors’ interest in recovering full payment of debts in these categories outweighed the debtors’ interest in a complete fresh start”).

<sup>11</sup>John M. Czarnetzky, *The Individual and Failure: A Theory of The Bankruptcy Discharge*, 32 ARIZ. ST. L.J. 393, 405 (2000) (discussing an entrepreneurial theory behind the bankruptcy discharge); Adam Feibelman, *Defining The Social Insurance Function of Consumer Bankruptcy*, 13 AM. BANKR. INST. L. REV. 129 (2005) (discussing the function of bankruptcy as social insurance).

<sup>12</sup>11 U.S.C. § 523(a)(2).

<sup>13</sup>11 U.S.C. § 523(a)(4).

<sup>14</sup>11 U.S.C. § 523(a)(4).

<sup>15</sup>11 U.S.C. § 523(a)(6).

debtor's operation of a vehicle while the debtor was intoxicated.<sup>16</sup>

This Article focuses on the bankruptcy discharge exception for “defalcation while acting in a fiduciary capacity.”<sup>17</sup> Since the adoption of the 1841 Bankruptcy Act<sup>18</sup> some 172 years ago, the meaning of “defalcation” has been unclear<sup>19</sup> and changing.<sup>20</sup> There has been a “longstanding disagreement”<sup>21</sup> among courts<sup>22</sup> as well as scholars<sup>23</sup> on what is required. Even though exceptions to discharge “should be confined to those plainly expressed,”<sup>24</sup> a broad spectrum of different meanings has been attributed to the term by the federal circuit courts. The difficulty has come in part because it is hard to delineate

---

<sup>16</sup>11 U.S.C. § 523(a)(9).

<sup>17</sup>11 U.S.C. § 523(a)(4).

<sup>18</sup>Defalcation in connection with nondischargeable debt first appeared in the 1841 Bankruptcy Act. Act of Aug. 19, 1841, ch. 9, 5 Stat. 440, 441 (1841).

<sup>19</sup>Judge Learned Hand described court decisions addressing the meaning of defalcation as “not indeed very satisfactory.” *Cent. Hanover Bank & Trust Co. v. Herbst*, 93 F.2d 510, 512 (2nd Cir. 1937); Report of the Commission on the Bankruptcy Laws of the United States, H.R. Doc. No. 93-137, pt. II, ¶ 4-506, note 11 (noting the term defalcation was uncertain in meaning); *Quaif v. Johnson*, 4 F.3d 950, 955 (11th Cir. 1993) (noting “the precise meaning of ‘defalcation’ for purposes of § 523(a)(4) has never been entirely clear.”)

<sup>20</sup>Zvi S. Rosen, *Discharging Fiduciary Debts*, 87 AM. BANKR. L.J. 51 (Winter 2013) (examining the evolution and historical meaning of the term “defalcation”).

<sup>21</sup>*Bullock v. BankChampaign, N.A.*, \_\_\_ U.S. \_\_\_, 133 S. Ct. 1754, 1759 (2013).

<sup>22</sup>*Antlers Roof-Truss & Builders Supply v. Storie (In re Storie)*, 216 B.R. 283, 288 (10th Cir. B.A.P. 1997) (focusing on the debtor's failure to account for entrusted funds “due to any breach of a fiduciary duty, whether intentional, willful, reckless, or negligent”); *Republic of Rwanda v. Uwimana (In re Uwimana)*, 274 F.3d 806, 811 (4th Cir. 2001) (stating “negligence or even an innocent mistake which results in misappropriation or failure to account is sufficient”); *Blyler v. Hemmeter (In re Hemmeter)*, 242 F.3d 1186, 1190 (9th Cir. 2001); *Follett Higher Educ. Group, Inc. v. Berman (In re Berman)*, 629 F.3d 761, 766 n.3 (7th Cir. 2011) (stating “[d]efalcation requires something more than negligence or mistake, but less than fraud”); *FNFS, Ltd. v. Harwood (In re Harwood)*, 637 F.3d 615, 624 (5th Cir. 2011) (requiring a willful neglect of duty “measured objectively by reference to what a reasonable person in the debtor's position knew or reasonably should have known”); *Rutanen v. Baylis (In re Baylis)*, 313 F.3d 9, 20 (1st Cir. 2002) (stating “defalcation requires something close to a showing of extreme recklessness”).

<sup>23</sup>Andrea Johnson, *The Defalcation Exception to Discharge: Should a Fiduciary's Mistake Prohibit a Discharge from Debt?*, 27 W. NEW ENG. L. REV., 93, 131 (2005) (recommending a “willful neglect” standard of intent); Rosen, *supra* note 20, at 87 (asserting there is no need to impose any type of mental state requirement); Matthew W. Knox, *Persistent Confusion: The Circuit Split over the Exception to Discharge for Defalcation Under 11 U.S.C. § 523(a)(4)*, 2008 COLUM. BUS. L. REV. 1078, 1110 (2008) (claiming a “willful neglect or recklessness” standard would be best); Alyssa Miller, “Some Portion of Misconduct”: *The Argument for a Negligence Standard for Excepting Discharge of Debts Incurred Through Defalcation*, 2 WM. & MARY BUS. L. REV. 185, 204 (2011) (arguing a “negligence” standard should be applied); Bradley M. Elbein, *An Obscure Revolution: The Liability of Professionals in Bankruptcy*, 48 S.C. L. REV. 743, 769 (1997) (focusing on professional fiduciaries and stating “it makes sense to avoid the metaphysical debates over defalcation and fiduciary and instead to ask a relatively simple question: Did the debtor use his superior knowledge and power to take advantage of the creditor?”).

<sup>24</sup>*Gleason v. Thaw*, 236 U.S. 558, 562 (1915). *Bullock* avoided stating that exceptions to discharge should be strictly or narrowly construed. The attorney representing *Bullock* on appeal before the Court suggested that “[e]schewing the phrase ‘strict construction’ may have avoided friction with some members of the Court who might object to that freighted language.” Thomas M. Byrne, *Defalcation Defined; Bullock v. BankChampaign*, 30 BANKR. STRATEGIST 9 (July 1, 2013).

how culpable a debtor's conduct must be in order to preclude the fresh start by not discharging a debt. The U.S. Supreme Court's recent *Bullock v. BankChampaign* decision<sup>25</sup> ("*Bullock*") resolved the circuit split by holding that defalcation includes a culpable state of mind requirement involving "knowledge of, or gross recklessness in respect to, the improper nature of the relevant fiduciary behavior."<sup>26</sup> *Bullock* adopted the Model Penal Code's definition of "recklessly" as the new, uniform standard to be applied in all federal circuits.<sup>27</sup>

This Article does not question whether *Bullock* chose "the correct" state of mind for the defalcation exception to discharge. Instead, it focuses on the many implications and challenges from *Bullock* that will need to be addressed by courts in the future. Part II of this Article explains the pre-*Bullock* circuit split on the different mental states required for defalcation, identifies the broadening scope of fiduciary capacity, and summarizes the *Bullock* background and decision. Part III explores the challenges arising from the *Bullock* decision. First, it explains why applying the Model Penal Code definition of recklessly to civil fiduciary law is awkward and disjointed.

Second, it highlights why the Model Penal Code's definition of recklessly is abstract and difficult to apply. It examines the crucial distinction between objective and subjective standards and clarifies which standard applies to the respective elements of the new recklessly test. It also provides distinctions and contours that have been drawn by courts in criminal cases and criminal law scholars for each element of recklessly. Third, it explores the seemingly unworkable criteria created by *Bullock*'s modification of the definition of recklessly to also include the separate criminal law doctrine of willful blindness. *Bullock*'s implications on summary judgment proceedings and pleading requirements are also discussed. After describing these challenges, this Article suggests an approach to reconcile the problem arising from *Bullock*'s modification of recklessly and establishes an overall analytical framework to apply *Bullock*'s new test.

## II. BACKGROUND

### A. PRE-BULLOCK CIRCUIT SPLIT: THE SPECTRUM OF STANDARDS CONSTITUTING DEFALCATION

Before *Bullock*, the federal circuits spanned the spectrum on whether defalcation required a state of mind and if so, what level of culpability was required.

---

<sup>25</sup>*Bullock v. BankChampaign, N.A.*, 133 S. Ct. 1754 (2013).

<sup>26</sup>*Id.* at 1757.

<sup>27</sup>*Id.* at 1759.

### 1. *Fiduciary Status Regardless of State of Mind*

One end of the range did not even require a specific state of mind, instead looking at the nature of the debt arising from the debtor's status as a fiduciary and at the breach of the fiduciary duty. The Tenth Circuit Bankruptcy Appellate Panel focused on the debtor's failure to account for entrusted funds "due to any breach of a fiduciary duty, whether intentional, willful, reckless, or negligent."<sup>28</sup> No mental state was required for this approach<sup>29</sup> because it assumed the "requisite badness" was achieved by the breach of an elevated standard of care/loyalty applicable to fiduciaries.<sup>30</sup> The focus was on the fiduciary's special legal status with respect to the creditor, and the public policy of protecting the integrity of fiduciary relationships. Under this view, the term "defalcation" simply described the breach of a certain type of fiduciary duty (i.e. the failure to account for entrusted funds) by the debtor-fiduciary.<sup>31</sup> The Fourth Circuit included innocent mistakes and negligence.<sup>32</sup> The Ninth Circuit found defalcation for "innocent acts of failure to fully account for money received in trust"<sup>33</sup> and the Eighth Circuit included "the innocent default of a fiduciary who fails to account fully for money received."<sup>34</sup>

Under this view, a fiduciary debtor's culpability need not exist (or need only be slight) in order to remove the fresh start and not discharge a debt because it would encompass inadvertent and ordinary mistakes of judgment. In a fiduciary debtor context, this view cuts away huge swathes from the fresh start policy because any breach of fiduciary duty in connection with a failure to account for entrusted funds results in nondischargeable debt. This view is unique in that it focuses more on the nature<sup>35</sup> of the debt arising in a fiduciary context than it does on the bad conduct<sup>36</sup> of the fiduciary debtor. In contrast, the views of the other circuits focus more on the conduct of the debtor.

### 2. *Objective Recklessness*

Moving beyond the nature of the debt analysis, other circuits required

<sup>28</sup>*In re Storie*, 216 B.R. at 288.

<sup>29</sup>*Id.* (stating "[t]here is no mental state required in section 523(a)(4) for a 'defalcation'").

<sup>30</sup>*Id.*

<sup>31</sup>*Id.* at 287.

<sup>32</sup>*In re Uwimana*, 274 F.3d at 811 (stating "negligence or even an innocent mistake which results in misappropriation or failure to account is sufficient").

<sup>33</sup>*In re Hemmeter*, 242 F.3d at 1190.

<sup>34</sup>*Tudor Oaks Ltd. P'ship v. Cochrane (In re Cochrane)*, 124 F.3d 978, 984 (8th Cir. 1997).

<sup>35</sup>For nondischargeability purposes, this view appears to place debt connected with the breach of a fiduciary debtor in the same category as taxes, educational loans, or domestic support payments—debts that are important to society for policy reasons.

<sup>36</sup>However, in an unpublished opinion, the Tenth Circuit commented that at least "some portion of misconduct" was required. See *Okla. Grocers Assoc., Inc. v. Millikan (In re Millikan)*, 188 Fed. App'x 699, 702 (10th Cir. 2006) (stating defalcation "requires, at least, 'some portion of misconduct'" but declining to reconcile the varying opinions of other circuit courts).

the debtor to have “some degree of fault.”<sup>37</sup> The Seventh Circuit said “[d]efalcation requires something more than negligence or mistake, but less than fraud.”<sup>38</sup> The Fifth Circuit said “a willful neglect of duty” would suffice, which it defined as not requiring actual intent but rather as “measured objectively by reference to what a reasonable person in the debtor’s position knew or reasonably should have known.”<sup>39</sup> The Sixth and Eleventh Circuits agreed and required the fiduciary debtor to have been “objectively reckless.”<sup>40</sup>

### 3. *Extreme Recklessness or Scier*

The highest state of mind requirement on the spectrum was extreme recklessness or scier.<sup>41</sup> The First Circuit explained:

To show defalcation, a creditor need not prove that a debtor acted knowingly or willfully, in the sense of specific intent. However, a creditor must be able to show that a debtor’s actions were so egregious that they come close to the level that would be required to prove fraud, embezzlement, or larceny.

A debtor fiduciary may not escape the exclusion from discharge of his debt arising out of defalcation by saying he had no specific intent. As in other areas of the law, circumstances will provide the level of wrongdoing needed to constitute a defalcation. One useful analogy is to the law of securities, which requires “scier.” Scier, in the context of securities fraud, is a mental state embracing intent to deceive, manipulate, or defraud. A form of recklessness can meet the requirement of scier, but it is more like a lesser form of intent. This form of recklessness is an extreme departure from the standards of ordinary care. The mental state required for defalcation is akin to the level of recklessness required for scier. It is more than the mere conscious taking of risk associated with the usual torts standard of recklessness. Instead, defalcation requires something close to a showing of extreme recklessness.<sup>42</sup>

---

<sup>37</sup>*Follett Higher Educ. Group, Inc.*, 629 F.3d at 766 n.3.

<sup>38</sup>*Id.*

<sup>39</sup>*In re Harwood*, 637 F.3d at 624.

<sup>40</sup>*Patel v. Shamrock Floorcovering Serv., Inc. (In re Patel)*, 565 F.3d 963, 970-71 (6th Cir. 2009); *Bullock v. BankChampaign, N.A. (In re Bullock)*, 670 F.3d 1160, 1165 (11th Cir. 2012) (stating it was aligning itself with the Fifth, Sixth, and Seventh Circuits).

<sup>41</sup>*In re Baylis*, 313 F.3d 9, 18 (1st Cir. 2002).

<sup>42</sup>*Id.* at 20.

The Second Circuit agreed and required “a showing of conscious misbehavior or extreme recklessness—a showing akin to the showing required for scienter in the securities law context.”<sup>43</sup> This higher standard prevented a finding of defalcation for every debt incurred in connection with the mere breach of a fiduciary duty and also furthered to a greater extent the fresh start policy of bankruptcy law.<sup>44</sup>

#### B. THE BROADENING SCOPE OF A “FIDUCIARY CAPACITY” IN SECTION 523(A)(4)

Section 523(a)(4) of the Bankruptcy Code requires “defalcation while acting in a fiduciary capacity.”<sup>45</sup> The meaning of defalcation is even more important given the judicial broadening of the term “fiduciary capacity” in § 523(a)(4). The law on what constitutes a fiduciary capacity is murky<sup>46</sup> and there is an unsettled debate.<sup>47</sup> Over time, courts have been trending away from a very narrow interpretation of fiduciary capacity to a broad one.

<sup>43</sup>*Denton v. Hyman* (*In re Hyman*), 502 F.3d 61, 68 (2d Cir. 2007) (stating “we now align ourselves with the First Circuit”).

<sup>44</sup>*In re Baylis*, 313 F.3d at 19 (stating “[o]ur view is based on both the structure of 11 U.S.C. § 523(a) and the ‘fresh start’ policy” and is “consistent with the ‘fresh start’ policy undergirding the bankruptcy system”).

<sup>45</sup>11 U.S.C. § 523(a)(4).

<sup>46</sup>Ann K. Wooster, Annotation, *Who Is Acting in “Fiduciary Capacity” Within Meaning of Fraud or Defalcation Discharge Exception in Bankruptcy* (11 U.S.C.A. § 523(a)(4))—*Fiduciary Capacity of Debtors Other Than Sales, Purchasing, or Leasing Agent Debtors*, 17 A.L.R. FED. 2d 33 (2007); Ann K. Wooster, Annotation, *Who Is Acting in “Fiduciary Capacity” Within Meaning of Fraud or Defalcation Discharge Exception in Bankruptcy* (11 U.S.C.A. § 523(a)(4))—*Fiduciary Capacity of Debtors Involved in Sale, Purchase, or Lease of Goods or Services Other Than Legal, Financial, Investment, or Banking Products or Services*, 15 A.L.R. FED. 2d 337 (2006).

<sup>47</sup>Rosen, *supra* note 20, at 66 (arguing that “[b]y opening the gate to state law concepts of a general fiduciary duty, rather than limiting it to duties arising from an express or technical trust, this exception threatened to swallow the general discharge”); Jennifer Liotta, *ERISA Fiduciaries in Bankruptcy: Preserving Individual Liability for Defalcation and Fraud Debts Under 11 U.S.C. § 523(a)(4)*, 22 EMORY BANKR. DEV. J. 725, 758 (2006) (arguing an ERISA fiduciary should be a fiduciary capacity for purposes of Section 523(a)(4)); Bradley Kendall Mahanay, *An Analysis of the Matter of Bennett and Its Effect on Non-Dischargeability of Debt for Defalcation While Acting In a Fiduciary Capacity*, 46 BAYLOR L. REV. 281, 292 (1994) (arguing a general partner should not be in a fiduciary capacity to limited partners for purposes of Section 523(a)(4)); Elbein, *supra* note 23, at 743 (claiming “[r]ecent cases have overturned a century and a half of interpretation. . .”); Michael D. Sousa, *Are You Your Produce Vendor’s Keeper? The Perishable Agricultural Commodities Act and § 523(a)(4) of the Code*, 15 J. BANKR. L. & PRAC. 6 ART. 3 (Dec. 2006) (stating “an expansion of the meaning of ‘fiduciary capacity’ to encompass trusts created by statute offends the admonitions of the United States Supreme Court to strictly limit this provision of the Bankruptcy Code”); Michael D. Sousa, *The Nondischargeability of Partners’ Debts Under § 523(a)(4): The Unresolved Collision Between the Bankruptcy Code and Partnership Law*, 14 J. BANKR. L. & PRAC. 3 ART. 2 (2005) (asserting the “proper approach is to follow those courts which conclude that co-partners do not act in a fiduciary capacity for purposes of determining the dischargeability of debts in bankruptcy”); Peter M. Reinhardt and William G. Horlbeck, *Defalcation While Acting In a Fiduciary Capacity: What Does It Mean?*, 79 COLO. LAW. 1773 (Aug. 1995) (claiming “[t]he meaning of fiduciary capacity under Code § 523(a)(4) is a matter of federal law and is narrower than the traditional, common-law meaning of the term ‘fiduciary’”).

For example, in 1844 the Supreme Court<sup>48</sup> interpreted “fiduciary capacity” in the 1841 Bankruptcy Act as being limited to “technical trusts, and not those which the law implies from the contract.”<sup>49</sup> In 1934, the Court kept the same meaning by construing “fiduciary capacity” under the 1898 Bankruptcy Act in a “strict and narrow sense.”<sup>50</sup> This initial narrow view limiting a fiduciary capacity to express and technical trusts is still followed by some courts,<sup>51</sup> but others have greatly expanded the scope. Some have found 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.”<sup>52</sup> Others have begun to focus on “characteristically fiduciary duties over and above the obligations inherent in an ordinary, arm’s length commercial relationship, whether such duties are created by contract, common law or statute.”<sup>53</sup>

Even though the determination of whether someone is acting in a fiduciary capacity is an issue of federal law,<sup>54</sup> courts have begun to “regularly”<sup>55</sup> look to state law to determine whether a fiduciary capacity exists and have found<sup>56</sup> a fiduciary capacity in a wide variety of circumstances. For example, debtors have been found to be acting in a fiduciary capacity as the attorney or escrow holder in connection with an attorney-client relationship,<sup>57</sup> as a

<sup>48</sup>*Chapman v. Forsyth*, 43 U.S. 202 (1844).

<sup>49</sup>*Id.* at 208; see also *Davis v. Aetna Acceptance Co.*, 293 U.S. 328, 333 (1934) (reaffirming a limited judicial construction by interpreting “fiduciary capacity” in Section 17(4) of the 1898 Bankruptcy Act in the same manner).

<sup>50</sup>*Davis*, 293 U.S. at 333 (quoting *Chapman* and stating the scope of the exception was to be limited accordingly).

<sup>51</sup>*Rhode Island Lottery Comm’n v. Cairone (In re Cairone)*, 12 B.R. 60, 62 (Bankr. D. R.I. 1981) (noting that “[t]he traditional definition of a ‘fiduciary’ is not applicable in bankruptcy law” and that the “general meaning—a relationship involving confidence, trust and good faith—is far too broad”); *BAMCO 18 v. Reeves (In re Reeves)*, 124 B.R. 5, 10 (Bankr. D. N.H. 1990) (stating “I realize that many lower court decisions following the *Davis* decision have in effect ignored the Supreme Court’s teaching regarding technical and express trusts”); *Spinosa v. Heilman (In re Heilman)*, 241 B.R. 137, 160 (Bankr. D. Md. 1999) (stating “[m]any opinions, in effect, have permitted State courts and legislatures to overrule *Chapman v. Forsyth* and restrict the class of debtors to whom a bankruptcy discharge is available by deferring to the State law of fiduciaries”).

<sup>52</sup>*LSP Investment P’ship v. Bennett (In re Bennett)*, 989 F.2d 779, 784-85 (5th Cir. 1993); *Abrams v. Sea Palms Associates, Ltd.*, 229 B.R. 784, 792 (9th Cir. B.A.P. 1999).

<sup>53</sup>*Zohman v. Zoldan (In re Zoldan)*, 221 B.R. 79, 87 (Bankr. S.D.N.Y. 1998); *Corestates Asset Mgmt v. Kohler (In re Kohler)*, 255 B.R. 666, 668 (Bankr. E.D. Pa. 2000).

<sup>54</sup>*In re Cochrane*, 124 F.3d at 984.

<sup>55</sup>*Buchholz v. Cook (In re Cook)*, 263 B.R. 249, 255 (Bankr. N.D. Iowa 2001).

<sup>56</sup>One court perceptively observed that “in the cases of express or technical trusts, fiduciary duties are accepted by the fiduciary in the factual sense, and not imposed in the legal sense . . . . The true distinction of *Chapman* is that an express or technical trust, or its equivalent, is required, which can never be created by statute along absent the parties’ own intent.” *In re Heilman*, 241 B.R. at 166.

<sup>57</sup>*FDIC v. Mmahat*, 907 F.2d 546, 550 (5th Cir. 1990), cert. denied, 499 U.S. 936 (1991); *Shea v. Goldstein (In re Goldstein)*, 234 B.R. 214, 221 (Bankr. D. Mass. 1999); *Rodrigue v. Humphrey (In re*

partner in a partnership,<sup>58</sup> as directors or officers of insolvent corporations,<sup>59</sup> as managers of limited liability companies,<sup>60</sup> as joint venturers in a farming operation,<sup>61</sup> as trustees under the Perishable Agricultural Commodities Act,<sup>62</sup> as fiduciaries under the Employee Retirement Income Security Act of 1974 (ERISA),<sup>63</sup> and as insurance agents collecting insurance policy premiums.<sup>64</sup>

These various fiduciary capacities arise from many different sources. A fiduciary relationship may be created by a state statute,<sup>65</sup> a combination of state statute and common law,<sup>66</sup> a city ordinance,<sup>67</sup> a federal statute,<sup>68</sup> or by private, voluntary agreements such as indemnity agreements,<sup>69</sup> dealer sales agreements,<sup>70</sup> or instruments creating an express trust.<sup>71</sup> Thus, there are many different types and sources of fiduciary duties. With the scope of what

Humphrey), 350 B.R. 657, 660 (Bankr. E.D. La. 2006); *Bookbinder v. Pleeter* (*In re Pleeter*), 293 B.R. 812, 816 (Bankr. S.D. Fla. 2003); *Andy Warhol Found. for Visual Arts, Inc. v. Hayes* (*In re Hayes*), 183 F.3d 162, 173 (2d Cir. 1999).

<sup>58</sup>*Ragsdale v. Haller* (*In re Ragsdale*), 780 F.2d 794, 796-97 (9th Cir. 1986) (holding California had made all partners trustees over the assets of the partnership and that California partners are fiduciaries within the meaning of § 523(a)(4)); *In re Bennett*, 989 F.2d at 781 (stating “Texas law clearly and expressly imposes trust obligations on managing partners of limited partnerships and these obligations are sufficient to meet the narrow requirements of section 523(a)(4)”).

<sup>59</sup>*JP Morgan Chase Bank v. Tamis* (*In re Tamis*), 398 B.R. 124, 130 (Bankr. D. N.J. 2008) (holding officers and directors of insolvent corporation owed a fiduciary duty to the creditors of the corporation); *Berres v. Bruning* (*In re Bruning*), 143 B.R. 253, 256 (D. Colo. 1992) (holding California common law creates a fiduciary relationship between the officers and directors of an insolvent corporation and its creditors).

<sup>60</sup>*In re Garland*, 501 B.R. 195, 201 (Bankr. S.D. N.Y. 2013) (noting that the debtor misappropriated assets while acting as a managing member and that under New York law, managers of limited liability companies owe fiduciary duties to the company and to members of the company); *McCarthy v. Nature’s Wing Fin Design, LLC* (*In re McCarthy*), Nos. CC-10-1445-PaMkB, CC-10-1446-PaMkB, 2011 WL 4485866, p. 8 (9th Cir. BAP Aug. 10, 2011).

<sup>61</sup>*Selenske v. Selenske* (*In re Selenske*), 103 B.R. 200, 203-04 (Bankr. E.D. Wis. 1989).

<sup>62</sup>*Consumers Produce Co. v. Masdea* (*In re Masdea*), 307 B.R. 466, 474 (Bankr. W.D. Pa. 2004).

<sup>63</sup>*In re Hemmeter*, 242 F.3d at 1190.

<sup>64</sup>*In re Reliance Ins. Co. v. Miller*, 144 Fed. Appx. 966, 972 (4th Cir. 2005).

<sup>65</sup>*Stowe v. Bologna* (*In re Bologna*), 206 B.R. 628 (Bankr. D. Mass. 1997) (finding that a debtor landlord holding a security deposit under a Massachusetts statute was acting in a fiduciary capacity); *Alaska Teamster-Employer Pension Trust v. Wise* (*In re Wise*), 120 B.R. 537 (Bankr. D. Alaska 1990) (deeming a debtor a landlord with respect to security deposits under Alaska’s Uniform Residential Landlord and Tenant Act).

<sup>66</sup>*In re Ragsdale*, 780 F.2d at 796 (finding a fiduciary capacity based on the California Corporate Code and case law).

<sup>67</sup>*In re McGee*, 353 F.3d 537 (7th Cir. 2003) (finding fiduciary capacity based on the Chicago Municipal Code addressing a landlord’s obligations to hold a tenants security deposit).

<sup>68</sup>*In re Masdea*, 307 B.R. at 474 (finding a fiduciary capacity based on the Perishable Agricultural Commodities Act, 7 U.S.C. § 499e(c)(2)).

<sup>69</sup>*Poynter v. Great American Ins. Co.*, 482 B.R. 557, 563 (W.D. Ky 2012) (finding a fiduciary capacity based on a debtor that acted as a general contractor and signed an agreement of indemnity).

<sup>70</sup>*Kubota Tractor Corp. v. Strack* (*In re Strack*), 524 F.3d 493, 500 (4th Cir. 2008).

<sup>71</sup>*In re Bullock*, 670 F.3d at 1164 (Bullock was the trustee of his father’s trust).

constitutes a “fiduciary capacity” broadening over time, the mental standard from *Bullock* will apply to an ever-greater universe of debtor conduct.

### C. THE BASICS OF *BULLOCK*

#### 1. *Bullock Factual Background*

The facts of *Bullock* allowed the Court to define defalcation without addressing the meaning of fiduciary capacity.<sup>72</sup> *Bullock* arose out of a dispute between some of the beneficiaries of a living trust and their brother, a non-professional trustee of the trust.<sup>73</sup> In 1978, a father created an irrevocable living trust in favor of his five children and named one of his sons, Randy Bullock (“Mr. Bullock”), the trustee.<sup>74</sup> The sole asset of the trust was a life insurance policy on the life of the father.<sup>75</sup> The trust instrument permitted the trustee to borrow funds from the insurer against the policy’s value in only two situations: (1) to pay the life insurance premiums; and (2) to satisfy a beneficiary’s request for withdrawal.<sup>76</sup> Mr. Bullock was unaware of the existence of the trust or of his position as trustee until his father contacted him to request a loan for the benefit of Mr. Bullock’s mother.<sup>77</sup> Mr. Bullock subsequently borrowed funds against the cash value of the life insurance policy on three separate occasions and loaned the proceeds to his mother and to business entities in which he had an interest.<sup>78</sup> The loans accrued interest at the insurance company’s determined rate of 6%.<sup>79</sup> Although all of the borrowed funds were repaid to the trust along with 6% interest,<sup>80</sup> the trust did not earn any profits on the loans.<sup>81</sup> BankChampaign, N.A. (“BankChampaign”) was eventually placed as the successor trustee of the trust.<sup>82</sup>

#### 2. *Bullock Procedural Background*

Two of Mr. Bullock’s brothers, who were beneficiaries of the trust, sued Mr. Bullock in Illinois state court alleging Mr. Bullock breached his fiduciary

---

<sup>72</sup>Specifically, the fact that Mr. Bullock was the trustee of an express trust. *Id.* at 1164 (stating “[t]he parties do not dispute that the judgment debt arose from conduct that occurred while Bullock was acting in a fiduciary capacity (i.e., while he was the trustee of his father’s trust)”).

<sup>73</sup>*BankChampaign, N.A. v. Bullock*, No. 10-80003, 2010 WL 2202826, \*3 (Bankr. N.D. Ala. May 27, 2010).

<sup>74</sup>*Id.*; *Bullock*, 133 S. Ct. at 1757.

<sup>75</sup>*Bullock*, 133 S. Ct. at 1757.

<sup>76</sup>*In re Bullock*, 670 F.3d at 1162.

<sup>77</sup>*Bullock v. Bullock*, No. 99-CH-34, Order (Circuit Court for the Fifth Judicial Circuit of Ill. Filed December 23, 2002).

<sup>78</sup>*BankChampaign, N.A.*, 2010 WL 2202826, at \*3.

<sup>79</sup>*Bullock*, 133 S. Ct. at 1757.

<sup>80</sup>*Id.*

<sup>81</sup>*BankChampaign, N.A.*, 2010 WL 2202826, at \*3.

<sup>82</sup>Second Amended Complaint filed July 10, 2001 in *Bullock v. Bullock*, No. 99-CH-34 (Circuit Court for the Fifth Judicial Circuit of Ill.).

duty as trustee of the trust and that any profits earned by Mr. Bullock and his mother as a result of the loans should be turned over to the trust.<sup>83</sup> The Illinois court found Mr. Bullock did “not appear to have had a malicious motive in borrowing funds from the trust,” but held that “neither the facts and circumstances surrounding the loans nor the motives of [Mr. Bullock] can excuse him from liability. There has been a clear breach of [Mr. Bullock’s] fiduciary duty, and the Plaintiffs are entitled to damages.”<sup>84</sup> The court noted that the loans were “inappropriate,” acknowledged that Mr. Bullock had “in fact, repaid the loans,” and ordered Mr. Bullock to pay the trust “\$250,000 to represent the benefits he received from his breaches” plus additional fees and costs.<sup>85</sup>

Mr. Bullock was unable to pay the court-ordered payment and filed a voluntary petition for relief under Chapter 7 of the Bankruptcy Code.<sup>86</sup> BankChampaign filed an adversary proceeding to determine the dischargeability of the Illinois court-ordered payment under § 523(a)(4) of the Bankruptcy Code.<sup>87</sup> Based on collateral estoppel, the bankruptcy court held the debt was nondischargeable because the issues determined by the Illinois court were the same as those arising in the adversary proceeding.<sup>88</sup> Mr. Bullock appealed to the federal district court, which affirmed, finding “nothing erroneous in the [b]ankruptcy court’s determination that the Illinois state court judgment was non-dischargeable” and “that it was collaterally estopped from reopening [the] issue.”<sup>89</sup>

Mr. Bullock then appealed to the Eleventh Circuit, which also affirmed, finding that Mr. Bullock’s conduct constituted defalcation.<sup>90</sup> After a brief summary of the split in the federal circuits, the Eleventh Circuit noted that defalcation “requires more than mere negligence” and requires “a known breach of a fiduciary duty, such that the conduct can be characterized as objectively reckless.”<sup>91</sup> By requiring a showing of recklessness by the fiduciary, the Eleventh Circuit consciously noted it was aligning itself with the Fifth, Sixth, and Seventh Circuits.<sup>92</sup> In characterizing Mr. Bullock’s conduct as objectively reckless, the Eleventh Circuit inferred culpability as follows:

---

<sup>83</sup>*Id.*

<sup>84</sup>*Bullock v. Bullock*, No. 99-CH-34, Order (Circuit Court for the Fifth Judicial Circuit of Ill. Filed December 23, 2002).

<sup>85</sup>*Id.*

<sup>86</sup>Bankruptcy Petition No. 09-84300-JAC7, filed October 21, 2009 in the U.S. Bankruptcy Court for the Northern District of Alabama.

<sup>87</sup>*BankChampaign, N.A.*, 2010 WL 2202826, \*1.

<sup>88</sup>*Id.*

<sup>89</sup>*Bullock v. BankChampaign, N.A.*, No. CV-10-J-1905-NE (N.D. Ala. March 22, 2011).

<sup>90</sup>*In re Bullock*, 670 F.3d at 1164.

<sup>91</sup>*Id.* at 1166.

<sup>92</sup>*Id.*

“[b]ecause Mr. Bullock was the trustee of the trust, he certainly *should have known* that he was engaging in self-dealing, given that he knowingly benefited from the loans.”<sup>93</sup>

### 3. *Bullock* Supreme Court Decision

Mr. Bullock petitioned for,<sup>94</sup> and the U.S. Supreme Court granted,<sup>95</sup> certiorari on the question of what degree of misconduct was required to constitute defalcation. In resolving the circuit split, *Bullock* did not adopt a specific standard from the federal circuits. Instead, the Court unanimously decided that defalcation “includes a culpable state of mind requirement”<sup>96</sup> that involves “knowledge of, or gross recklessness in respect to, the improper nature of the relevant fiduciary behavior.”<sup>97</sup> It can be satisfied through either (i) “conduct that the fiduciary knows is improper,”<sup>98</sup> or (ii) “reckless conduct of the kind that the criminal law often treats as the equivalent,”<sup>99</sup> meaning “the kind set forth in the Model Penal Code.”<sup>100</sup>

*Bullock*'s new standard is most similar to the “extreme recklessness or scienter” state of mind from the First and Second Circuits, but it is different because it focuses on the Model Penal Code instead of the securities law concept of scienter.<sup>101</sup> *Bullock* compared<sup>102</sup> the Model Penal Code's definition of “recklessly” to scienter through the citing reference “Cf.,” which means the “[c]ited authority supports a proposition *different from* the main proposition but sufficiently analogous to lend support.”<sup>103</sup> *Bullock* also cited a Second Circuit decision for support, explaining that “at least some Circuits

<sup>93</sup>*Id.* (emphasis added).

<sup>94</sup>*In re Bullock*, 670 F.3d 1160 (11th Cir. 2012), *petition for cert. filed*, 2012 WL 2311991 (U.S. June 14, 2012) (No. 11-1518).

<sup>95</sup>*In re Bullock*, 670 F.3d 1160 (11th Cir. 2012), *cert. granted*, 133 S.Ct. 529 (2012), 80 U.S.L.W. 3709 (U.S. Oct. 29, 2012) (No. 11-1518).

<sup>96</sup>*Bullock*, 133 S. Ct. at 1757.

<sup>97</sup>*Id.*

<sup>98</sup>*Id.* at 1759.

<sup>99</sup>*Id.*

<sup>100</sup>*Id.*

<sup>101</sup>In a typical 10(b) securities law action, “the term ‘scienter’ refers to a mental state embracing intent to deceive, manipulate, or defraud.” *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 194 n.12 (1976). “For the scienter element, most courts have concluded that recklessness is sufficient.” William H. Kuehnle, *On Scienter, Knowledge, and Recklessness Under the Federal Securities Laws*, 34 HOUS. L. REV. 121, 179 (1997). In the securities law context, recklessness is defined as “an extreme departure from the standards of ordinary care, and which presents a danger of misleading buyers or sellers that is either known to the defendant or is so obvious that the actor must have been aware of it.” *Sundstrand Corp. v. Sun Chemical Corp.*, 553 F.2d 1033, 1045 (7th Cir. 1977) (quoting *Franke v. Midwestern Okla. Dev. Auth.*, 428 F. Supp. 719, 725 (W.D. Okla. 1976), *vacated on other grounds*, *Cronin v. Midwestern Okla. Dev. Auth.*, 619 F.2d 856 (10th Cir. 1980)).

<sup>102</sup>*Bullock*, 133 S. Ct. at 1760.

<sup>103</sup>THE BLUEBOOK: A UNIFORM SYSTEM OF CITATION R. 1.2, at 55 (Columbia Law Review Ass'n et al. eds., 19th ed. 2010) (emphasis added).

have interpreted the [defalcation] statute similarly.”<sup>104</sup> Thus, in resolving the circuit split, *Bullock* established a new mental standard requirement.

*Bullock* quoted the Model Penal Code’s definition of recklessly but rephrased it to relate to the violation of a fiduciary duty:

Where actual knowledge of wrongdoing is lacking, we consider conduct as equivalent if the fiduciary “consciously disregards” (or is willfully blind to) “a substantial and unjustifiable risk” that his conduct will turn out to violate a fiduciary duty. . . . That risk “must be of such a nature and degree that, considering the nature and purpose of the actor’s conduct and the circumstances known to him, its disregard involves a *gross deviation* from the standard of conduct that a law-abiding person would observe in the actor’s situation.”<sup>105</sup>

The Court gave five reasons for this heightened mental standard. First, it used a canon of interpretation<sup>106</sup> that looked at the mental state required for the other statutory terms in § 523(a)(4)—namely fraud, embezzlement and larceny—in order to impose a mental standard in the definition of defalcation. Second, it noted that a heightened mental standard prevented the meaning of defalcation from being identical to its statutory neighbors of embezzlement and larceny and made it distinguishable from fiduciary fraud.<sup>107</sup> Third, requiring a heightened mental standard was consistent with the principle that exceptions to discharge should be confined to those plainly expressed.<sup>108</sup> Fourth, some circuits had already imposed a similar heightened mental standard for many years without administrative or other practical difficulties. Finally, there were no strong considerations that favored a different interpretation.<sup>109</sup> *Bullock* vacated the Eleventh Circuit’s judgment and remanded the case “to permit the court to determine whether further proceedings are needed and, if so, to apply the heightened standard that we have set forth.”<sup>110</sup>

As mentioned earlier, most of the exceptions to discharge in § 523(a) are based on a policy concern—either the important nature of the debt or some

---

<sup>104</sup>*Bullock*, 133 S. Ct. at 1761.

<sup>105</sup>*Id.* at 1759-1760 (quoting MODEL PENAL CODE § 2.02(2)(c) (1985)).

<sup>106</sup>*Noscitur a sociis*, which means “it is known from its associates.” BLACK’S LAW DICTIONARY 1668 (7th ed. 1999).

<sup>107</sup>*Bullock*, 133 S. Ct. at 1757 (stating defalcation involves neither conversion nor taking and carrying away another’s property, nor falsity and that it may be used to refer to nonfraudulent breaches of fiduciary duty).

<sup>108</sup>*Id.* at 1760.

<sup>109</sup>*Id.* at 1761 (noting that an opposing consideration proffered by the Government had two equally plausible explanations and was inconclusive).

<sup>110</sup>*Id.*

type of culpable conduct by the debtor.<sup>111</sup> The characterization of a discharge exception as a “bad conduct of debtor” or “nature of debt” exception is important because it provides policy guidance to courts when applying a discharge exception in the fog of new facts where the light of precedent is too dim to be helpful. For example, the characterization of a domestic support obligation<sup>112</sup> in the “type of debt” category confirms that one of the primary reasons it is a discharge exception is because society holds the interests of the beneficiaries of domestic support obligations, such as obligations debtors owe to dependent children or ex-spouses, as being more important than the fresh start of a debtor through a discharge. Thus, when a court is asked to consider whether some new type of quasi-related support obligation is a domestic support obligation, it can be guided by focusing not on the debtor’s culpable conduct in connection with the creation of the debt, but on whether the claimant fits within the circle of beneficiaries that the discharge exception was intended to protect.

The characterization of the discharge exception for “defalcation while acting in a fiduciary capacity” has historically been unclear. Before *Bullock*, one court had ultimately concluded that defalcation by a fiduciary was a “bad conduct of debtor” discharge exception, but noted that “[i]t is arguable that defalcation by a fiduciary fits into [the] ‘type of debt’ category.”<sup>113</sup> Scholars have taken both sides of the issue.<sup>114</sup>

*Bullock*’s mandate of a mental state clearly places the exception in the “bad conduct of debtor” category.<sup>115</sup> Although there is still a significant amount of uncertainty about the scope of a “fiduciary capacity” under § 523(a)(4),<sup>116</sup> the clarification that “defalcation” is a “bad conduct of debtor” exception puts the interests of the beneficiaries of the fiduciary relationship in the periphery and places the debtor’s culpability as the focal point. This position is confirmed by *Bullock*’s emphasis on “the improper nature of the relevant fiduciary behavior”<sup>117</sup> instead of on the existence of a debt arising from a fiduciary relationship. In addition, when explaining the considerations that lead to requiring a mental standard for defalcation, the Court stated that

---

<sup>111</sup>See Part I, Introduction.

<sup>112</sup>11 U.S.C. § 523(a)(5).

<sup>113</sup>*In re Baylis*, 313 F.3d at 19.

<sup>114</sup>Andrea Johnson, *The Defalcation Exception to Discharge*, 27 W. NEW ENG. L. REV., 93, 119 (2005) (stating “Section 523(a)(4) is probably more like fault-based exceptions, in that it contains language that suggests dishonesty on the part of the debtor”); Rosen, *supra* note 20, at 87 (asserting the defalcation exception applies only when there is a failure to remit or account for funds or property held in an express or technical trust and that the debtor’s type of mental state does not matter).

<sup>115</sup>Characterizing defalcation while acting in a fiduciary capacity as a “type of debt” category likely would have required a simple breach of fiduciary duty and changed the focus from the debtor to the beneficiary of the fiduciary duty.

<sup>116</sup>See Part III.A.

<sup>117</sup>*Bullock*, 133 S. Ct. at 1757 (emphasis added).

its interpretation was “consistent with a set of statutory exceptions that Congress normally confines to circumstances where strong, special policy considerations, *such as the presence of fault*, argue for preserving the debt, thereby benefiting, for example, a typically more honest creditor.”<sup>118</sup> Ultimately, the fact that *Bullock* imposed a heightened state of mind requirement goes to the heart of a “bad conduct of debtor” exception.

### III. ANALYSIS OF BULLOCK: IMPLICATIONS AND PRECAUTIONS

This Article does not question whether *Bullock* chose “the correct” state of mind for the defalcation exception to discharge. Instead, it focuses on the many implications and challenges from *Bullock* that will need to be addressed by courts in the future. The analysis devotes significant attention to the Model Penal Code’s definition of “recklessly,” because it is the minimum<sup>119</sup> mental state required to find defalcation under *Bullock*’s new test and the most difficult to apply. The analysis will start by explaining why applying the Model Penal Code definition of recklessly to civil fiduciary law is awkward. Second, it explores the reasons the Model Penal Code’s definition of recklessly is difficult to apply. Third, it explains *Bullock*’s seemingly unworkable criteria involving willful blindness and offers a solution. *Bullock*’s implications on summary judgment proceedings and pleading requirements are also raised. Finally, this Article establishes an overall analytical framework to apply *Bullock*’s new test.

#### A. THE AWKWARDNESS OF APPLYING THE MODEL PENAL CODE’S DEFINITION OF “RECKLESSLY” TO CIVIL FIDUCIARY LAW

The Model Penal Code was a project of the American Law Institute and was designed to provide a comprehensive and cohesive model<sup>120</sup> for states “that would clarify some aspects of the [criminal] law and improve upon aspects that were irrational or unwise.”<sup>121</sup> In a general sense, the phrase “state of mind” refers to “a family of concepts that includes choice, voluntari-

---

<sup>118</sup>*Id.* at 1761 (emphasis added).

<sup>119</sup>Model Penal Code § 2.02(2)(5) (stating that “[w]hen recklessness suffices to establish an element, such element also is established if a person acts purposely or knowingly”).

<sup>120</sup>*But see* David M. Treiman, *Recklessness and the Model Penal Code*, 9 AM. J. CRIM. L. 281, 328-334 (1981) (explaining that “the *Model Penal Code* was not intended to be uniform legislation like the *Uniform Commercial Code*. All the states which have modeled their criminal codes after the *Model Penal Code* have incorporated extensive modifications. Every state which has used the *Model Penal Code* definition of recklessness has modified it to some extent”).

<sup>121</sup>Kent Greenawalt, *The Cultural Defense: Reflections in Light of the Model Penal Code and The Religious Freedom Restoration Act*, 6 OHIO ST. J. CRIM. L. 299, 305 (2008) (Professor Greenawalt served as the Chief Reporter for the American Law Institute in creating the explanatory comments to the Model Penal Code).

ness, consciousness, belief, desire, motive, purpose, and intention.”<sup>122</sup> Under the Model Penal Code, each<sup>123</sup> crime has its own type of mental state<sup>124</sup> or “culpability” and there are four types: purposely, knowingly, recklessly, and negligently.<sup>125</sup> Much like the definitions in § 101 of the Bankruptcy Code,<sup>126</sup> the mental state definitions in the Model Penal Code were designed to be used with other operational provisions of the Model Penal Code. For example, the crime of “entrapment” in the Model Penal Code includes “making *knowingly* false representations.”<sup>127</sup> The Model Penal Code’s description of entrapment expressly uses the defined term “knowingly,” just as the Bankruptcy Code’s provision on the allowance of claims<sup>128</sup> uses the defined term “claim.”<sup>129</sup> Although this type of statutory organization is a familiar and elementary concept, it is useful to recognize the context in which the Model Penal Code’s definition of “recklessly” was designed to be used.

*Bullock* plucked the definition of “recklessly” from the Model Penal Code and implanted it into the defalcation analysis.<sup>130</sup> “The Model [Penal] Code’s approach is based upon the view that clear analysis requires that the question of the kind of [mental state] required to establish the commission of an offense be faced separately with respect to each material element of the crime.”<sup>131</sup> In the Model Penal Code, the defined mental states “apply to all the material elements of the offense, unless a contrary purpose plainly appears.”<sup>132</sup> Unlike the Model Penal Code, where elements are described and defined mental states are expressly used in the descriptions of the offenses, the descriptions of fiduciary capacities are not connected to the mental states of the Model Penal Code. As explained earlier, there are many different sources giving rise to the various fiduciary capacities of debtors under

---

<sup>122</sup>Kenneth W. Simons, *Rethinking Mental States*, 72 B.U. L. REV. 463, 529 (1992) (stating that “one should avoid the fallacy of predicating mental states on some mysterious entity—‘the mind.’ People, not minds, have beliefs, desires, and intentions”).

<sup>123</sup>Except for strict liability offenses. See MODEL PENAL CODE § 2.05 (1962).

<sup>124</sup>Many scholars have observed that the term “mental state” is not accurate because negligence is not truly a mental state. Treiman, *supra* note 120, at 287; Karlen, *Mens Rea: A New Analysis*, 9 TOL. L. REV. 191, 210 (1978); G. FLETCHER, *RETHINKING CRIMINAL LAW*, 442, n. 13 (1978); W. LAFAVE & A. SCOTT, *HANDBOOK ON CRIMINAL LAW*, 192 (1972); G. WILLIAMS, *THE MENTAL ELEMENT IN CRIME*, 57 (1965).

<sup>125</sup>MODEL PENAL CODE § 2.02 (1962).

<sup>126</sup>11 U.S.C. § 101.

<sup>127</sup>MODEL PENAL CODE § 2.13(1)(a) (1962).

<sup>128</sup>11 U.S.C. § 502.

<sup>129</sup>11 U.S.C. § 101(5).

<sup>130</sup>This is similar to using a rubber kickball to play a soccer game. It will work even though the kickball was not designed for soccer. The players will just need to adjust to the different attributes of the ball.

<sup>131</sup>MODEL PENAL CODE AND COMMENTARIES § 2.02 cmt. 1 (Am. Law Inst. 1985).

<sup>132</sup>MODEL PENAL CODE § 2.02(4) (1962).

§ 523(a)(4). Few if any sources expressly use the term “recklessly” when describing the debtor’s fiduciary duties.

Moreover, fiduciary duties may not be expressed in terms of elements. For example, in *Bullock* the trust instrument permitted the trustee to borrow funds from the insurer against the policy’s value in only two situations: (1) to pay the life insurance premiums; and (2) to satisfy a beneficiary’s request for withdrawal.<sup>133</sup> The trust instrument merely set forth permissible reasons to borrow funds against the policy’s value. Many sources of fiduciary duties will lack the Model Penal Code’s structure of using “recklessly” to modify elements of offenses. There will rarely if ever be seamless nesting between the Model Penal Code’s “recklessly” mental standard and the source of a debtor’s fiduciary duty.

Although this creates some amount of “square peg in a round hole” difficulty,<sup>134</sup> *Bullock* provided guidance on how the mental state “recklessly” is to be applied when determining whether there is a defalcation while acting in a fiduciary capacity. It is “recklessness in respect to the improper nature of the relevant fiduciary behavior.”<sup>135</sup> More specifically, *Bullock* focused on the risk that a debtor’s “conduct will turn out to violate a fiduciary duty.”<sup>136</sup>

#### B. DIFFICULTIES WHEN APPLYING THE MODEL PENAL CODE’S DEFINITION OF “RECKLESSLY”

The Model Penal Code’s definition of “recklessly” is difficult to apply because it contains both objective and subjective standards. It also adds a layer of complexity by focusing on the risk of a breach of fiduciary duty, instead of just the breach itself. Each element of the definition of “recklessly” will be explored.

##### 1. *Objective and Subjective Standards in the Determination of Recklessly*

In order to ensure that a debtor’s conduct was bad enough to forfeit a discharge of debt, *Bullock* defined defalcation to require “an intentional wrong,” which includes “conduct that the fiduciary knows is improper.”<sup>137</sup> *Bullock* then broadened the scope of defalcation to include “reckless conduct of the kind that the criminal law often treats as the equivalent” and “reckless

---

<sup>133</sup>*In re Bullock*, 670 F.3d at 1162.

<sup>134</sup>Comment 3 to the definition of recklessly in Section 2.02(2)(c) suggests that the term recklessly was defined to apply to any material element, regardless of whether the element relates to the nature of the actor’s conduct, or to the existence of the requisite attendant circumstances, or to the result that may ensue. MODEL PENAL CODE AND COMMENTARIES § 2.02 cmt. 3 (Am. Law Inst. 1985).

<sup>135</sup>*Bullock*, 133 S. Ct. at 1757.

<sup>136</sup>*Id.* at 1759-1760.

<sup>137</sup>*Id.* at 1759.

conduct of the kind set forth in the Model Penal Code.”<sup>138</sup> Reaching down across the culpability line from knowingly improper conduct to the reckless category highlights the importance of understanding what level of awareness a debtor must have in connection with conduct that constitutes defalcation. As will be explained below, the Model Penal Code’s definition of recklessly requires both subjective and objective determinations. The implications of *Bullock* are thus best understood through the distinction between the objective and subjective standards that are used when determining awareness of risk.

i. The Difference Between Objective and Subjective Standards

The Court’s earlier opinion in *Farmer v. Brennan*<sup>139</sup> provides a helpful framework for distinguishing objective and subjective standards.<sup>140</sup> Although *Farmer* was an Eighth Amendment case relating to the standard for deliberate indifference, its distinction between objective and subjective standards is useful.

According to *Farmer*, in an objective standard, a person is reckless if the person “acts or (if the person has a duty to act) fails to act in the face of an unjustifiably high risk of harm that is either known or so obvious that it should be known.”<sup>141</sup> This means a person is deemed reckless if the risk is at a sufficiently obvious level that it should have been known, regardless of whether the person actually was aware of the risk.<sup>142</sup>

But under a subjective standard, *Farmer* provides that a person is reckless when he “disregards a risk of harm of which he is aware.”<sup>143</sup> A subjective standard is about the actual thoughts of the actor. That is, under a purely subjective standard, the person “must both be aware of facts from which the inference could be drawn that a substantial risk of serious harm exists, and he must also draw the inference.”<sup>144</sup> This means there is no recklessness under a subjective standard if a serious risk of harm is obvious but no inference can be made that the actor was actually aware of the risk.<sup>145</sup> Under *Farmer*, circumstantial evidence showing a person “must have known” about the risk of harm

---

<sup>138</sup>*Id.*

<sup>139</sup>*Farmer v. Brennan*, 511 U.S. 825 (1994).

<sup>140</sup>See *Piamba Cortex v. American Airlines, Inc.*, 177 F.3d 1272, 1290-1291 (11th Cir. 1999) (using the structure of *Farmer v. Brennan* to decide a case under the Warsaw Convention).

<sup>141</sup>*Farmer*, 511 U.S. at 836.

<sup>142</sup>*Piamba Cortex*, 177 F.3d at 1290-1291 (stating “[t]he objective test is satisfied if a grave risk is sufficiently obvious, because the person ‘should have’ been aware of the risk regardless of whether he actually recognized it”).

<sup>143</sup>*Farmer*, 511 U.S. at 837.

<sup>144</sup>*Id.*

<sup>145</sup>*Id.* (stating “[t]hat a trier of fact may infer knowledge from the obvious . . . does not mean that it must do so”).

is sufficient to permit a trier of fact to infer<sup>146</sup> that the person had actual knowledge of the risk of harm (meaning he drew the inference).<sup>147</sup> *Farmer* warned however, that “courts should be careful to ensure that the requirement of subjective culpability is not lost. It is not enough merely to find that a reasonable person would have known, or that the defendant should have known.”<sup>148</sup>

Regardless of how reckless is defined, *Farmer* provides two useful standards for evaluating awareness of risk. First, an objective standard is a legal norm based on what a “reasonable person would have known” or what the “litigant should have known,” rather than what the litigant consciously thought, believed or understood. A subjective standard is based on what the litigant was actually aware of and may be satisfied by circumstantial evidence showing that the “litigant must have known.”

## ii. Objective and Subjective Standards in the Tort Restatements

The tort restatements provide a good illustration of the difficulty in applying objective and subjective standards of awareness of risk. The Restatement of Torts was first published in 1934 and the Restatement (Second) of Torts in 1964.<sup>149</sup> Despite having the benefit of a standard tort law definition of recklessness for many years, both courts and scholars have called the term nebulous and fraught with misunderstanding.<sup>150</sup> As one scholar observed, “it appears that courts are applying a sort of moral intuition in drawing the lines between recklessness and other types of conduct.”<sup>151</sup> The judicial quandary arising from attempts to reconcile objective and subjective standards of awareness risk has been described as follows:

---

<sup>146</sup>Infer means a deduction based on evidence.

<sup>147</sup>*Farmer*, 511 U.S. at 842-843.

<sup>148</sup>*Id.* at 843, n.8.

<sup>149</sup>RESTATEMENT (FIRST) OF TORTS § 500 (1934); RESTATEMENT (SECOND) OF TORTS § 500, (1965).

<sup>150</sup>*Burnett v. City of Adrian*, 326 N.W.2d 810, 820 (Mich. 1982) (stating the definition of recklessness was “fraught with misunderstanding”); Jim Hasenfus, Comment, *The Role of Recklessness in American Systems of Comparative Fault*, 43 OHIO ST. L.J. 399, 400 n.7 (1982) (stating the various labels applied to recklessness have “led to considerable confusion”); Randolph Stuart Sergeant, *Gross, Reckless, Wanton, and Indifferent: Gross Negligence in Maryland Civil Law*, 30 U. BALT. L. REV. 1, 2 (2000) (stating the definition of recklessness remains nebulous); Geoffrey Christopher Rapp, *The Wreckage of Recklessness*, 86 WASH. U. L. REV. 111, 134 (2008) (stating “[c]ourts are unsure whether recklessness is closer to intentional tort or negligence, and unsure whether the differences between recklessness and whichever pole it abuts are differences of kind or of degree”).

<sup>151</sup>Rapp, *supra* note 150, at 134 (stating “the confusing and muddled articulation of the doctrine of recklessness in the First and Second Restatements has left room for courts to apply naked intuition to the cases before them. With the doctrine itself hopelessly ill-defined, courts have not produced systematically coherent jurisprudence in the area”).

Courts have wrestled with whether recklessness can be proven even in the absence of *conscious* awareness of risk on the part of a defendant. . . . It is generally undisputed that recklessness requires some level of consciousness; what confuses courts is whether a conscious action without a conscious appreciation of risk will be sufficient to state such a claim. Some courts have described a defendant's conscious awareness of risk as "vital" and "crucial" in establishing recklessness. Other courts have taken the middle ground: recognizing that while consciousness of risk is required, such consciousness can be implied or constructive, proven by the circumstances confronting the defendant rather than any direct evidence of cognitive recognition of risk.<sup>152</sup>

In defining reckless disregard of safety, both the First and Second Restatement of Torts define recklessness to include an objective standard of awareness of risk. They require a person to act or fail to act "having reason to know of facts which would lead a reasonable man to realize" that the risk exists.<sup>153</sup> This objective standard infers an awareness of risk because a reasonable person would have been aware. It focuses on whether a typical person would have realized the risk.<sup>154</sup> This means a court could find a person was reckless even if the person was not consciously aware of the risk because the person merely had reason to know. In other words, under the First and Second Restatements, a finding of recklessness is merited because the person "failed to draw an inference that a reasonable person would have drawn."<sup>155</sup> One of the restatement comments explains:

In order that the actor's conduct may be reckless, *it is not necessary that he himself recognize it* as being extremely dangerous. His inability to realize the danger may be due to his own reckless temperament, or to the abnormally favorable results of previous conduct of the same sort. It is enough that he knows or *has reason to know of circumstances which would bring home to the realization of the ordinary, reasonable man the highly dangerous character of his conduct.*<sup>156</sup>

The First and Second Restatement's approach is similar to the "objective recklessness" standard from the Eleventh Circuit that *Bullock* rejected. The

<sup>152</sup>Rapp, *supra* note 150, at 147-148.

<sup>153</sup>RESTATEMENT (FIRST) OF TORTS, § 500 (1934); RESTATEMENT (SECOND) OF TORTS § 500 (1965).

<sup>154</sup>RESTATEMENT (SECOND) OF TORTS § 500 (1965).

<sup>155</sup>RESTATEMENT (THIRD) OF TORTS: *Phys. & Emot. Harm* § 2 cmt. c (2010).

<sup>156</sup>RESTATEMENT (SECOND) OF TORTS § 500, cmt. c (1964) (emphases added).

Eleventh Circuit found Bullock had committed a defalcation “[b]ecause Bullock was the trustee of the trust, he certainly *should have known* that he was engaging in self-dealing, given that he knowingly benefitted from the loans.”<sup>157</sup> *Bullock* rejected this type of objective “should have known” standard because it was not culpable enough to forfeit a discharge of debt.<sup>158</sup>

The Restatement (Third) of Torts, which was published in 2010, takes a different approach.<sup>159</sup> Under the First and Second Restatements, a person can be found reckless “whose only fault consists of the failure to draw an inference that a reasonable person would have drawn.”<sup>160</sup> The Restatement (Third) of Torts treats that type of fault as “too ordinary to justify a finding of recklessness.”<sup>161</sup> It therefore mixed in a subjective aspect, stating that a person acts recklessly if the person “knows facts that make the risk obvious to another in the person’s situation.”<sup>162</sup> This definition is a hybrid of sorts. It is objective in the sense that it is based on the obviousness to “another” hypothetical person, yet it is subjective because the hypothetical person is placed in the litigant’s situation. A restatement comment explains:

The obviousness requirement . . . does not require that the risk be obvious to all, but rather obvious to others in the actor’s situation. . . . If, for example, the actor is a 10-year-old child, the question is whether the risk is obvious to other actors of the same age. While inexperience and mental disability are ordinarily not taken into account in assessing whether the actor’s conduct is negligent, when the issue is the actor’s recklessness the question to be considered is whether the risk would have been obvious to other beginners or others suffering from a like mental disability.<sup>163</sup>

The Third Restatement’s definition of recklessness adds a significant subjective aspect, but it does not entirely reach the level of a pure subjective standard of awareness of risk because it does not require that the person actually be aware of the risk (or the inference from circumstantial evidence that the litigant must have known). Here again, *Bullock* did not look to the tort restatements’ approach to recklessness because the level of fault was too shal-

<sup>157</sup>*In re Bullock*, 670 F.3d at 1166 (emphasis added).

<sup>158</sup>*Bullock*, 133 S. Ct. at 1759 (remanding the case “to permit the court to determine whether further proceedings are needed and, if so, to apply the heightened standard that we have set forth”).

<sup>159</sup>RESTATEMENT (THIRD) OF TORTS: *Phys. & Emot. Harm* § 2 (2010). The drafters of the Third Restatement described defining recklessness as “especially difficult.” Harvey S. Perlman & Gary T. Schwartz, *General Principles*, 10 KAN J. L. & PUB. POL’Y 8, 10 (2000).

<sup>160</sup>RESTATEMENT (THIRD) OF TORTS: *Phys. & Emot. Harm* § 2 cmt. c (2010).

<sup>161</sup>*Id.* at § 2 cmt. c.

<sup>162</sup>*Id.* at § 2.

<sup>163</sup>*Id.* at § 2 cmt. c.

low—meaning the degree of culpability was not bad enough to forfeit a discharge of debt. The Court turned instead to the criminal law.

iii. The Objective and Subjective Aspects of the Model Penal Code's Definition of Recklessly

The Model Penal Code's definition of recklessly requires both objective and subjective determinations. It defines recklessly as follows:

A person acts recklessly with respect to a material element of an offense when he consciously disregards a substantial and unjustifiable risk that the material element exists or will result from his conduct. The risk must be of such a nature and degree that, considering the nature and purpose of the actor's conduct and the circumstances known to him, its disregard involves a gross deviation from the standard of conduct that a law-abiding person would observe in the actor's situation.<sup>164</sup>

Based on the words “consciously disregards,” “purpose of the actor's conduct,” and “circumstances known to him,” a purely subjective standard applies to whether the debtor was aware of the risk.<sup>165</sup> But a hybrid of objective and subjective standards applies to the determination of whether (i) the risk was substantial and unjustifiable and (ii) its disregard amounted to a gross deviation. The objective aspect derives from the words “substantial and unjustifiable” and the hypothetical “law-abiding person.”<sup>166</sup> The subjective aspect comes from consideration of the actor's conduct in the context of the actor's situation as well as the hypothetical law-abiding person being placed “in the actor's situation.”<sup>167</sup>

2. *Substantial and Unjustifiable Risk*

In order to meet the Model Penal Code's definition of recklessness, a debtor must be aware of a risk that is both “substantial and unjustifiable.”<sup>168</sup> The drafters of the Model Penal Code viewed the attributes of “substantial” and “unjustifiable” as hydraulic-like sliding factors, explaining that “less substantial risks might suffice for liability if there is no pretense of any justifica-

---

<sup>164</sup>MODEL PENAL CODE § 2.02(2)(c) (1962).

<sup>165</sup>Robin Charlow, *Wilful Ignorance and Criminal Culpability*, 70 TEX. L. REV. 1351, 1380 (1992) (stating “[i]n the case of recklessness, the actor must be subjectively aware of the risk he faces, but the substantiality, unjustifiability, or possibility of the risk, whichever is required, is objectively measured”); *but see* Treiman, *supra* note 120, at 328-334 (stating “[r]ecklessness is more complex because it has both subjective (conscious disregard or aware of and consciously disregards) and objective (substantial and unjustifiable risk, gross deviation from the standard of conduct of a law-abiding/reasonable person) aspects”).

<sup>166</sup>MODEL PENAL CODE § 2.02(2)(c) (1962).

<sup>167</sup>*Id.*

<sup>168</sup>*Id.*

tion for running the risk.”<sup>169</sup>

i. Substantial Risk

The requirement that the risk be “substantial” involves both the probability and significance of the risk. As to probability, the Model Penal Code requires something less than “practical certainty.”<sup>170</sup> As for the significance of the risk, one author suggested that the requirement of substantiality might serve to exclude “de minimis violations of the law.”<sup>171</sup> In the civil fiduciary context, this could be analogized to minor or immaterial breaches of fiduciary duties.

One court explained the mixture of probability and significance (or magnitude) of risk as follows:

A risk does not have to be “more likely than not to occur” or “probable” in order to be substantial. A risk may be substantial even if the chance that the harm will occur is well below fifty percent. Some risks may be substantial even if they carry a low degree of probability because the magnitude of the harm is potentially great. For example, if a person holds a revolver with a single bullet in one of the chambers, points the gun at another’s head and pulls the trigger, then the risk of death is substantial even though the odds that death will result are no better than one in six. . . . Conversely, a relatively high probability that a very minor harm will occur probably does not involve a “substantial” risk. Thus, in order to determine whether a risk is substantial, the court must consider both the likelihood that harm will occur and the magnitude of potential harm, mindful that a risk may be “substantial” even if the odds of the harm occurring are lower than fifty percent.<sup>172</sup>

Turning to the bankruptcy context, the *Bullock* Court focused on the risk that a debtor’s “conduct will turn out to violate a fiduciary duty.”<sup>173</sup> In making this determination, courts should consider the probability that the fiduciary debtor’s conduct will violate a fiduciary duty and the significance or magnitude of the pertinent fiduciary duty. This analysis focuses on how substantial the risk was. It is different than the threshold question of whether a

---

<sup>169</sup>MODEL PENAL CODE AND COMMENTARIES § 2.02 cmt. 3 (Am. Law Inst. 1985).

<sup>170</sup>Compare the definitions of knowledge and recklessly. MODEL PENAL CODE §§ 2.02(2)(b)(ii) and 2.02(2)(c) (1962).

<sup>171</sup>Treiman, *supra* note 120, at 337-338.

<sup>172</sup>*People v. Hall*, 999 P.2d 207, 217-218 (Colo. 2000) (involving criminal case under a statute that adopted the Model Penal Code’s definition of recklessly) (internal citations omitted).

<sup>173</sup>*Bullock*, 133 S. Ct. at 1759.

debtor was acting “in a fiduciary capacity”<sup>174</sup> under § 523(a)(4) at the time of the defalcation.

## ii. Unjustifiable Risk

In a criminal context, a risk is unjustifiable when “the social costs outweigh the benefits of the risk.”<sup>175</sup> “To determine whether a risk is justifiable one must balance the potential harm against the potential gain.”<sup>176</sup> The Model Penal Code contains many examples of justifiable<sup>177</sup> risks, such as necessity,<sup>178</sup> use of force in self-protection,<sup>179</sup> use of force in law enforcement,<sup>180</sup> and possibly consent.<sup>181</sup>

In a fiduciary debtor context, justifiability could include factors such as the interests of the beneficiaries of the relevant fiduciary duty, whether the debtor’s motive in disregarding the risk related to a proper purpose (such as furthering the interests of the beneficiaries as opposed to self-dealing), and whether the beneficiaries of the fiduciary duty consented to the fiduciary debtor’s conduct.

## iii. The Nature and Degree of the Risk

The Model Penal Code’s definition of recklessly contains several considerations in connection with evaluation of the risk. The first is the nature of the actor’s conduct.<sup>182</sup> This consideration requires the actor’s conduct be identified so that it can be compared to the “standard of conduct that a law-abiding person would observe in the actor’s situation.”<sup>183</sup> The second consideration is the purpose of the actor’s conduct.<sup>184</sup> Under the comments, “[e]ven substantial risks, it is clear, may be created without recklessness when the actor is seeking to serve a proper purpose, as when a surgeon performs an operation that he knows is very likely to be fatal but reasonably thinks to be necessary because the patient has no other, safer chance.”<sup>185</sup> The

<sup>174</sup>11 U.S.C. § 523(a)(4).

<sup>175</sup>G. FLETCHER, *RETHINKING CRIMINAL LAW*, § 4.3, p. 261 (1978).

<sup>176</sup>Treiman, *supra* note 120, at 334 (arguing that consideration of factors utilized to determine unreasonableness of risk contained in the Restatement (Second) of Torts should be appropriate for determination of whether a risk is unjustifiable).

<sup>177</sup>MARKUS D. DUBBER, *CRIMINAL LAW MODEL PENAL CODE*, 186 (Foundation Press 2002).

<sup>178</sup>MODEL PENAL CODE § 3.02(1)(a) (1962) (stating “[c]onduct which the actor believes to be necessary to avoid a harm or evil to himself or to another is justifiable, provided that the harm or evil sought to be avoided by such conduct is greater than that sought to be prevented by the law defining the offense charged. . .”).

<sup>179</sup>*Id.* at § 3.04(1).

<sup>180</sup>*Id.* at § 3.07(1).

<sup>181</sup>*Id.* at § 2.11(1).

<sup>182</sup>*Id.* at § 2.02(2)(c).

<sup>183</sup>*Id.*

<sup>184</sup>*Id.*

<sup>185</sup>MODEL PENAL CODE AND COMMENTARIES § 2.02 cmt. 3 (Am. Law Inst. 1985).

final consideration is the circumstances known to the actor.<sup>186</sup> Each of these considerations helps ensure there is sufficient culpability associated with the actor's conduct.

### 3. *The Debtor Consciously Disregarded the Risk*

Standing alone, a debtor's awareness of a substantial and unjustifiable risk does not amount to recklessness. The risk must be "consciously disregarded."<sup>187</sup>

#### i. Conscious Disregard

Acting recklessly is "conscious risk creation."<sup>188</sup> It involves a state of awareness of risk—that is of "a probability less than substantially certainty."<sup>189</sup> It is a purely subjective standard.

Awareness of a risk is different than the circumstances known to the actor. "Being aware or conscious of something suggests that the something is in the person's thoughts at the moment."<sup>190</sup> Recklessness "describes a willingness to act in the face of a perceived probability of the existence or creation of a particular fact, circumstance, or result."<sup>191</sup> "[C]onscious disregard should be viewed as requiring a response that the actor makes realizing that it might be inappropriate. Failure to perceive the potential inappropriateness of the response would constitute only negligence."<sup>192</sup> Hence, the Model Penal Code's definition of recklessly excludes from culpability a debtor's inability to be aware of risk, even if a reasonable person in the same situation would have recognized the risk. This heightened mental state ensures a debtor's conduct is bad enough to justify an exception to discharge. If circumstantial evidence is being used to infer that the debtor was actually aware of the risk (conscious of it), the evidence needs to show the debtor "must have known" about the risk.

#### ii. Gross Deviation

"[T]he culpability of disregarding a risk derives from a conscious depar-

<sup>186</sup>MODEL PENAL CODE § 2.02(2)(c) (1962).

<sup>187</sup>MODEL PENAL CODE § 2.02(2)(c) (1962).

<sup>188</sup>MODEL PENAL CODE AND COMMENTARIES § 2.02 cmt. 3 (Am. Law Inst. 1985).

<sup>189</sup>*Id.*

<sup>190</sup>Treiman, *supra* note 120, at 334 ("Knowledge, on the other hand, may be in a person's conscious thoughts, or may be something tucked away in the person's memory. Obviously we all have considerably more knowledge than we have in our conscious thoughts at any moment. We may know something without being currently aware or conscious of the fact or idea. . . . Since the *Model Penal Code* concept of recklessness utilizes awareness rather than knowledge of the risk, this would appear to exclude the situation in which the actor had knowledge of a risk, but was not aware of it at the moment. Having knowledge of a risk involved in specific conduct, but not being aware of the risk at the moment, that is, not stopping to think of the consequences, may be negligent but it is not reckless").

<sup>191</sup>Ira P. Robbins, *The Ostrich Instruction: Deliberate Ignorance as a Criminal Mens Rea*, 81 CRIM. L. & CRIMINOLOGY 191, 221-222 (1990).

<sup>192</sup>Treiman, *supra* note 120, at 371.

ture from a level of legally permissible risk-taking.”<sup>193</sup> The disregard must be “a gross deviation from the standard of conduct that a law-abiding person would observe in the actor’s situation.”<sup>194</sup> The comparison of the actor’s conduct to a law-abiding person is a question of fact. The comments explain:

[T]he jury must evaluate the actor’s conduct and determine whether it should be condemned. The [Model Penal] Code proposes, therefore, that this difficulty be accepted frankly, and that the jury be asked to measure the substantiality and unjustifiability of the risk by asking whether its disregard, given the actor’s perceptions, involved a gross deviation from the standard of conduct that a law-abiding person in the actor’s situation would observe.<sup>195</sup>

The Model Penal Code does not provide a definition for “gross deviation.” State courts have defined it as a “great or substantial deviation, not just a slight or moderate deviation”<sup>196</sup> and more than “a deviation that was simply unreasonable or thoughtless.”<sup>197</sup> Montana statutorily defines the term “gross-deviation” in its definition of criminal negligence as “a deviation that is considerably greater than lack of ordinary care.”<sup>198</sup> One scholar described the difference between an ordinary deviation and a gross deviation as representing “a value judgment which cannot be reduced to a legal formula.”<sup>199</sup> In a fiduciary context, in order to amount to a gross deviation, the fiduciary debtor’s conduct should be beyond a simple breach of a trustee’s duty of prudent administration<sup>200</sup> and a reasonable exercise of a trustee’s discretionary powers.

### iii. Law-Abiding Person

In a criminal law context, the comparison to a hypothetical “law-abiding” person makes sense. It is the criminal law’s equivalent<sup>201</sup> to a reasonable person from tort law. One scholar believes “[i]t is unlikely that there is any

<sup>193</sup>G. FLETCHER, *RETHINKING CRIMINAL LAW*, § 4.3, p. 261 (1978).

<sup>194</sup>MODEL PENAL CODE § 2.02(2)(c) (1962).

<sup>195</sup>MODEL PENAL CODE AND COMMENTARIES § 2.02 cmt. 3 (Am. Law Inst. 1985).

<sup>196</sup>State v. Garcia, 838 A.2d 1064, 1075 (Conn. App. 2004).

<sup>197</sup>State v. Littlefield, 876 A.2d 712, 728 (N.H. 2005).

<sup>198</sup>MONT. CODE ANN. § 45-2-101(43) (2011).

<sup>199</sup>Treiman, *supra* note 120, at 350 (stating “whether a conscious disregard of a risk is a gross deviation from a legal norm is a question of fact for the jury”).

<sup>200</sup>Uniform Trust Code, drafted by the National Conference of Commissioners on Uniform State Laws, § 804 (last revised or amended in 2010) (“A trustee shall administer the trust as a prudent person would, by considering the purposes, terms, distributional requirements, and other circumstances of the trust. In satisfying this standard, the trustee shall exercise reasonable care, skill, and caution.”)

<sup>201</sup>Actually, the Model Penal Code’s definition of “negligently” also makes the gross deviation comparison to a “reasonable person.” MODEL PENAL CODE § 2.02(2)(d) (1962).

remaining practical significance to this variation.”<sup>202</sup> Another scholar claims the difference is that the culpability for recklessness derives from a “choice to violate a legal imperative”<sup>203</sup> but culpability for negligence follows “the failure to meet reasonable standards of attentiveness.”<sup>204</sup>

A law-abiding person is one who knows the law and complies with it. As for knowledge of the law, the maxim “ignorance of the law is no excuse”<sup>205</sup> is a familiar concept<sup>206</sup> and “[n]o doctrine is more universal or of more ancient vintage in the law than that ignorance of the law excuses no one.”<sup>207</sup> It is commonly applied in a criminal context<sup>208</sup> but rarely in one that is civil.<sup>209</sup> The basic proposition is that knowledge of the law defining an offense is often not itself an element of the offense.<sup>210</sup> In other words, it does not matter if an actor is not aware of the law that sets forth the definition of the crime in question.<sup>211</sup>

There are strong policy grounds supporting the rule in criminal law. If all

<sup>202</sup>Treiman, *supra* note 120, at 334 (noting “[o]nly two states, Hawaii and New Hampshire, have retained the term law-abiding for recklessness, and Hawaii eliminated the difference between recklessness and negligence by using the term law-abiding for both. Every other state has eliminated the difference between recklessness and negligence”).

<sup>203</sup>G. FLETCHER, *RETHINKING CRIMINAL LAW*, 262, (1978).

<sup>204</sup>*Id.*

<sup>205</sup>Black’s Dictionary provides that the legal maxim “*Ignorantia juris non excusat*” means ignorance of the law does not excuse.

<sup>206</sup>*Lambert v. People of the State of California*, 355 U.S. 225, 228 (1957) (stating “[t]he rule that ‘ignorance of the law will not excuse’ is deep in our law. . . .”)

<sup>207</sup>*People v. Bowman*, 320 P.2d 70, 77 (Cal. App. 1958).

<sup>208</sup>*Cheek v. U.S.*, 498 U.S. 192, 199 (1991) (stating “[t]he general rule that ignorance of the law or a mistake of law is no defense to criminal prosecution is deeply rooted in the American legal system”).

<sup>209</sup>*Frank P. Randazzo v. Harris Bank Palatine, N.A.*, 262 F.3d 663, 667 (7th Cir. 2001) (stating that “[a]lthough the principle that ‘ignorance of the law is no excuse’ has been unquestioned in Anglo-American criminal jurisprudence, the development of an analogous principle in civil matters always has been subject to more limitations because of the development of equitable principles in chancery practice.”); Robert A. Prentice, *Clinical Trial Results, Physicians, and Insider Trading*, 20 J. LEGAL MED. 195, 201-202 (1999) (stating “[g]iven that ignorance of the law is no excuse, simple lack of knowledge about the particulars of insider trading law generally is not an excuse in an insider trading civil or criminal action. The law is clear that the SEC, in a civil case, or the Department of Justice, in a criminal case, need not show that insider trading defendants specifically intended to violate the law.”); *Longe v. Boise Cascade Corp.*, 762 A.2d 1248, 1258 (Vt. 2000) (holding employer had no duty to ensure employee understood his rights under Vermont’s workers’ compensation statute).

<sup>210</sup>Model Penal Code § 2.02(2)(9) and explanatory note (stating “[n]either knowledge nor recklessness or negligence as to whether conduct constitutes an offense or as to the existence, meaning or application of the law determining the elements of an offense is an element of such offense, unless the definition of the offense or the Code so provide”).

<sup>211</sup>Comment 11 explains: “The proper arena for the principle that ignorance or mistake of law does not afford an excuse is thus with respect to the particular law that sets forth the definition of the crime in question. It is knowledge of *that* law that is normally not a part of the crime, and it is ignorance or mistake as to *that* law that is denied defensive significance by this subsection of the Code and by the traditional common law approach to the issue.” MODEL PENAL CODE AND COMMENTARIES § 2.02 cmt. 11 (Am. Law Inst. 1985) (emphasis in original).

defendants were entitled to raise ignorance of the law as a defense, it would become a shield for the guilty because an inquiry into whether a defendant was at fault in his ignorance would be too complicated and difficult.<sup>212</sup> Rational enforcement and publication of law contribute to voluntary compliance, which leads to a more ordered society.<sup>213</sup> Society must presume such knowledge for an ordered state.<sup>214</sup> The rule also encourages individuals to learn their obligations.<sup>215</sup>

In the Model Penal Code's definition of recklessly, the comparison is between the actor's conduct and the conduct that a hypothetical law-abiding person "would observe in the actor's situation."<sup>216</sup> In a defalcation analysis under *Bullock*, comparing to a "law-abiding person" is problematic because the context is the civil law of fiduciaries, not the criminal law. Unlike the criminal law, where knowledge of the law is constructively imposed, a fiduciary debtor having civil fiduciary duties may not be deemed to know those duties and may in fact be unaware of the entire scope of such duties. Even where constructive knowledge of fiduciary duties is imposed,<sup>217</sup> *Bullock*'s new standard requiring the debtor have subjective awareness of the risk changes the law and would preclude the imposition of constructive knowledge of fiduciary duties (because that would result in an objective "should have known" standard).

As for the meaning of a "law-abiding person"—on one hand, "the standard of conduct that a law-abiding person would observe in the actor's situation"<sup>218</sup> could be equivalent to what a perfect fiduciary would do. That is, a "law-abiding person" is interpreted to mean a fiduciary debtor whose conduct is fully compliant with the technical letter of all applicable fiduciary duties

<sup>212</sup>WAYNE R. LAFAVE, *SUBSTANTIVE CRIMINAL LAW* § 5.6(d) (2d. ed.); Livingston Hall & Selig J. Seligman, *Mistake of Law and Mens Rea*, 8 U. CHI. L. REV. 641, 646-648 (1941) (observing that administration of justice would be virtually impossible).

<sup>213</sup>Mark D. Yochum, *The Death of a Maxim: Ignorance of Law Is No Excuse (Killed By Money, Guns and a Little Sex) "Ignorance of the Law Excuses No Man; Not that All Men Know the Law, But Because It's An Excuse Every Man Will Plead, and No Man Can Tell How To Refute Him,"* 13 ST. JOHN'S J. LEGAL COMMENT, 635, 638 (1999).

<sup>214</sup>*Id.* at 638 (citing OLIVER WENDELL HOLMES, *THE COMMON LAW* 48 (Little, Brown, and Co. 1909 (1881))).

<sup>215</sup>WAYNE R. LAFAVE, *SUBSTANTIVE CRIMINAL LAW* § 5.6(d) (2d. ed.) (stating "conviction of defendants for violation of new or forgotten criminal laws serves to bring home to the general public the existence of the rules and aids in establishing them as the social mores of the community").

<sup>216</sup>MODEL PENAL CODE § 2.02(2)(c) (1962).

<sup>217</sup>*In re Storie*, 216 B.R. at 287 (stating "[c]ourts also agree that fiduciaries are charged with knowledge of their duties and of applicable law, and that a subjective intent to breach a fiduciary duty or a law is irrelevant. . . . The requirement that a fiduciary be charged with knowledge of his or her duties and of the law 'prevents ignorance of the law from becoming a defense to nondischargeability and provides an incentive for individuals . . . who are engaged in occupations subject to special statutes to apprise themselves of their obligations under the law').

<sup>218</sup>MODEL PENAL CODE § 2.02(2)(c) (1962).

(including those duties imposed by private agreements). The concern with equating “law-abiding person” with a “perfect fiduciary” is that the recklessly test is measuring whether there is a “gross deviation” or difference between the fiduciary debtor’s disregard and the standard of conduct that a law-abiding person would observe in the actor’s situation. If “law-abiding person” is interpreted to mean a “perfect fiduciary,” it would make a finding of gross deviation more likely because it furthers the distance between the fiduciary debtor’s actual conduct compared to a level of perfect compliance (making the difference in conduct greater because the comparison bar is being set at the highest level).

On the other hand, equating a “law-abiding person” to a “reasonable fiduciary” would ratchet up the level of culpability necessary to constitute a gross deviation, because the starting point for the comparison of whether there was a gross deviation would be something short of perfect compliance. The bankruptcy policy of protecting a debtor’s fresh start and ensuring sufficiently bad conduct to lose a discharge favor the interpretation of “law-abiding person” to mean a “reasonable fiduciary.”

C. THE ANALYTICAL PROBLEMS ARISING FROM *BULLOCK*’S  
INFUSION OF “WILLFULLY BLIND” INTO THE MODEL PENAL  
CODE’S DEFINITION OF RECKLESSLY

Assuming there is a substantial and unjustifiable risk but the debtor has not “consciously disregarded” it, there may still be a finding of recklessness based on willful blindness. In reciting the Model Penal Code’s definition of recklessly, *Bullock* inserted a very confusing parenthetical. The Court stated that conduct is reckless “if the fiduciary ‘consciously disregards’ (*or is willfully blind to*) ‘a substantial and unjustifiable risk.’”<sup>219</sup>

The words “willfully blind” are not part of the Model Penal Code’s definition of recklessly.<sup>220</sup> In fact, the words do not appear anywhere in the Model Penal Code. They make a brief appearance in Comment 9 which relates to Model Penal Code Section 2.02(7), which states: “knowledge is established if a person is aware of a high probability of its existence, unless he actually believes that it does not exist.”<sup>221</sup> Comment 9 explains that this provision “deals with the situation that British commentators have denominated ‘wilful blindness’ or ‘connivance,’ the case of the actor who is aware of the probable existence of a material fact but does not determine whether it exists or does not exist.”<sup>222</sup>

*Bullock* gave a head-nod endorsement of the Model Penal Code’s defini-

---

<sup>219</sup>*Bullock*, 133 S. Ct. at 1759 (emphasis added).

<sup>220</sup>MODEL PENAL CODE § 2.02(2)(c) (1962).

<sup>221</sup>*Id.* at § 2.02(7).

<sup>222</sup>MODEL PENAL CODE AND COMMENTARIES § 2.02 cmt. 9 (Am. Law Inst. 1985).

tion by citing Comment 9 and parenthetically noting that “the Model Penal Code’s definition of ‘knowledge’ was designed to include ‘wilful blindness.’”<sup>223</sup> This phraseology is odd, because in a criminal context, the question is more commonly about whether willful blindness can substitute for a statutory requirement of knowledge, not whether knowledge encompasses willful blindness.

Although there has been a debate by both scholars<sup>224</sup> and courts<sup>225</sup> on whether “willful blindness” can substitute for knowledge, the Supreme Court resolved the uncertainty in *Global-Tech Appliances, Inc. v. SEB S.A.*<sup>226</sup> holding in a patent infringement case that willful blindness can substitute for a statutory requirement of knowledge.<sup>227</sup>

Comment 9 to the Model Penal Code explains that willful blindness amounts to knowledge only “when what is involved is a matter of existing fact, but not when what is involved is the result of the defendant’s conduct, necessarily a matter of the future at the time of acting.”<sup>228</sup> *Global-Tech Appliances* maintained this distinction when it prefaced its quotation of Section 2.02(7):

Later, a 1962 proposed draft of the Model Penal Code, which has since become official, attempted to incorporate the doctrine by defining “*knowledge of the existence of a particular fact*” to include a situation in which “a person is aware of a high probability of [the fact’s] existence, unless he actually believes that it does not exist.”<sup>229</sup>

*Global-Tech Appliances* summarized the federal criminal jurisprudence<sup>230</sup>

<sup>223</sup>*Bullock*, 133 S. Ct. at 1759.

<sup>224</sup>Robbins, *supra* note 191, at 195 (arguing willful blindness constitutes recklessness, not knowledge); Charlow, *supra* note 165, at 1429 (arguing formulations of willful blindness describe a mental state that is not as blameworthy as knowledge); ROLLIN M. PERKINS, CRIMINAL LAW 776 (2d ed. 1969) (stating a person who deliberately shuts his eyes to avoid knowing what would otherwise be obvious is treated as having “knowledge” of the facts as they are ultimately discovered to be); GLANVILLE WILLIAMS, CRIMINAL LAW, THE GENERAL PART § 57 at 159 (2d ed. 1961) (stating “[t]he rule of willful blindness is equivalent to knowledge is essential, and is found throughout the criminal law”).

<sup>225</sup>*United States v. Jewell*, 532 F.2d 697, 700 (9th Cir. 1976) (holding that knowingly includes a mental state in which the defendant is aware that the fact in question is highly probable but consciously avoids enlightenment); *United States v. Craig*, 178 F.3d 891, 896 (7th Cir. 1999) (equating actual knowledge with the deliberate avoidance of knowledge).

<sup>226</sup>*Global-Tech Appliances, Inc. v. SEB S.A.*, 131 S. Ct. 2060 (2011) (applying a federal statute on induced infringement of a patent that required knowledge).

<sup>227</sup>*Id.* at 2068.

<sup>228</sup>MODEL PENAL CODE AND COMMENTARIES § 2.02 cmt. 9 (Am. Law Inst. 1985).

<sup>229</sup>*Global-Tech Appliances, Inc.*, 131 S. Ct. at 2069 (emphasis added).

<sup>230</sup>*Id.* (stating that “every Court of Appeals—with the possible exception of the District of Columbia Circuit, . . . has fully embraced willful blindness, applying the doctrine to a wide range of criminal statutes,” and explaining that “[g]iven the long history of willful blindness and its wide acceptance in the

and held that willful blindness requires that: “(1) the defendant must subjectively believe that there is a high probability that a fact exists and (2) the defendant must take deliberate actions to avoid learning of that fact.”<sup>231</sup> *Global-Tech Appliances* then explained how willful blindness is different than recklessness or negligence under the Model Penal Code:

We think these requirements give willful blindness an appropriately limited scope that surpasses recklessness and negligence. Under this formulation, a willfully blind defendant is one who takes deliberate actions to avoid confirming a high probability of wrongdoing and who can almost be said to have actually known the critical facts. By contrast, a reckless defendant is one who merely knows of a substantial and unjustified risk of such wrongdoing, and a negligent defendant is one who should have known of a similar risk but, in fact, did not.<sup>232</sup>

*Global-Tech Appliances* provides a clear test for willful blindness when it comes to the existence of a particular fact. The analysis gets a little muddled when one wonders if *Bullock*'s risk “that his conduct will turn out to violate a fiduciary duty”<sup>233</sup> relates to “the existence of a particular fact”<sup>234</sup> or is “a result of the defendant’s conduct, necessarily a matter of the future at the time of acting.”<sup>235</sup>

The difficult question is how to reconcile *Bullock*'s insertion of “willfully blind”<sup>236</sup> in the middle of the Model Penal Code’s recklessly definition when the Court has previously held in *Global-Tech Appliances* that it is not recklessness. *Bullock* stated, “[W]e consider conduct as equivalent if the fiduciary ‘consciously disregards’ (or is willfully blind to) ‘a substantial and unjustifiable risk’ that his conduct will turn out to violate a fiduciary duty.”<sup>237</sup> The context<sup>238</sup> and location<sup>239</sup> of *Bullock*'s embedding of “willfully blind” suggests it is an alternative to the “conscious disregard” requirement of recklessness, not a wholesale substitute of willful blindness as a stand-alone test for defalcation. So under *Bullock*, willful blindness cannot be substituted for reckless-

---

Federal Judiciary, we can see no reason why the doctrine should not apply in civil lawsuits for induced patent infringement”).

<sup>231</sup>*Id.* at 2070.

<sup>232</sup>*Id.* at 2070-2071 (emphasis added).

<sup>233</sup>*Bullock*, 133 S. Ct. at 1759.

<sup>234</sup>MODEL PENAL CODE AND COMMENTARIES § 2.02 cmt. 9 (Am. Law Inst. 1985).

<sup>235</sup>*Id.*

<sup>236</sup>*Bullock*, 133 S. Ct. at 1759.

<sup>237</sup>*Id.*

<sup>238</sup>*Bullock* used a parenthetical and the conjunction “or” to introduce the terms “willfully blind.”

<sup>239</sup>*Bullock* placed the parenthetical “willfully blind” directly after the “consciously disregards” portion of the Model Penal Code’s recklessly definition.

ness as a whole. It can only replace the “conscious disregard” element of recklessness.

Implanting “willfully blind” as an alternate to “consciously disregard” causes analytical problems. Recklessly’s “conscious disregard” is about awareness of risk, “that is of a probability less than substantial certainty.”<sup>240</sup> Willful blindness on the other hand, requires a person be aware of a “high probability that a fact exists.”<sup>241</sup> Both recklessness and willful blindness involve awareness, but the subject of the awareness is different. The focus of willful blindness under the Model Penal Code is on how certain a person is about a fact.<sup>242</sup> A fact may be different than a risk. Moreover, *Bullock* stated that reckless conduct includes a fiduciary being willfully blind to a substantial and unjustifiable risk.<sup>243</sup> Taken literally, this results in seemingly unworkable<sup>244</sup> criteria that requires a high probability<sup>245</sup> of a probability less than substantial certainty.<sup>246</sup>

For example, “if there is no social utility in doing what he is doing, one might be reckless though the chances of harm are something less than 1%.”<sup>247</sup> Yet, “‘high probability’ entails well over a 51% chance of harm.”<sup>248</sup> In addition, a mistaken belief may negate culpability under willful blindness but not under recklessness.<sup>249</sup> It is also unclear how the two elements of willful blindness interact with the requirements of recklessness, such as the balancing of potential harm and gain.

Despite these abstract analytical difficulties, the new test from *Bullock* is what it is. Perhaps the best solution is to interpret *Bullock* as modifying the requirements of willful blindness from focusing on a fact to a risk. Hence, as adapted by *Bullock*, willful blindness requires a debtor to (a) subjectively believe that there was a high probability that a substantial and unjustifiable risk existed, and (b) take deliberate actions to avoid learning of that risk. These

<sup>240</sup>MODEL PENAL CODE AND COMMENTARIES § 2.02 cmt. 3 (Am. Law Inst. 1985).

<sup>241</sup>*Global-Tech Appliances, Inc.*, 121 S. Ct. at 2069. See also MODEL PENAL CODE § 2.02(7) (1962).

<sup>242</sup>David Luban, *Contrived Ignorance*, 87 GEO. L.J. 957, 962 (1999).

<sup>243</sup>*Bullock*, 133 S. Ct. at 1759.

<sup>244</sup>It seems to create some type of quasi-conditional probability.

<sup>245</sup>The “high probability” of the existence of a fact comes from Section 2.02(7) of the Model Penal Code and the *Global-Tech Appliances* case.

<sup>246</sup>The “probability less than substantial certainty” derives from Comment 3 to Section 2.02 of the Model Penal Code.

<sup>247</sup>WAYNE R. LEFAVE, CRIMINAL LAW § 5.4(f) at 285 (5th ed. 2010).

<sup>248</sup>Jonathan L. Marcus, *Model Penal Code Section 2.02(7) and Willful Blindness*, 102 YALE L. J. 2231, 2239-2240 (1993).

<sup>249</sup>*Id.* (“For example, consider the actor who believes the gun she points at her friend is empty (because her parents told her that the gun was rarely loaded) and is shocked when the gun fires as she pulls the trigger. This actor could not be convicted of knowingly shooting her friend, because she was not aware of a high probability that the gun was loaded and she actually believed the gun to be empty. On the other hand, she could be convicted for recklessness because she consciously disregarded a substantial and unjustifiable risk that the gun was loaded.”).

adapted willful blindness requirements may be substituted for a debtor's subjective awareness and disregard of a substantial and unjustifiable risk.

As to the first requirement of willful blindness, criminal courts have held that a high probability may be proven by evidence demonstrating either that the defendant suspected the risk, that the circumstances indicate that he was aware of the risk, or spoke to another about the likelihood of the risk.<sup>250</sup>

Criminal courts have determined that the second requirement of willful blindness may be satisfied by evidence of "overt physical acts" or "purely psychological avoidance."<sup>251</sup> Overt physical acts would include efforts by a debtor to "insulate himself from the [substantial and unjustifiable risk] so that he could deny knowledge of it"<sup>252</sup> and "purposely contriv[ing] to avoid learning all of the facts in order to have a defense in the event of a subsequent prosecution."<sup>253</sup> Thus, an overt physical act requires "evidence the [debtor] physically acted to avoid knowledge."<sup>254</sup> Psychological avoidance involves the "cutting off of [the debtor's] normal curiosity by an effort of will"<sup>255</sup> such as "consciously refus[ing] to take basic investigatory steps."<sup>256</sup>

#### D. ADDITIONAL IMPLICATIONS THAT MAY ARISE FROM BULLOCK

Two unrelated additional implications from *Bullock* may arise. First, in jurisdictions that historically did not require a specific mental state for a defalcation, the heightened mental standard from *Bullock* may make it difficult for creditor/plaintiffs to prevail on summary judgment in adversary proceedings alleging nondischargeability due to defalcation.<sup>257</sup>

Second, *Bullock*'s new standard also may have created a heightened pleading requirement. In addition to the general requirement that a plaintiff must plead sufficient facts,<sup>258</sup> allegations of fraud or mistake require the plaintiff to

<sup>250</sup>United States v. Yi, 704 F.3d 800, 805 (9th Cir. 2013); U.S. S.E.C. v. Big Apple Consulting USA, Inc., No. 6:09-cv-1963-Orl-28GJK, 2012 WL 3264512, p. 4. (M.D. Fla. Aug. 9, 2012).

<sup>251</sup>Yvonne Lee, *Global-Tech Appliances, Inc. v. SEB S.A.: Discovering Willfully Blind Territory in Induced Patent Infringement*, 27 BERKELEY TECH. L.J. 325, 339, (2012).

<sup>252</sup>United States v. Diaz, 864 F.2d 544, 551 (7th Cir. 1988).

<sup>253</sup>United States v. Brandon, 17 F.3d 409, 452 (1st Cir. 1994) (citing United States v. Rivera, 944 F.2d 1563, 1571 (11th Cir. 1991)).

<sup>254</sup>United States v. Carrillo, 435 F.3d 767, 780 (7th Cir. 2006).

<sup>255</sup>*Id.*

<sup>256</sup>United States v. St. Michael's Credit Union, 880 F.2d 579, 585 (1st Cir. 1989).

<sup>257</sup>First American Title Insurance Company v. Moses (*In re Moses*), No. 10-51769-ess, 2013 WL 3804721 (Bankr. E.D. N.Y. July 19, 2013) (holding there was a dispute of material fact on whether the debtor carried out his professional activities with the required culpable state of mind); Neff v. Akbari-Shahmirzadi, (*In re Akbari-Shahmirzadi*), No. 7-11-15351, 2013 WL 3300056 (Bankr. D. New Mexico July 1, 2013) (holding there were material disputed facts about defendant's state of mind).

<sup>258</sup>FED. R. BANKR. P. 7008 (incorporating Rule 8 of the Federal Rules of Civil Procedure); Bell Atlantic Corp. v. Twombly, 550 U.S. 544, 570 (2007) (stating the plaintiff must provide "enough facts to state a claim to relief that is plausible on its face"); Ashcroft v. Iqbal, 556 U.S. 662, 664 (2009) (stating that "[a] court considering a motion to dismiss may begin by identifying allegations that, because they are mere

“state with particularity the circumstances constituting fraud or mistake.”<sup>259</sup> In jurisdictions that treat breach of a fiduciary duty by self-dealing as being in the nature of fraud,<sup>260</sup> such a breach may trigger the heightened pleading requirement. Even if *Bullock*’s new standard is not deemed to trigger the particularity requirement for fraud, plaintiffs should be careful in wording defalcation averments.<sup>261</sup> For example, alleging that a fiduciary debtor “knew or should have known” or “recognized or should have recognized” creates a risk that the claim may be dismissed.<sup>262</sup> As explained earlier, the new test under *Bullock* adopts subjective and objective standards that apply to specific elements of defalcation. Making an objective “should have known” allegation for a subjective “knew or must have known” element could result in a dismissal of the claim.

#### E. THE NEW ANALYTICAL STRUCTURE OF DETERMINING DEFALCATION WHILE ACTING IN A FIDUCIARY CAPACITY

The new analytical approach to determining whether a debt is for defalcation while acting in a fiduciary capacity under § 523(a)(4) has several steps. The pitfalls identified in this Article can be avoided by methodically analyzing each step separately and making reasonable adaptations where criminal law and fiduciary law differ. Under *Bullock*, defalcation requires:

- (1) the debtor be acting in a certain type<sup>263</sup> of “fiduciary capacity” under § 523(a)(4).
- (2) According to the Supreme Court’s 1934 decision in *Davis v. Aetna Acceptance Co.*, the debtor must be acting in the fiduciary capacity “before the wrong and without reference thereto.”<sup>264</sup> The “wrong” is the violation of the fiduciary duty.

---

conclusions, are not entitled to the assumption of truth. While legal conclusions can provide the complaint’s framework, they must be supported by factual allegations”).

<sup>259</sup>FED. R. BANKR. P. 7009 (incorporating Rule 9(b) of the Federal Rules of Civil Procedure).

<sup>260</sup>*Maksym v. Loesch*, 937 F.2d 1237, 1241 (7th Cir. 1991) (“self-dealing in the course of a fiduciary relationship is . . . a form of fraud”).

<sup>261</sup>Unlike many of the other exceptions to discharge in § 523(a), debts that would otherwise be non-dischargeable under § 523(a)(4) are automatically discharged unless a creditor specifically requests the court determine the dischargeability of the debt. 11 U.S.C. § 523(c). The determination is made in an adversary proceeding and Bankruptcy Rule 4007(c) requires a complaint be filed no later than sixty days after the first date set for the meeting of creditors. FED. R. BANKR. P. 4007(c), 4007(e) and 7001(6).

<sup>262</sup>*Vasudevan Software Inc. v. Tibco Software, Inc.*, No. C 11-06638 RS, 2012 WL 1831543 (N.D. Cal. May 18, 2012).

<sup>263</sup>See Part II, Section B.

<sup>264</sup>*Davis*, 293 U.S. at 331, (quoting Bankruptcy Act of 1898, § 17, 30 Stat. 544, 550, formerly codified at 11 U.S.C. § 35 (repealed 1978)) (interpreting a predecessor to the current Bankruptcy Code that stated: “A discharge in bankruptcy shall release a bankrupt from all his provable debts, except such as . . . were created by his fraud, embezzlement, misappropriation, or defalcation while acting as an officer or in any fiduciary capacity.”)

- (3) Using an objective standard, there must be a “substantial and unjustified” risk that a fiduciary duty would be violated. Substantiality involves both the probability and significance of the risk. Justifiability looks at the propriety of the risk. This evaluation has subjective aspects because it also considers the nature of the debtor’s conduct, the purpose of the debtor’s conduct, and the circumstances known to the debtor.
- (4) Using a subjective standard, the debtor must have consciously disregarded the risk. Conscious disregard requires proof that the debtor had an actual awareness of the risk or circumstantial evidence inferring the debtor must have been aware of the risk. Disregard can be evaluated by considering whether the debtor’s conduct was a gross deviation from the standard of conduct that a reasonable fiduciary in the debtor’s situation would have observed. A gross deviation involves conduct that is beyond a simple breach of a trustee’s duty of prudent administration and a reasonable exercise of a trustee’s discretionary powers.
- (5) Finally, if there is no conscious disregard, the debtor must have been willfully blind to the substantial and unjustifiable risk. This requires a debtor to (a) subjectively believe that there was a high probability that a substantial and unjustifiable risk existed, and (b) take deliberate actions to avoid learning of that risk.

#### IV. CONCLUSION

*Bullock* resolved the circuit split and set forth the minimum culpability required by a fiduciary debtor to make a debt nondischargeable. The heightened “recklessly” standard makes it likely that courts will find more and more debts arising from a debtor’s breach of fiduciary duty to be dischargeable, and furthers the bankruptcy policy of providing debtors with a fresh start. But using the Model Penal Code’s “recklessly” definition is awkward in a civil fiduciary context. Courts must take care to ensure that they break down the elements of *Bullock*’s “recklessly” standard into the corresponding objective and subjective parts. They should also exercise caution in applying the “willful blindness” standard as a substitute for “conscious disregard.” If the “willful blindness” standard is used, courts should modify it to focus on risk. Courts may avoid the pitfalls of the *Bullock* “recklessly” standard by following the analytical framework suggested in this Article. Without using such a

methodical approach, courts will risk inconsistent and unpredictable application of the defalcation exception to discharge.

