

11 U.S.C. § 541(d)  
O.R.S. 20.096  
Agency  
Constructive trust  
Equitable lien

National Warranty Corporation v. Williams/Wilson Dodge Subaru, Inc.,  
Adv. No. 690-6019

National Warranty Corporation v. Williams/Wilson Automobiles, Inc.,  
Adv. No. 690-6025

1/8/91

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unpublished

In consolidated adversary proceedings, National Warranty Corp. (NWC) sought imposition of an equitable lien or constructive trust on funds received by debtors (two related car dealerships) from purchasers of extended warranty contracts. NWC alleged debtors were its agents in selling its warranty contracts who breached their fiduciary duty to turn over proceeds from the sale of NWC's contracts.

The court refused to impose a constructive trust under state law, ruling that agreements between the debtors and NWC created no agency relationship but merely evidenced a typical debtor-creditor relationship (NWC was not liable for performance on the warranty contracts executed between debtors and their customers). Further, Ninth Circuit bankruptcy law prohibits recognition of a constructive trust where the funds sought are commingled in a general fund and cannot be traced. Attorney fees were awarded to debtors under contract language allowing fees to the prevailing party in "any legal proceeding . . . interpreting or enforcing the agreements".

E91-1(10)

UNITED STATES BANKRUPTCY COURT  
FOR THE DISTRICT OF OREGON

IN RE	)	
	)	
NATIONAL WARRANTY CORPORATION,	)	
	)	
Plaintiff,	)	
vs.	)	Adversary No. 690-6019-H
	)	
WILLIAMS/WILSON DODGE SUBARU,	)	
INC.,	)	
	)	
Defendant.	)	
_____	)	
NATIONAL WARRANTY CORPORATION,	)	
	)	
Plaintiff,	)	
vs.	)	Adversary No. 690-6025-H
	)	
WILLIAMS/WILSON AUTOMOBILES,	)	
INC.,	)	
	)	
Defendant.	)	MEMORANDUM OPINION
_____	)	

Before the court are cross-motions for summary judgment in two adversary proceedings which the court has consolidated for administrative convenience. Both cases involve related debtors and identical legal issues.

Plaintiff, National Warranty Corp., (hereinafter NWC) seeks a declaration of the rights of the parties with respect to certain funds held by the debtors and a charge against those funds in the form of an

equitable lien on its behalf. The parties rely on their written contracts and affidavits submitted in support of their motions. The facts contained in the affidavits are uncontested. The matter may be determined on the motions.

#### **FACTS**

The parties entered into two contracts, the Administration Agreement and the Dealer Agreement. These contracts contain corresponding language and contemplate that NWC would provide the debtors, owners of several car dealerships, with extended service contract agreements, promotional materials and other forms necessary to promote the sale by the debtors of the service contracts to buyers of new and used cars. In exchange the debtors were to remit a fixed fee to NWC for each approved extended service contract sold. The fixed fee was generally about 60% of the price paid by the car buyer for the extended warranty but could vary as the debtors had sole discretion to determine the price charged to customers and could retain the difference between the price charged and the fee remitted to NWC.

In return for payment of the fixed fee, NWC agreed to administer the extended service contracts for the debtors. From the amount remitted to it NWC established a reserve fund from which to purchase stop loss insurance, pay future claims for repairs of service holders, and provide for its administrative fees. Repairs under the service contracts had to be pre-approved by NWC before it would reimburse the debtors or other authorized mechanics for such services.

At the beginning of each month the debtors would send NWC all the service contracts they had sold during the previous month. Several weeks later NWC would return a billing statement requesting payment of a

specific amount based on the number of warranty contracts it had agreed to administer. The debtors customarily commingled the proceeds from the sale of the customer service contracts in their various bank accounts and used these funds, and others, to pay their bills in the ordinary course of business. The debtors also would remit payment to NWC out of one of their general commingled accounts.

The debtors filed their Chapter 11 petitions on December 19, 1989 and on January 3, 1990. At that time they owed NWC \$21,887 and \$40,465.32, respectively, for warranties sold pre-petition. After filing bankruptcy the debtors remitted no further funds to NWC for extended service contracts sold pre-petition and which NWC had already approved for administration.

It is uncontested that the only cash presently in the debtors' accounts represent proceeds from the post-petition sale of assets, free and clear of liens, or are funds remaining from post-petition financing previously approved by the court.

The extended service contract executed between the debtor and its customers states in part:

"ADMINISTRATOR - \* \* \* The Administrator is not a warrantor or contractor hereunder." (Emphasis added)

\* \* \*

"I. AGREEMENT

"In return for payment \* \* \* the dealer will provide you with the protection described in this service contract." (Emphasis added)

\* \* \*

"II. DEFINITION

"'PARTIES TO THIS AGREEMENT' are YOU and the DEALER.

"'ADMINISTRATOR' means the agency or firm that provides only administrative services to the Dealer. The Administrator does not assume and specifically disclaims any liability to you for any benefits provided herein; the obligations are those of the dealer. The liability of the Administrator

is only with the dealer in accordance with their separate agreement." (Emphasis added)

\* \* \*

"VIII. G. ADMINISTRATOR'S LIABILITY

"The Administrator does not assume any liability to you under this Vehicle Service Contract. Liability is specifically disclaimed. The Administrator's liability is only to us under our separate agreement." (Emphasis added)

Paragraph 8 of the Dealer Agreement between the debtors and NWC states:

"Administrator shall not be liable to perform any [extended service] Contract of, or pay any costs or expenses incurred by Dealer, and Administrator shall not be liable for the quality of any parts or workmanship, nor for bodily injury or property damage claims, nor for any other liability arising from the performance or nonperformance by Dealer of any [extended service] Contract."

**LEGAL ANALYSIS**

Although in its complaint NWC asks the court to charge the funds in the hands of the debtors with an equitable lien on its behalf, through its memorandum in support of its motion for summary judgment NWC argues the debtors hold the funds in constructive trust for it as the debtors were its agent for the purpose of transferring the funds to it from customers; and that pursuant to 11 U.S.C. § 541(d) the court must recognize their equitable interest in those funds.

The existence and nature of the debtor's interests in property are determined by reference to state law. Oregon courts seem to use the terms "equitable lien" and "constructive trust" interchangeably. See generally Mattson v. Commercial Credit Business Loans, Inc., 301 Or. 407, 723 P.2d 996 (1986); Johnson v. Steen, 281 Or. 361, 575 P.2d 141 (1978); Jimenez v. Lee, 274 Or. 457, 547 P.2d 126 (1976); Barnes v. Eastern & Western Lumber Co., 205 Or. 553, 287 P.2d 929 (1955). Based on the analysis presented by the plaintiff in its memorandum, this court will

assume the plaintiff's prayer in its complaint for the imposition of an equitable lien on its behalf is a request that first, the court recognize that under the facts state law would subject the funds at issue to a constructive trust on its behalf and, second, the court find that § 541(d) requires recognition of that constructive trust as part of federal bankruptcy law. The plaintiff's arguments fail on both levels.

A bankruptcy court may impose a constructive trust under certain narrow circumstances. In Oregon a constructive trust is one created by operation of law when one, through abuse of a fiduciary or confidential relationship, or by bad faith, fraud, duress, concealment, undue influence or other unconscionable conduct, has obtained the legal right to hold property, and is unjustly enriched thereby, and ought not, in equity and good conscience, be permitted to hold and enjoy that property. Marston v. Myers, 217 Or. 498, 342 P.2d 1111, 1116-17 (1959); see also Albino v. Albino, 279 Or. 537, 568 P.2d 1344, 1351 (1977). NWC has alleged no bad faith, fraud, duress, concealment, undue influence or other unconscionable conduct on the part of the debtors. Rather, it claims it had a confidential relationship with the debtors who were its agents for the purposes of transferring funds to it from car customers and who breached their duty to act in the best interest of their principal.

Generally, an agent owes a fiduciary duty to its principal to act in the principal's best interest. RESTATEMENT (SECOND) OF AGENCY § 13, at 58. It is conceivable that this fiduciary duty might give rise to a confidential relationship. Thus if this court were to find that the debtors acted as the agent of NWC in executing the extended service

contracts and collecting payments on its behalf, there might be a basis for finding that a constructive trust would be imposed under state law.

In Oregon "[t]he standards for finding an agency relationship include the right of the principal to control the agent's dealings and the principal's responsibility to pay for services provided." Amfac Foods, Inc. v. International Systems & Controls Corp., 52 Or.App. 907, 630 P.2d 868, 874 (1981), rev'd on other grounds, 294 Or. 94, 654 P.2d 1092 (1982). Moreover, "[o]ne of the distinctive functions of an agent, and sometimes called the primary purpose, is to bring his principal into contractual relations with third parties." John I. Haas, Inc. v. Ellis, 227 Or. 170, 180, 361 P.2d 820, 824 (1961). The debtors were not the agents of NWC for the following reasons.

The language of the extended service customer contract and the dealer/administrator contracts provides that they are separate and distinct contracts. In becoming a party to the extended service contracts with customers and collecting payment for those contracts, the dealer did not act on behalf of NWC. NWC, as "administrator" of those contracts, disclaimed all liability to the customer for services under the contract. The debtors in their individual capacity were directly responsible to customers for those services. This independence is reaffirmed by the fact that the debtors were free to charge their customers any amount for the extended service contracts. NWC did not attempt to control the debtors in its handling of the funds paid by customers for the extended service contracts. It placed no restrictions at all on the use or application of the funds in the hands of the debtors. Rather, the debtors were free to mingle these funds in their

general accounts. Thus the funds were not "earmarked" for payment only to NWC.

This court concludes the relationship between the parties was purely contractual, and involved no agency relationship between the debtors and NWC. The debtors' failure to remit funds collected from the sale of extended warranties merely represents a breach of the dealer agreement which would excuse NWC's performance under the administration agreement for those warranty contracts it had agreed to "administer."

Even if this court were to find the relationship between the debtors and NWC supported NWC's demand for imposition of a constructive trust under state law, this court, under federal bankruptcy law, could not impose such a trust. If the trust res consists of funds, the creditor who wishes a bankruptcy court to impose a constructive trust on those funds must demonstrate they have been traced and are identifiable. Matter of Esgro, 645 F.2d 794, 797 (9th Cir. 1981), citing Elliot v. Bumb, 356 F.2d 749, 754 (9th Cir.), cert. denied, 385 U.S. 829, 87 S.Ct. 67, 17 L.Ed.2d (1966); see also In re Bullion Reserve of North America, 836 F.2d 1214, 1218 (9th Cir. 1988) (tracing required even where there is an express trust). This is because bankruptcy courts must "necessarily act very cautiously in exercising such a relatively undefined equitable power in favor of one group of potential creditors at the expense of other creditors, for ratable distribution among all creditors is one of the strongest policies behind the bankruptcy laws." In re North American Coin & Currency, 767 F.2d 1573, 1575 (9th Cir. 1985), cert. denied sub nom., Torres v. Eastlick, 475 U.S. 1083, 106 S.Ct. 1462, 89 L.Ed.2d 719 (1986).

NWC's reliance on In re Martin Fein & Co., Inc, 43 Bankr. 623 (Bankr. S.D. N.Y. 1984) to support its position on both legal issues is misplaced. There the court held that a confidential relationship existed between two bankrupts, a liquidation auctioneer and its client, based on the fact that the auctioneer was the agent of the principal/seller. The court imposed a constructive trust on the proceeds of the sale even though they were commingled with other funds in the auctioneer's general bank account. It was significant that the funds in the auctioneer's general bank account had been frozen by the court. The court reasoned that although there was no identifiable trust res, the auction proceeds could be traced to the bank account and remained there. The facts of the instant case are distinguishable. First, the Fein court found an agency relationship existed. Second, it found the commingled proceeds could be traced. Under our undisputed facts the commingled proceeds from the sale of warranty contracts have been dissipated.

The court must address one last issue. NWC originally sought its costs and attorney's fees based on a clause in its contracts with the debtors that provides attorney's fees to the prevailing party in "any legal proceeding commenced for the purpose of interpreting or enforcing any provision of this agreement". It later withdrew its request for attorney's fees and urged the court to disallow debtors' similar prayer as "Plaintiff has not sought a judgment based upon the parties' contractual obligations . . . [Rather] . . . it filed an action for declaratory judgment to establish an equitable lien."

Contractual attorney's fees clauses are authorized by statute. See O.R.S. 20.096. This court must determine whether the suits brought by NWC against the debtors are a "legal proceeding commenced for the purpose

of interpreting or enforcing" a provision of the agreement. The court concludes that they were. In order for the court to consider the relief requested by NWC, it necessarily had to review and interpret the terms of the contract between the parties. Although NWC requested an equitable remedy from the court rather than a legal one, this court does not interpret the contractual wording "legal proceeding" to limit collection of fees to those circumstances where a party to the contract seeks a legal remedy. A more natural reading is to include within the meaning of the provision any action under the law to which a party must resort for relief. This court will award attorney's fees to the defendants.

This memorandum opinion contains the court's findings of fact and conclusions of law and pursuant to Bankruptcy Rule 9014, which incorporates Rule 7052, they will not be separately stated.

An order consistent herewith shall be entered.

POLLY S. HIGDON  
Bankruptcy Judge

ORDER (to be entered in both adversaries)

Based on the Memorandum Opinion of the court entered on January \_\_, 1991; now, therefore

IT IS HEREBY ORDERED that plaintiff's motion for summary judgment is denied, and

IT IS FURTHER ORDERED that defendant's motion for summary judgment is granted, and

IT IS FURTHER ORDERED that the defendants shall have judgment against plaintiff for their reasonable costs and attorney's fees incurred defending this action. For this purpose the defendants shall submit an itemized statement of their costs and fees to the court with copies to plaintiff within 30 days.