DEBTOR EMBEZZLEMENT OF COLLATERAL*

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This Article is about collateral and the "embezzlement" exception to discharge under § 523(a)(4) of the Bankruptcy Code. Under the Uniform Commercial Code, collateral is property subject to a security interest. The "embezzlement" exception to discharge requires a debtor fraudulently appropriate entrusted property. A debtor fraudulently appropriates a security interest when the debtor, in conjunction with circumstances indicating fraud, transfers collateral or proceeds of collateral to a transferee who takes free of the security interest. A secured party "entrusts" its security interest to a debtor in situations where a debtor has power or control over collateral. There is a split among bankruptcy courts on whether a security interest can satisfy the "property" requirement of embezzlement. Some courts hold that it does. Others conclude that when a debtor appropriates collateral, the security interest is merely a lien and is therefore insufficient to support a claim of embezzlement. The rationale is that the debtor is the owner of the collateral and a debtor cannot embezzle the debtor's own property. This Article challenges that premise by evaluating the history and nature of a Uniform Commercial Code security interest. It argues that a security interest satisfies the "property" requirement of embezzlement because it embodies the fundamental property interests of the right to transfer, the right to control, and the right to use. A debtor can embezzle a security interest. Debt related to such embezzlement should not be discharged.

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I. INTRODUCTION

One purpose of bankruptcy law is to give the "honest but unfortunate debtor" a fresh start.[1] The exceptions to discharge are a statutory implementation of the "honest" aspect of that policy. They place limits on the scope of the discharge.[2] This Article is about collateral and the

[1] 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'" (quoting Grogan v. Garner, 498 U.S. 279, 286–87 (1991))).

[2] Cohen v. de la Cruz, 523 U.S. 213, 222 (1998) ("The 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.'" (quoting *Grogan v. Garner*, 498 U.S. 279, 287 (1991))); Bruning v. United States, 376 U.S. 358, 361 (1964) (noting the predecessor to section 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"); *see also* Jonathon S. Byington, *Debtor Malice*, 29 OHIO ST. L.J. 1023 (2018) (analyzing the

"embezzlement" exception to discharge under § 523(a)(4) of the Bankruptcy Code. For purposes of this Article, collateral is property subject to a Uniform Commercial Code Article 9 security interest ("UCC security interest").[3] This Article argues that a debtor can embezzle a UCC security interest in situations where a debtor, in conjunction with circumstances indicating fraud, transfers collateral or proceeds of collateral to a transferee who takes free of the UCC security interest.

This Article begins by skimming over the appearances of the term "embezzlement" in the bankruptcy acts as well as the Supreme Court's limited guidance on its meaning. It then observes that nearly every U.S. Circuit Court of Appeals has defined embezzlement for bankruptcy purposes based on an 1895 federal criminal law decision entitled *Moore v. United States*, wherein the Supreme Court defined embezzlement as "the fraudulent appropriation of property by a person to whom such property has been entrusted, or into whose hands it has lawfully come."[4]

This Article walks through the *Moore* definition of embezzlement with an emphasis on the "property" element. On its face, applying the *Moore* definition in a bankruptcy context seems fairly straightforward. But there is a split among bankruptcy courts on whether a UCC security interest can satisfy the "property" element. Some courts hold that it does. Others conclude that when a debtor appropriates property subject to a UCC security interest, the security interest is merely a lien and is therefore insufficient to support a claim of embezzlement. The rationale is that the debtor is the owner of the collateral and a debtor cannot embezzle the debtor's own property.

For example, in the Chapter 7 case of *In re Barnes*, inventory was subject to a UCC security interest.[5] The debtor agreed in a security agreement to not sell the inventory out of the ordinary course of business unless he received written permission from the secured party.[6] In what the bankruptcy court characterized as "a most cavalier manner," the debtor sold the inventory out of the ordinary course of business to a third party and

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meaning of willful and malicious injury under § 523(a)(6)); Jonathon S. Byington, *The Fresh Start Canon*, 69 FLA. L. REV. 115, 117 (2017) (describing a rival policy to the fresh start, that "discharge of debt is a selectively conferred privilege" and that the Bankruptcy Code "manifests the 'discharge restrictions' policy through provisions that deny a debtor a discharge altogether under § 727(a) or except specific, individual debts from discharge under § 523(a)").

[3] U.C.C. § 9-102(a)(12) (2010).

[4] Moore v. United States, 160 U.S. 268, 269-70 (1895).

[5] Franklin Bank, S.S.B. v. Barnes (*In re* Barnes), 369 B.R. 298, 304 (Bankr. W.D. Tex. 2007). The collateral was inventory.

[6] *Id.* at 305. The debtor was an individual who, along with his wife, wholly owned the business entity.

spent the sale proceeds.[7] The debtor did not get written permission.[8] In fact, on the day the debtor sold the inventory, the debtor had a conference call with the secured party but "[a]t no time during this exchange of information … did [the debtor] ever inform them that he was in the process of closing the sale that very day."[9] After reviewing the matter, the bankruptcy court found that the debtor "willingly breached" the security agreement and that the debtor's actions were wrong but not embezzlement.[10] The bankruptcy court explained:

> It was not the security interest of the Bank that was in the hands of [the debtor]. It was property of [the debtor] in the hands of [the debtor] which the [d]ebtor sold. … [W]here a creditor holds nothing more than a security interest in a debtor's property, the relationship is insufficient to support a finding of embezzlement.[11]

This Article challenges the premise that a UCC security interest cannot be embezzled when a debtor transfers collateral or proceeds of collateral to a transferee who takes free of the UCC security interest. It does so by evaluating the nature of a UCC security interest. It explores a debtor's and secured party's respective interests in collateral along with the inevitable passage of the totality of all property interests in collateral to either the debtor (upon satisfaction of the obligation and release of the UCC security interest), the secured party (upon default and either disposition, collection, or acceptance of collateral), or a transferee who takes free of the UCC security interest.[12] The nature of a UCC security interest is analyzed by considering the fundamental property interests of the right to transfer, the right to possess (or control for intangible personal property), and the right to use. A UCC security interest satisfies the "property" element of embezzlement because it embodies each of these fundamental property interests.

As for the other elements of embezzlement, a secured party entrusts its UCC security interest to a debtor in situations where a debtor has power or control over the collateral. A debtor fraudulently appropriates a UCC

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[7] *Id.* at 302-305.

[8] *Id.* at 305.

[9] *Id.* at 304.

[10] *Id.* at 306.

[11] *Id.* at 305-306 (quoting *In re* Moller, WL 1200916 (Bankr. N.D. Iowa 2005)).

[12] In situations where a UCC security interest continues in collateral notwithstanding a debtor's sale, lease, license, exchange, or other disposition to an initial transferee, the collateral so disposed will continue to be subject to the security interest until either the secured party disposes, collects, or accepts the collateral or another transferee takes the property free of the security interest. See U.C.C. § 9-315(a)(1) (2010).

security interest when the debtor, in conjunction with circumstances indicating fraud, transfers collateral or proceeds of collateral to a transferee who takes free of the UCC security interest. Importantly, the requirement that a debtor's appropriation be fraudulent separates dischargeable debt relating to run-of-the-mill debtor defaults under a security agreement from the rarer cases that rise to the level of embezzlement. From a policy perspective, an exception to discharge should not be interpreted in a way that applies the exception to every debt.[13] The "fraudulent appropriation" requirement ensures that the embezzlement exception to discharge is not applied in a way that results in the exception encompassing every debt involving a UCC security interest.

II. BACKGROUND

This Part surveys the term "embezzlement" in the bankruptcy acts as well as the few Supreme Court decisions that have mentioned the term in a bankruptcy context. The Supreme Court's bankruptcy decisions are not helpful in determining the meaning of embezzlement. No bankruptcy scholarship has focused solely on embezzlement.[14] Nearly all of the U.S. Circuit Courts of Appeals have adopted a criminal law definition from the

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[13] Chapman v. Forsyth, 43 U.S. 202, 208 (1844) (noting that one of the litigant's proposed interpretations of an exception to discharge "would have left but few debts on which the law [meaning a discharge of debt] could operate").

[14] Scholarship in this area is less than scant. Several articles mention embezzlement in a bankruptcy context but only one addressed its meaning. That article was published in 1998 and digested then-existing caselaw on embezzlement. *See* Leah A. Kahl and Peter C. Ismay, *Exceptions to Discharge for Fiduciary Fraud, Larceny, and Embezzlement*, 7 J. BANKR. L. & PRAC. 119, 145 (1998) (summarizing caselaw requirements); *See also* David Gray Carlson, *Mere Conduit*, 93 AM. BANKR. L.J. 475, 497 (2019) (evaluating embezzlement as a fraudulent transfer); Gideon Parchomovsky and Alex Stein, *Catalogs*, 115 COLUM. L. REV. 165, 183 (2015) (explaining that the statutory terms larceny, embezzlement and fraud are an example of a catalog); H.C. Jones III, *Fraud and Defalcation by a Fiduciary: The Amorphous Exception to Bankruptcy Discharge*, 45 U. BALT. L. REV. 133, 150 (2015) (analyzing the meaning of the term defalcation by comparing it to embezzlement); Tara C. Pakrouh, *"Fraud Junior": An Analysis of the Supreme Court's Construction of Defalcation and Pension-Fund Trustee Decisions in Bankruptcy Law*, 39 DEL. J. CORP. L. 497, 517 (2014) (arguing Congress should separate embezzlement and larceny from "fraud or defalcation while acting in a fiduciary capacity"); Paul W. Bonapfel, John A. Thomson Jr., Richard Thomson, and Edward P. Philpot, *Symposium: Consumer Bankruptcy Panel Fiduciary Exceptions to Discharge With a Focus on Defalcation*, 29 EMORY BANKR. DEV. J. 359, 380 (2013) (discussing different intent elements for defalcation and embezzlement); Charles Jordan Tabb, *The Scope of the Fresh Start in Bankruptcy: Collateral Conversions and the Dischargeability Debate*, 59 GEO. WASH. L. REV. 56 (1990 (focusing on the willful and malicious injury exception to discharge); Jeffrey Thomas Ferriell, *The Preclusive Effect of State Court Decisions in Bankruptcy FIRST INSTALLMENT*, 58 AM. BANKR. L.J. 349, 375 (1984) (focusing on issue preclusion and noting that criminal convictions for embezzlement or other theft offenses are likely to have resolved issues identical to those important under section 523(a)(4)).

1895 Supreme Court decision of *Moore v. United States*.[15] This Part ends by examining *Moore*.

A. BANKRUPTCY ACT OF 1867 AND TWO SUPREME COURT DECISIONS

Neither the Bankruptcy Act of 1800[16] nor the Bankruptcy Act of 1841[17] contained the word "embezzlement." The term first appeared in the Bankruptcy Act of 1867 as an exception to discharge.[18] As for legislative history, this part of the Bankruptcy Act of 1867 was modeled after Massachusetts insolvency law.[19] The 1859 Massachusetts statute on courts of insolvency allowed a judge to examine under oath "anyone suspected of having fraudulently received, concealed, embezzled, or conveyed away, any money, goods, effects, or other estate, of the debtor."[20]

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[15] Moore v. United States, 160 U.S. 268 (1895).

[16] Bankruptcy Act of 1800, ch. 19, 2 Stat. 19 (repealed 1803) (stating in § 34 that "a verdict shall thereupon pass for the defendant, unless the plaintiff in such action can prove the said certificate was obtained unfairly, and by fraud, or unless he can make appear any concealment of estate or effects, by such bankrupt to the value of one hundred dollars."). The Act was primarily a creditor remedy against merchant debtors. *See* Charles Jordan Tabb, *The History of the Bankruptcy Laws in the United States*, 3 AM. BANKR. INST. L. REV. 5, 14 (1995).

[17] Bankruptcy Act of 1841, ch. 9, 5 Stat. 440 (repealed 1843) (stating in § 4 that "if any such bankrupt shall be guilty of any fraud or wilful concealment of his property or rights of property, or shall have preferred any of his creditors contrary to the provisions of this act, or shall wilfully omit or refuse to comply with any orders or directions of such court, or to conform to any other requisites of this act, or shall, in the proceedings under this act, admit a false or fictitious debt against his estate, he shall not be entitled to any such discharge or certificate."). The Bankruptcy Act of 1841 was modeled after the Massachusetts Insolvency Law of 1838. CHARLES WARREN, BANKRUPTCY IN UNITED STATES HISTORY 70 (1935); Tabb, *supra* note 16, at 17.

[18] Bankruptcy Act of 1867, ch. 176, § 33, 14 Stat. 517 (repealed 1878) (stating "no debt created by the fraud or embezzlement of the bankrupt, or by his defalcation as a public officer, or while acting in any fiduciary character, shall be discharged under this act."); *see also* U.S. v. Herron, 87 U.S. 251, 253 (1873) (stating "[w]ith the exception of the debts specified in the thirty-third section, the act provides that a discharge duly granted under the act shall release the bankrupt from all debts….").

[19] F. REGIS NOEL, A HISTORY OF THE BANKRUPTCY LAW, 153 (Chas. H. Potter & Co. 1919). See also JOSEPH CUTLER, INSOLVENT LAWS OF MASSACHUSETTS WITH NOTES OF DECISIONS, 100-101 (4th ed. 1878). On March 27, 1866, the House of Representatives was considering a "Bankrupt Bill." 39 Cong. Globe 1685 (1866). After the clerk read the section of the bill on exceptions to discharge, Representative John Bassett Alley from Massachusetts stated:

> Mr. Speaker, I wish to say in reference to this section that it was adopted in the committee mainly through my efforts. … I simply wish to say that this section is deemed by some to be of vital importance to the creditor interest. Its provisions are in the Massachusetts law. … I am of (sic) opinion if a bankrupt scheme could be devised similar to that in Massachusetts it would be productive of great good both to the creditor and debtor interest of the country. 39 Cong. Globe 1693 (1866).

[20] General Statutes of the Commonwealth of Massachusetts, Ch. 118 § 107 (1859). Section 79 provided an exception to discharge for a debt created by the debtor's defalcation but it did not mention embezzlement. At the time, an assignee had a role similar to the modern-day trustee in a liquidation bankruptcy. The judge could remove the assignee if the assignee "fraudulently received, concealed,

Supreme Court decisions interpreting the Bankruptcy Act of 1867 do not define embezzlement. In 1877, when it was interpreting the "fraud" exception to discharge, the Supreme Court remarked that embezzlement involved an "intentional wrong."[21] Seven years later, the Supreme Court mentioned but did not concentrate on embezzlement when it addressed exceptions to discharge involving fraud and fiduciary character.[22] In 1878, Congress repealed the Bankruptcy Act of 1867 for reasons unrelated to the "embezzlement" exception to discharge.[23]

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embezzled, or conveyed away, any of the money, goods, effects, or other estate, of the debtor…" General Statutes of the Commonwealth of Massachusetts, Ch. 118 § 57 (1859). The Supreme Judicial Court of Massachusetts issued an opinion in 1865 involving petitioners who refused to be sworn and submit themselves to examination by the judge of insolvency in Massachusetts because of 5th Amendment concerns. In analyzing embezzlement as a ground for examination, the Massachusetts court held:

> Nor do we think that the word "embezzled," in the statute, is to be construed as referring to a criminal embezzlement. It is not to be supposed that the legislature intended that a person charged with a crime should be compelled to answer under oath whether he is guilty of it. Its meaning is rather to be found in the words with which it is connected, and as importing an act which is a violation of a civil right, and not the technical offence of embezzlement under the statute. … The right of the legislature to require a disclosure in answer to a complaint under that statute was fully sustained by this court; and the petitioners are bound to submit themselves to examination until they can state, as an objection to some specific interrogatory, that an answer to it would tend to criminate them. *Sawin v. Martin*, 11 Allen 439, 440-441 (1865).

Incidentally, the 1882 Massachusetts statute on courts of insolvency contained an exception to discharge for a debt "by the fraud or embezzlement of the debtor." General Statutes of the Commonwealth of Massachusetts, Ch. 157 § 84 (1882). See also JOSEPH CUTLER, INSOLVENT LAWS OF MASSACHUSETTS WITH NOTES OF DECISIONS, 149 (4th ed. 1878) (citing St. 1846, c. 168, § 1).

[21] Neal v. Clark, 95 U.S. 704, 709 (1877) (stating that "in the section of the law of 1867 which sets forth the classes of debts which are exempted from the operation of a discharge in bankruptcy, debts created by 'fraud' are associated directly with debts created by 'embezzlement.' Such association justifies, if it does not imperatively require, the conclusion that the 'fraud' referred to in that section means positive fraud, or fraud in fact, involving moral turpitude or intentional wrong, as does embezzlement; and not implied fraud, or fraud in law, which may exist without the imputation of bad faith or immorality."); *See also* Forsyth v. Vehmeyer, 177 U.S. 177, 182 (1900) (addressing fraud under the Bankruptcy Act of 1867 and finding that "[a] representation as to a fact, made knowingly, falsely, and fraudulently, for the purpose of obtaining money from another, and by means of which such money is obtained, creates a debt by means of a fraud involving moral turpitude and intentional wrong.").

[22] Hennequin v. Clews, 111 U.S. 676, 678 (1884) (affirming a determination by the New York Court of Appeals that a debt was not created by fraud, embezzlement, nor while the debtor was acting a fiduciary character for a debt "which arises from his appropriating to his own use collateral securities deposited with him as security for the payment of money or the performance of a duty, and his failure or refusal to return the same after the money has been paid or the duty performed.").

[23] 45 CONG. REC. 2nd sess. 2512-16 (1878). *See also* NOEL, *supra* note 19 at 153-156 (providing helpful background on the practical challenges of implementing the Act as well as the political situation leading up to its repeal).

B. BANKRUPTCY ACT OF 1898 AND ONE SUPREME COURT DECISION

About twenty years later, the term "embezzlement" appeared in the Bankruptcy Act of 1898 as an exception to discharge.[24] In 1904, the Supreme Court clarified that a debtor must be acting in a fiduciary capacity in order for a debt created by the debtor's embezzlement to be excepted from discharge.[25] This is the only Supreme Court decision on embezzlement under the Bankruptcy Act of 1898.

C. BANKRUPTCY LAW REFORM ACT OF 1978 AND ONE SUPREME COURT DECISION

In 1970, Congress created a commission to study the bankruptcy laws of the United States ("Commission").[26] The Commission filed its report in 1973 and recommended that:

> Claims arising from conduct of the debtor egregiously violating community standards, such as claims for fraud, larceny, embezzlement, willful and malicious wrongs, and civil penalties, should not be discharged because social policy directs, impliedly at least, that the debtor should not be able to escape his responsibility through the bankruptcy process.[27]

The Commission recommended a bill containing an exception to discharge for "any liability for embezzlement or larceny"[28] with the following explanation:

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[24] Bankruptcy Act of 1898, ch. 541, § 17(a)(4), 30 Stat. 544, 550 (repealed 1978). It labeled the exceptions to discharge as "Debts Not Affected by a Discharge" and stated in § 17(a) that: "A discharge in bankruptcy shall release a bankrupt from all of his provable debts, except such as … (4) were created by his fraud, embezzlement, misappropriation, or defalcation while acting as an officer or in any fiduciary capacity." Although there were amendments to the Bankruptcy Act of 1898 prior to its repeal in 1978, none of them related to the "embezzlement" exception to discharge. *See* Act of Feb. 5, 1903, ch. 487, § 5, 32 Stat. 797, 797–98 (amending the Bankruptcy Act of 1898) and Act of Oct. 19, 1970, Pub. L. No. 91-467, § 5, 84 Stat. 990, 992 (amending § 17(a)(2) of the Bankruptcy Act of 1898).

[25] Crawford v. Burke, 195 U.S. 176, 194 (1904) (answering the question of whether "these words apply to all debts created by the fraud, embezzlement, misappropriation of the bankrupt, or only to such as were created while he was acting as an officer or in some fiduciary capacity."). The fiduciary capacity requirement for embezzlement was subsequently superseded when the Bankruptcy Act of 1898 was repealed in 1978. Bankruptcy Law Reform Act of 1978, Pub. L. No. 95-598, § 523, 92 Stat. 2549, 2590–91 (codified at 11 U.S.C. § 523(a)(4) (2019)).

[26] *See* Act of July 24, 1970, Pub. L. No. 91-354, 84 Stat. 468.

[27] Report of Commission on Bankruptcy Laws of United States, part I, pg. 79, 13034-4 (1973).

[28] Bankruptcy Act Revision: Hearings Before the Subcomm. On Civil and Constitutional Rights of the Comm. On the Judiciary on H.R. 31 and H.R. 32, 94th Cong., 1st and 2d Sess., Serial No. 27, Appendix 1 (1976), *available at* https://babel.hathitrust.org/cgi/pt?id=pur1.32754078046996&view=1up&seq=365.

> The limiting words, "while acting as an officer or in any fiduciary capacity," the scope of which is controverted under the present Act, are eliminated. Thus, for example, the uncertainty whether this ground for nondischargeability applies only to a corporate or public officer or extends also to a corporate employee, partner, or other agent is abolished. The terms "misappropriation" and "defalcation" are discarded as overbroad and uncertain in meaning. The standard of "fraud" is moved to a more appropriate location in clause (2), and the precisely definable term "larceny" is added to the remaining term "embezzlement" to cover conduct clearly within the intended scope of this ground for nondischargeability.[29]

The National Conference of Bankruptcy Judges ("NCBJ") requested a bill that worded the exception to discharge as "any civil liability for embezzlement or larceny."[30] The National Bankruptcy Conference considered the Commission's and NCBJ's language and proposed "any liability for embezzlement or larceny."[31] The legislative process leading up to the enactment of the Bankruptcy Law Reform Act of 1978 (the "Act") was complicated and is recounted elsewhere.[32]

The Act renumbered the "embezzlement" exception to discharge from § 17 to § 524.[33] It also reworded the exception to discharge from a debt created by the debtor's "fraud, embezzlement, misappropriation, or

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[29] Report of Commission on Bankruptcy Laws of United States, part II, pg. 139, notes to § 4-506 (1973), 93 Congress, 1st Session, House Document No. 93-137, Part II (internal citations omitted).

[30] Bankruptcy Act Revision: Hearings Before the Subcomm. On Civil and Constitutional Rights of the Comm. On the Judiciary on H.R. 31 and H.R. 32, 94th Cong., 1st and 2d Sess., Serial No. 27, Appendix 1 (1976), *available at* https://babel.hathitrust.org/cgi/pt?id=pur1.32754078046996&view=1up&seq=365.

[31] Bankruptcy Act Revision: Hearings Before the Subcomm. On Civil and Constitutional Rights of the Comm. On the Judiciary on H.R. 31 and H.R. 32, 94th Cong., 1st and 2d Sess., Serial No. 27, Appendix 2 (1976), *available at* https://babel.hathitrust.org/cgi/pt?id=pur1.32754078046996&view=1up&seq=365.

[32] Kenneth N. Klee, *Legislative History of the New Bankruptcy Law*, 28 DEPAUL L. REV. 941 (1979) (Mr. Klee was a member of the house staff at the time the bankruptcy reform legislation was passed); Eric A. Posner, *The Political Economy of the Bankruptcy Reform Act of 1978*, 96 MICH. L. REV. 47 (1997) (stating the legislative history is complex and "consists of thousands of pages of hearings, reports, and debates spanning a decade"); J. Ronald Trost and Lawrence P. King, *Congress and Bankruptcy Reform Circa 1977*, THE BUSINESS LAWYER, Vol. 33, No. 2, pp. 489-557 (January 1978). On October 5, 1978, Senator DeConcini made the following Senate floor statement: "Section 523(a)(4) of the House amendment represents a compromise between the House bill and the Senate amendment." 124 Cong. Rec. 33998 (daily ed. Oct. 5, 1978) (remarks of Sen. DeConcini). The Bankruptcy Law Reform Act of 1978 was enacted on November 6, 1978. Bankruptcy Law Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549.

[33] Brown v. Felsen, 442 U.S. 127, 129 n.1 (1979) (noting that "[d]ischarge provisions substantially similar to § 17 of the [1898 Act] appear in § 523 of the new law").

defalcation while acting as an officer or in any fiduciary capacity"[34] to a debt "for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny."[35] This change dropped the term "misappropriation" and added the term "larceny." It also reworded the phrase "while acting as an officer or in any fiduciary capacity" to "while acting in a fiduciary capacity" and moved the phrase's location so it modified fraud and defalcation but not embezzlement. Thus, the "embezzlement" exception to discharge no longer requires the debtor to have embezzled while acting in a fiduciary capacity.[36] Although the Act has been amended several times, none of the amendments changed the "embezzlement" exception to discharge.[37]

In 2013, the Supreme Court interpreted the "defalcation" exception to discharge by comparing it to embezzlement and noted that "embezzlement requires a showing of wrongful intent" and that "[a]s commonly used, 'embezzlement' requires conversion."[38] As the foregoing summary shows, the bankruptcy acts, legislative history, and Supreme Court decisions in a bankruptcy context provide insufficient guidance on the meaning of "embezzlement." The U.S. Circuit Courts of Appeals have looked elsewhere for guidance.

D. THE U.S. CIRCUIT COURTS OF APPEALS HAVE ADOPTED A CRIMINAL LAW DEFINITION OF EMBEZZLEMENT FROM THE 1895 SUPREME COURT DECISION OF MOORE V. UNITED STATES

In its 1895 decision, *Moore v. United States*, the Supreme Court defined embezzlement as "the fraudulent appropriation of property by a

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[34] Bankruptcy Act of 1898, ch. 541, § 17(a)(4), 30 Stat. 544, 550 (repealed 1978).

[35] Bankruptcy Law Reform Act of 1978, Pub. L. No. 95-598, § 523, 92 Stat. 2549, 2590–91 (1978).

[36] Bullock v. BankChampaign, N.A., 589 U.S. 267, 275 (2013) (explaining that "[t]he statutory provision makes clear that the first two terms [embezzlement and larceny] apply outside of the fiduciary context"); *see also* Comptom v. Moschell *(In re* Moschell*)*, 607 B.R. 487, 497-498 (Bankr. W.D. Penn. 2019) (holding that an embezzlement claim need not plead or show the debtor was a fiduciary); Jonathon S. Byington, *Fiduciary Capacity and the Bankruptcy Discharge*, 24 AM. BANKR. INST. L. REV. 1, 15–17 (2016) (analyzing the meaning of fiduciary capacity under § 523(a)(4)).

[37] Compare for example, Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, § 215, 119 Stat. 23, at 54 (2005) (codified at 11 U.S.C. § 523(a)(4)) to Bankruptcy Law Reform Act of 1978, Pub. L. No. 95-598, § 523, 92 Stat. 2549, 2590–91 (1978). For a helpful review of the legislative history of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, *see* Susan Jensen, *A Legislative History of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005*, 79 AM. BANKR. L.J. 485 (2005). See also Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, 98 Stat. 333 (codified in scattered sections of 11 U.S.C. and 28 U.S.C.); Bankruptcy Judges, United States Trustees, and Family Farmer Bankruptcy Act of 1986, Pub. L. No. 99-554, 100 Stat. 3124 § 255 (codified as amended at 11 U.S.C. §§ 1201-1231); Small Business Reorganization Act of 2019, Pub. L. No. 116-54, 133 Stat. 1079 (codified in 11 U.S.C. §§ 1181-1195 and scattered sections of 11 U.S.C. and 28 U.S.C.).

[38] *Bullock*, 589 U.S. at 274-275. The "embezzlement" exception to discharge was not at issue in *Bullock*. See also Jonathon S. Byington, *The Challenges of the New Defalcation Standard*, 88 AM. BANKR. L.J. 3 (2014) (analyzing the meaning of defalcation under § 523(a)(4)).

person to whom such property has been entrusted, or into whose hands it has lawfully come."[39] *Moore* had nothing to do with bankruptcy law. Rather, the case was about the sufficiency of allegations in a criminal indictment against an assistant postmaster who was convicted of the federal crime of embezzlement.[40] The assistant postmaster appealed arguing the allegations in the indictment were not specific enough for the offense of embezzlement.[41] The Supreme Court agreed and found the allegations insufficient, concluding that "[t]here can be no doubt that a count charging the prisoner with stealing or purloining certain described goods, the property of the United States, would be sufficient, without further specification of the offence."[42]

Other than its definition of embezzlement, the *Moore* decision is unhelpful in providing guidance for applying embezzlement in a bankruptcy context. Nevertheless, nearly all U.S. Circuit Courts of Appeals have adopted the *Moore* definition when applying the "embezzlement" exception to discharge.[43] The U.S. Circuit Courts of Appeals for the Second and

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[39] Moore v. United States, 160 U.S. 268, 269-70 (1895).

[40] *Id.* at 269 (1895) (stating George S. Moore was convicted for violating 18 Stat. 479 (1874) and sentenced to imprisonment at hard labor). The first section of that statute states that "any person who shall embezzle, steal, or purloin any money, property, record, voucher, or valuable thing whatever, of the moneys, goods, chattels, records, or property of the United States, shall be deemed guilty of felony." *Id.*

[41] *Id.* (Moore argued there was no direct allegation in the indictment that (i) he was an assistant, clerk, or employee connected to the United States post office, (ii) the money of the United States was not identified or described, nor (iii) that the money came into his possession by virtue of his employment).

[42] *Id.* at 274 (reversing and remanding the case with directions to quash the indictment).

[43] Sherman v. Potapov (*In re* Sherman), 603 F.3d 11, 13 (1st Cir. 2010) (defining embezzlement as "the fraudulent conversion of the property of another by one who is already in lawful possession of it"); Schlessinger v. Schlessinger (*In re* Schlessinger), 208 Fed. Appx. 131 (unpublished 3rd Cir. 2006) (defining embezzlement as "the fraudulent appropriation of property by a person to whom such property has been entrusted or into whose hands it has lawfully come") (citing *Moore*, 160 U.S. at 269); Miller v. J.D. Abrams Inc. (*In re* Miller), 156 F.3d 598, 602 (5th Cir. 1998) (defining embezzlement as "'fraudulent appropriation of property by a person to whom such property has been entrusted, or into whose hands it has lawfully come"); Brady v. McAllister (*In re* Brady), 101 F.3d 1165, 1172 (6th Cir. 1996) (defining embezzlement as "the fraudulent appropriation of property by a person to whom such property has been entrusted or into whose hands it has lawfully come") (referencing *Moore*, 160 U.S. 268); *In re* Weber, 892 F.2d 534, 538 (7th Cir. 1989), abrogated on other grounds by Grogan v. Garner, 498 U.S. 279 (1991) (defining embezzlement as "the fraudulent appropriation of property by a person to whom such property has been entrusted or into whose hands it has lawfully come") (citing *Moore*, 160 U.S. at 269); Belfry v. Cardozo (*In re* Belfry), 862 F.2d 661, 662 (8th Cir. 1988) (defining embezzlement as "the fraudulent appropriation of property of another by a person to whom such property has been entrusted or into whose hands it has lawfully come") (quoting *In re* Schultz, 46 B.R. 880, 889 (Bankr. D. Nev. 1985)); TransAmerica Commercial Finance Corp. v. Littleton (*In re* Littleton), 942 F.2d 551, 555 (9th Cir. 1991) (defining embezzlement as "the fraudulent appropriation of property by a person to whom such property has been entrusted or into whose hands it has lawfully come") (quoting *Moore*, 160 U.S. at 269); Klemens v. Wallace (*In re* Wallace), 840 F.2d 762, 765 (10th Cir. 1988) (defining embezzlement as "the fraudulent appropriation of property by a person to whom such property has been entrusted or into whose hands it has lawfully come") (quoting Great American Insurance Co. v. Graziano (*In re*

Fourth Circuits have not addressed the issue, but bankruptcy courts in those circuits have adopted the same definition.[44]

III. ANALYSIS OF THE "EMBEZZLEMENT" EXCEPTION TO DISCHARGE

Section 523(a)(4) states that a discharge does not discharge an individual debtor from any debt for embezzlement.[45] Under the almost uniformly adopted approach of the U.S. Circuit Courts of Appeals, embezzlement has three requirements: (A) fraudulent appropriation (B) of property (C) by a person to whom such property has been entrusted or into whose hands it has lawfully come.[46] This Part examines each requirement.

Graziano), 35 B.R. 589, 594 (Bankr. E.D.N.Y. 1983)); Fernandez v. Havana Gardens, LLC, 562 Fed. Appx. 854, 856 (unpublished 11th Cir. 2014) (defining embezzlement as "the fraudulent appropriation of property by a person to whom such property has been entrusted, or into whose hands it has lawfully come") (quoting U.S. v. Sayklay, 542 F.2d 942, 944 (5th Cir. 1976)).

[44] For an example in the Second Circuit, *see* Gore v. Kressner (*In re* Kressner), 155 B.R. 68, 74 (Bankr. S.D.N.Y. 1993) (defining embezzlement as "the fraudulent appropriation of money by a person to whom such property had been entrusted or into whose hands it has lawfully come"); In the Fourth Circuit, *see* KMK Factoring, L.L.C. v. McKnew (*In re* McKnew), 270 B.R. 593, 631 (Bankr. E.D. Va. 2001) (defining embezzlement as "the fraudulent appropriation of property by a person to whom such property has been entrusted, or into whose hands it has lawfully come.").

[45] 11 U.S.C. § 523(a)(4) (2019).

[46] *In re Sherman*, 603 F.3d at 13 (defining embezzlement as "the fraudulent conversion of the property of another by one who is already in lawful possession of it"); the Court of Appeals for the Second Circuit has not addressed it, but several bankruptcy courts in the Second Circuit have, *see* Scheidelman v. Henderson (*In re* Henderson), 423 B.R. 598, 624 (Bankr. N.D. N.Y. 2010) (defining embezzlement as "the fraudulent appropriation of property by a person to whom such property has been intrusted, (sic) or into whose hands it has lawfully come") (citing *Moore*, 160 U.S. at 269) and Mirarchi v. Nofer (*In re* Nofer), 514 B.R. 346, 356 (Bankr. E.D. N.Y. 2014) (quoting *Moore v. U.S.*, 160 U.S. 268, 269 (1895)); *In re* Schlessinger, 208 Fed. Appx. 131 (unpublished 3rd Cir. 2006) (defining embezzlement as "the fraudulent appropriation of property by a person to whom such property has been entrusted or into whose hands it has lawfully come") (citing *Moore*, 160 U.S. at 269); *In re Miller*, 156 F.3d at 602 (defining embezzlement as "'fraudulent appropriation of property by a person to whom such property has been entrusted, or into whose hands it has lawfully come"); *In re Brady*, 101 F.3d at 1172 (defining embezzlement as "the fraudulent appropriation of property by a person to whom such property has been entrusted or into whose hands it has lawfully come") (referencing *Moore*, 160 U.S. 268); *In re* Weber, 892 F.2d 534, 538 (7th Cir. 1989) abrogated on other grounds by Grogan v. Garner, 498 U.S. 279 (1991) (defining embezzlement as "the fraudulent appropriation of property by a person to whom such property has been entrusted or into whose hands it has lawfully come") (citing *Moore*, 160 U.S. at 269); *In re Belfry*, 862 F.2d at 662 (defining embezzlement as "the fraudulent appropriation of property of another by a person to whom such property has been entrusted or into whose hands it has lawfully come") (quoting *In re* Schultz, 46 B.R. 880, 889 (Bankr. D. Nev. 1985)); *In re Littleton*, 942 F.2d at 555 (defining embezzlement as "the fraudulent appropriation of property by a person to whom such property has been entrusted or into whose hands it has lawfully come") (quoting *Moore*, 160 U.S. at 269); *In re Wallace*, 840 F.2d at 765 (defining embezzlement as "the fraudulent appropriation of property by a person to whom such property has been entrusted or into whose hands it has lawfully come") (quoting *In re Graziano*, 35 B.R. at 594); *Fernandez*, 562 Fed. Appx. at 856 (defining embezzlement as "the fraudulent appropriation of property by a person to whom such property has been entrusted, or into whose hands it has lawfully come") (quoting U.S. v. Sayklay, 542 F.2d 942, 944 (5th Cir. 1976)).

A. THE REQUIREMENT OF "FRAUDULENT APPROPRIATION"

"Fraudulent appropriation" requires the debtor to have appropriated the property for a use other than that for which it was entrusted and under circumstances that indicate fraud.[47] Appropriation involves the exercise of control over or use of entrusted property. The contract or understanding between the debtor and the other party often establishes the rights and obligations that determine whether the debtor has appropriated entrusted property.[48] For example, one court required proof "that the debtor was not lawfully entitled to use the funds for the purposes for which they were in fact used."[49] It found that "[o]bligations sufficient to support a claim of embezzlement are ones which make the debtor's discretionary use of the [property], prior to complying with the obligations, improper."[50] Courts determine whether a debtor was "lawfully entitled" to do something with entrusted property by considering any legal prohibitions (e.g., does the debtor have the legal right to do it), contractual obligations (e.g., does the debtor have any implicated contractual covenants or conditions), or other

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[47] *In re* Brady, 101 F.3d at 1173 (citing Ball v. McDowell (*In re* McDowell), 162 B.R. 136, 140 (Bankr. N.D. Ohio 1993)). *See also In re Sherman*, 603 F.3d at 13 (identifying the use of "entrusted money for the recipient's own purposes in a way he knows the entrustor did not intend or authorize") (citing United States v. Young, 955 F.2d 99, 102 (1st Cir. 1992) and Palmacci v. Umpierrez, 121 F.3d 781, 786 (1st Cir. 1997)); *In re Littleton*, 942 F.2d at 555 (stating the "appropriation of the property [must be for] a use other than which [it] was entrusted") (quoting National Bank of Commerce of Pine Bluff v. Hoffman (*In re* Hoffman), 70 B.R. 155, 162 (Bankr. W.D. Ark. 1986)); Mirarchi v. Nofer (*In re* Nofer), 514 B.R. 346, 356 (Bankr. E.D. N.Y. 2014) (requiring the debtor to have "appropriated the property for use other than the use for which the property was entrusted") (quoting Indo–Med Commodities, Inc. v. Wisell (*In re* Wisell), 494 B.R. 23, 40 (Bankr. E.D.N.Y. 2011)); Bombardier Capital, Inc. v. Tinkler (*In re* Tinkler), 311 B.R. 869, 873 (Bankr. Colo. 2004) (requiring the property be "misappropriated (used or consumed for a purpose other than that for which it was entrusted)") (quoting Bryant v. Tilley (*In re* Tilley), 286 B.R. 782, 789 (Bankr. Colo. 2002)0.

[48] Werner v. Hoffman, 5 F.3d 1170, 1172 (8th Cir. 1993) (looking to a lease agreement to determine if the debtor had obligations to segregate or refrain from using property); *See also* U.C.C. § 1-201(b)(3) and (12) (2010) (defining the terms "Agreement" and "Contract").

[49] *In re Belfry*, 862 F.2d at 662 (citing Great American Ins. Co. v. Storms (*In re* Storms), 28 B.R. 761, 765 (Bankr. E.D. N.C. 1983)). In *In re Belfry*, the court found no fraudulent appropriation where there was an understanding between parties that funds would be used exclusively for restoring a BMW vehicle and the debtor was free to use the funds as he saw fit prior to commencing work on the car. The court highlighted that under the arrangement between the parties, the debtor's obligation could be fully performed without regard to how the debtor used the money and that the debtor "was free to use the funds as he saw fit prior to commencing work on the car." *Id.* at 663. Based on that reasoning, the court found that there were no obligations imposed on the debtor that made the debtor's use of the funds unlawful. *Id.*

[50] *Id.* (citing Central Investors Real Estate Corp. v. Powell (*In re* Powell), 54 B.R. 123, 124 (Bankr. D. Or. 1983)) (finding that when an agreement permits a debtor full use of money, the result is a dischargeable breach of contract).

duties imposed under the circumstances (e.g., does the relationship impose duties on the debtor).[51]

A debtor's appropriation of entrusted property must be fraudulent.[52] "[F]raudulent intent is knowledge that the use is devoid of authorization."[53] "[T]here must be knowledge that the appropriation is contrary to the wishes of the owner."[54] A debtor's reasonable belief of authorization typically precludes a finding of fraudulent appropriation.[55] For example, the "retention of property in good faith, without secrecy or concealment, under a bona fide claim of right based upon reasonable grounds, generally is inconsistent with a fraudulent intent to embezzle."[56] Put another way:

> Where a debtor disposes of funds that have lawfully come into her hands, does not attempt to conceal that disposition,

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[51] Peavey Electronics Corp. v. Sinchak (*In re* Sinchak), 109 B.R. 273, 276-77 (Bankr. N.D. Ohio 1990) (focusing on the written contract between the parties and noting that "[a]ny use of the proceeds contrary to that provided for in the Security Agreement was beyond the Debtor's scope of authority and without the consent of the Creditor"); Great American Ins. Co. v. Storms (*In re* Storms), 28 B.R. 761, 765 (Bankr. E.D. N.C. 1983) (considering the written contract between the parties as well as the parties' conduct and noting that the debtor was not required to isolate or account for insurance premium funds nor were there any restriction on his use of them); Stentz v. Stentz (*In re* Stentz), 197 B.R. 966, 986 (Bankr. Neb. 1996) (considering a Nebraska statute on the rights of joint account holders as well as restraints on authority that funds be used at the debtor's father's direction or for his benefit instead of for the debtor's personal use); Brady v. McAllister (*In re* Brady), 101 F.3d 1165, 1173 (6th. Cir. 1996) (considering an oral agreement between a debtor and creditor that the creditor receive a 50% share of any proceeds of the sale of property). See also § 9-401 (2010).

[52] Sherman v. Potapov (*In re* Sherman), 603 F.3d 11, 13 (1st Cir. 2010) (requiring "fraudulent intent"); Miller v. J.D. Abrams Inc. (*In re* Miller), 156 F.3d 598, 602 (5th Cir. 1998) (stating "there must be proof of the debtor's fraudulent intent in taking the property") (citing *In re Brady*, 101 F.3d at 1173); *In re Littleton*, 942 F.2d at 555 (requiring "circumstances indicating fraud") (quoting National Bank of Commerce of Pine Bluff v. Hoffman (*In re* Hoffman), 70 B.R. 155, 162 (Bankr. W.D. Ark. 1986)); *In re Weber*, 892 F.2d 534, 538 (7th Cir. 1989) (requiring "fraudulent intent or deceit"); Mirarchi v. Nofer (*In re* Nofer), 514 B.R. 346, 356 (Bankr. E.D. N.Y. 2014) (quoting Indo–Med Commodities, Inc. v. Wisell (*In re* Wisell), 494 B.R. 23, 40 (Bankr. E.D.N.Y. 2011)); Fed. Ins. Co. v. Sorge (*In re* Sorge), 574 B.R. 72, 77 (Bankr. E.D. N.C. 2017); Fed. Ins. Co. v. Sorge (*In re* Sorge), 566 B.R. 369, 381 (Bankr. E.D.N.C. 2017) (quoting Peavey Electronics Corp. v. Sinchak (*In re* Sinchak), 109 B.R. 273, 276 (Bankr. N.D. Ohio 1990)); Bombardier Capital, Inc. v. Tinkler (*In re* Tinkler), 311 B.R. 869, 873 (Bankr. Colo. 2004) (requiring "fraudulent intent") (quoting Bryant v. Tilley (*In re* Tilley), 286 B.R. 782, 789 (Bankr. Colo. 2002)).

[53] Lennox v. Udelhoven (*In re* Udelhoven), 624 B.R. 629, 651 (Bankr. N.D. Ill. 2021) (citations and quotations omitted); *see also* Chriswell v. Alomari (*In re* Alomari), 486 B.R. 904, 917 (Bankr. N.D. Ill. 2013) (finding that "[b]ecause Defendant agreed to hold the Secured Deposit for Plaintiff's benefit, by intentionally spending that money to benefit his own interests, Defendant thereby committed embezzlement").

[54] MacArthur v. Cupit (*In re* Cupit), 514 B.R. 42, 59 (Bankr. Colo. 2014) (citing *U.S. v. Stockton*, 788 F.2d 210, 217 (4th Cir. 1986) and 3 Wayne R. LaFave, SUBSTANTIVE CRIMINAL LAW § 19.6(f)(1) (2d ed. 2012)).

[55] May v. Lyon (*In re* Lyon), 348 B.R. 9, 26 (Bankr. D. Conn. 2006) (evaluating the circumstances to determine debtor's authorization or reasonable belief as to authorization to withdraw funds for own benefit).

[56] Me. Bonding & Cas. Co. v. Crook (*In re* Crook), 13 B.R. 794, 798 (Bankr. D. Me. 1981).

> and has reasonable grounds to believe she has a right to use the money, the circumstances are not suggestive of a fraudulent intent. On the other hand, where a debtor uses entrusted funds for his own purposes, with knowledge such use is unauthorized, fraudulent intent is manifest…..[57]

A debtor's fraudulent intent "may be, and often must be, shown by circumstantial evidence."[58] Fraud comes in "many sizes, shapes, and shades of gray" and "a creditor may establish circumstances indicating a debtor's fraudulent intent, even if the debtor did not make a misrepresentation or misleading omission on which the creditor relied."[59] In other words, for embezzlement, the type of conduct necessary to satisfy circumstances indicating fraud "need not include a misrepresentation or any other particularized type of fraud identified in § 523(a)(2)(A)."[60] "When the debtor attempts to conceal the []appropriation or to deceive the creditor regarding the []appropriation, evidence of such concealment or deception can satisfy the 'circumstances indicating fraud' element."[61]

Bankruptcy courts evaluate the circumstances surrounding the case for traditional indicators of fraud such as "suspicious timing of events, insolvency, transfers to family members or other insiders."[62] But courts "should be cautious not to engage in factor-counting. Instead, the

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[57] Andrade v. Hill (*In re* Hill), 610 B.R. 154, 610 (Bankr. D. Me. 2019).

[58] Bank of America v. Armstrong (*In re* Armstrong), 498 B.R. 229, 237 (8th Cir. B.A.P. 2013) (identifying multiple failures of the debtor to comply with loan document requirements as sufficient circumstantial evidence). *See also* Cash Am. Fin. Servs. v. Fox (*In re* Fox), 370 B.R. 104, 116 (6th Cir. B.A.P. 2007) (stating "the debtor's fraudulent intent may often be shown by circumstantial evidence") (citing Fischer Inv. Capital, Inc. v. Cohen (*In re* Cohen), 334 B.R. 392, 400 n. 7 (Bankr.N.D.Ill.2005)); Westlake Flooring Co., LLC v. Staggs (*In re* Staggs), 573 B.R. 898, 915 (Bankr. N.D. Ala. 2017) (stating "[f]raudulent intent may be inferred from surrounding circumstances and the conduct of the accused.") (quoting Kern v. Taylor (*In re* Taylor), 551 B.R. 506, 521 (Bankr. M.D. Ala. 2016)); Hathaway v. OSB Mfg., Inc. (*In re* Hathaway), 364 B.R. 220, 239 (Bankr. E.D. Va. 2007) (stating "[t]he court may infer intent from the debtor's actions and surrounding circumstances") (citing Hall v. Blanton (*In re* Blanton), 149 B.R. 393, 394 (Bankr. E.D. Va. 1992)); Johnson v. Steen (*In re* Steen), 626 B.R. 469, 477 (Bankr. N.D. Tex. 2021) (finding fraudulent intent "may be inferred from the conduct of the Debtor and from the circumstances of the situation") (quoting Winn v. Holdaway (*In re* Holdaway), 388 B.R. 767, 778 (Bankr. S.D. Tex. 2008)).

[59] Cash Am. Fin. Servs. v. Fox (*In re* Fox), 370 B.R. 104, 116 (6th Cir. B.A.P. 2007) (citing WebMD Servs., Inc. v. Sedlacek (*In re* Sedlacek), 327 B.R. 872, 880-81 (Bankr. E.D. Tenn. 2005)).

[60] McClain v. Crown Coachworks, Inc. (*In re* McClain), 2017 WL 3298418 at *3 (9th Cir. B.A.P. 2017) (citing Phillips v. Arnold (*In re* Phillips), 2016 WL 7383964, at *5 (Mem. Dec.) (9th Cir. B.A.P. Dec. 16, 2016).

[61] *In re* McClain, 2017 WL 3298418 at *3 (9th Cir. B.A.P. 2017) (citing PMM Invs., LLC v. Campbell (*In re* Campbell), 490 B.R. 390, 402 (Bankr. D. Ariz. 2013) and Bello Paradiso, LLC v. Hatch (*In re* Hatch), 465 B.R. 479, 487–90 (Bankr. W.D. Mich. 2012).

[62] General Motors Acceptance Corp. v. Cline (*In re* Cline), 2010 Bankr. LEXIS 9 *22 (6th Cir. B.A.P. 2010) (quoting Automated Handling v. Knapik (*In re* Knapik), 322 B.R. 311, 316 (Bankr. N.D. Ohio 2004)).

circumstances surrounding the case should be reviewed and a determination made as to 'whether all the evidence leads to the conclusion that it is more probable than not that the debtor had the requisite fraudulent intent.'"[63] The "fraudulent appropriation" requirement may be satisfied even if a debtor's conduct was motivated by a desire to help the debtor's business and was not intended to harm the property owner.[64]

In situations where the entrusted property is a UCC security interest (see Sections B and C below), a debtor fraudulently appropriates the UCC security interest when the debtor, in conjunction with circumstances indicating fraud, transfers collateral or proceeds of collateral to a transferee who takes free of the UCC security interest. This type of transfer by a debtor is a complete appropriation because it annihilates the UCC security interest.[65]

B. THE REQUIREMENT OF "PROPERTY"

Bankruptcy courts have interpreted the "property" element of embezzlement broadly. A wide-range of different types of tangible and intangible property satisfy the requirement. For example, bankruptcy courts have found the following items constitute property for purposes of embezzlement: diamonds,[66] rock gravel,[67] a Range Rover vehicle,[68] a

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[63] *In re Cline*, 2010 Bankr. LEXIS 9 *22 (quoting Rembert v. AT&T Univ. Card Servs., Inc. (*In re* Rembert), 141 F.3d 277, 282 (6th Cir. 1998) (addressing a § 523(a)(2) claim)).

[64] *Id.* at *26. *See also* Sherman v. Potapov (*In re* Sherman), 403 B.R. 151, 158-59 (D. Mass. 2009) (observing that even if the debtor "truly was trying to save the company, that fact is not dispositive in the circumstances of this case"); National Bank of Commerce of Pine Bluff v. Hoffman (*In re* Hoffman), 70 B.R. 155, 163-64 (Bankr. W.D. Ark. 1986) (finding that a debtor's "use of proceeds for business debts and continued farm operations is no defense to proof of embezzlement"); Applegate v. Shuler (*In re* Shuler), 21 B.R. 643, 644 (Bankr. S.D. Idaho 1982) (finding fraudulent intent even if the debtor's intent "is to deprive [the creditor] of the funds only temporarily and not permanently"); Moonan v. Bevilacqua (*In re* Bevilacqua), 53 B.R. 331, 334 (Bankr. S.D.N.Y 1985) (concluding that "[e]ven if [the debtor] intended to use the funds only temporarily, [the creditor] was deprived of his property and the resulting conversion constitutes embezzlement for purposes of section 523(a)(4).").

[65] U.C.C. §§ 9-315(a)(1), 9-317, 9-320, 9-321, 9-330, 9-331, and 9-332 (2010).

[66] Israel v. Wolf (*In re* Wolf), 577 B.R. 327, 344 (Bankr. C.D. Cal. 2017).

[67] Outlander Gravel v. Nietert (*In re* Nietert), 521 B.R. 882, 888 (Bankr. W.D. Ark. 2013).

[68] NextGear Capital Inc. v. Mejorado (*In re* Mejorado), 605 B.R. 116, 125 (Bankr. N.D. Texas 2019).

machine gun,[69] a Rolex watch,[70] a checking account,[71] inventory,[72] funds credited to a deposit account to pay credit card charges,[73] funds involved in a funds transfer,[74] foreclosure sale proceeds,[75] the beneficial interest in trust assets,[76] escrowed funds,[77] membership interests in a limited liability company,[78] an electronic file of an employee handbook,[79] confidential information,[80] trade secrets,[81] food recipes,[82] and a business opportunity.[83] As one bankruptcy court explained in an embezzlement context:

> [T]here is no cogent reason to exclude intangible property from the coverage of the statute. A creditor, in this instance an employer, can be cheated or deprived of intangible property just as easily as tangible personal property or money. In this modern society, with its great reliance upon intellectual property and commercial ideas, theft of intangible property is always possible.[84]

Notably, embezzlement often involves an intangible asset such as funds credited to a deposit account, not actual money. The type of property that is embezzled does not and should not matter.

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[69] Lawrence v. Barber (*In re* Barber), 605 B.R. 495, 507 (Bankr. M.D. Tenn. 2019).

[70] Strause v. Atmadjian (*In re* Atmadjian), 577 B.R. 875, 887 (Bankr. C.D. Cal. 2017).

[71] Lewis v. Russo (*In re* Russo), 2019 Bankr. LEXIS 47, 94 (Bankr. N.J. 2019); *see also* Weigend v. Chwat (*In re* Chwat), 203 B.R. 242, (Bankr. E.D. Va. 1996) (finding sufficient property when a partner diverts partnership funds for his or her own use); Great American Insurance Co. v. Graziano (*In re* Graziano), 35 B.R. 589, 596 (Bankr. E.D.N.Y. 1983) (finding sufficient property when an employee misappropriates his or her employer's funds); May v. Lyon (*In re* Lyon), 348 B.R. 9, 26 (Bankr. D. Conn. 2006); Fleming Mfg. Co v. Keogh (*In re* Keogh), 509 B.R. 915, 936 (Bankr. E.D. Mo. 2014).

[72] Race Place of Danbury, Inc. v. Scheller (*In re* Scheller), 265 B.R. 39, 57 (Bankr. S.D.N.Y. 2001) (determining that missing inventory was property for purposes of embezzlement under § 523(a)(4)).

[73] Utah Behavioral Services v. Bringhurst (*In re* Bringhurst), 569 B.R. 814, 822 (Bankr. D. Utah 2017) (involving charges incurred on a credit card).

[74] Me. Coast Shellfish, LLC v. Cowles (*In re* Cowles), 578 B.R. 108, 145 (Bankr. D. Mass. 2017) (involving a wire transfer).

[75] Countrywide Home Loans, Inc. v. Cowin (*In re* Cowin), 492 B.R. 858, 909 (Bankr. S.D. Texas 2013).

[76] Ackerman v. Ackerman (*In re* Ackerman), 587 B.R. 750, 795 (Bankr. E.D. Mass. 2018).

[77] Comptom v. Moschell (*In re* Moschell), 607 B.R. 487, 497-498 (Bankr. W.D. Penn. 2019).

[78] Phelps v. Hunt (*In re* Hunt), 608 B.R. 477, 492 (Bankr. N.D. Texas 2019).

[79] Sierra Chemicals, LLC v. Mosley (*In re* Mosley), 501 B.R. 736, 746 (Bankr. D. N.M. 2013).

[80] Midway Collections, Inc. v. Graff (*In re* Graff), 475 B.R. 770 (Bankr. E.D. Texas 2012).

[81] Wallner v. Liebl (*In re* Liebl), 434 B.R. 529, 537 (Bankr. N.D. Ill. 2010).

[82] Naturally ME, Inc. v. Attridge (*In re* Natural Feast Corp.), 2006 Bankr LEXIS 5066, 2006 WL 2311115 (Bankr. D. Mass. 2006).

[83] Digital Commerce, Ltd v. Sullivan (*In re* Sullivan), 305 B.R. 809, 826 (Bankr. W.D. Mich. 2004) (finding "the 'property' at issue in this adversary proceeding is Digital Commerce's corporate opportunity to prepare the needs analysis for ASR").

[84] *Id.*

1. The Split on Whether a UCC Security Interest Satisfies the "Property" Requirement

Despite this otherwise broad interpretation, there is a split among bankruptcy courts on whether a secured party's UCC security interest satisfies the property requirement of embezzlement. Two approaches have emerged.

The first approach treats a UCC security interest as insufficient to meet the property requirement of embezzlement.[85] This approach focuses on the debtor being the owner of the property that is subject to the UCC security interest and the secured party having only a lien in the property.[86] The frequently repeated rationale is that "one cannot embezzle one's own property."[87] As one court put it, the "[secured party's] security interest does not give it an absolute ownership interest nor does it defeat [the debtor's] ownership interest."[88] Another court explained that the secured party "is not the owner of the [m]otorcycle; they possessed only a perfected security interest in the Debtor's property. Moreover, the undisputed facts reveal that the parties intended for the Debtor to have legal title to the [m]otorcycle. … In other words, [the secured party] possesses only a lien, and is not in ownership or possession of the property."[89] As to proceeds, yet another court said: "[a]s the owner of the collateral, the debtor remained the owner of its proceeds, even though both the collateral and its proceeds were subject to a security interest. No person can embezzle from himself."[90]

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[85] Fidelity Bank v. Jimenez (*In re* Jimenez), 608 B.R. 322, 330 (Bankr. M.D. Ga. 2019).

[86] *Id.* (finding "the property that was transferred was owned by Primera and not Fidelity Bank. Fidelity Bank merely had a security interest in that property. Accordingly, Plaintiff has failed to state an embezzlement claim under § 523(a)(4).").

[87] First National Bank of Fayetteville v. Phillips (*In re* Phillips), 882 F.2d 302, 304 (8th Cir. 1989).

[88] *Id.* at 304-305 (reasoning that "[b]ecause the funds belonged to Midwest subject to FNB's security interest, the debtors could not have embezzled the funds and the debt is not nondischargeable under section 523(a)(4).").

[89] Bombardier Capital, Inc. v. Dobek (*In re* Dobek), 278 B.R. 496, 510 (Bankr. N.D. Ill. 2002) (reasoning that a security interest is not an ownership interest that can be embezzled); *see also* Oak Street Funding LLC v. Brown (*In re* Brown), 399 B.R. 44, 47-48 (Bankr. N.D. Ind. 2008) (explaining that "a debtor that misappropriates a creditor's collateral, and uses it for purposes other than repaying the creditor's loan, does not steal or embezzle that property"); Bank of Castille v. Kjoller (*In re* Kjoller), 395 B.R. 845, 851 (Bankr. W.D. N.Y. 2008) (concluding that embezzlement "does not include property owned by a borrower in which a lender has a security interest"); Franklin Bank, S.S.B. v. Barnes (*In re* Barnes), 369 B.R. 298, 306 (Bankr. W.D. Tex. 2007) (concluding that "an owner of collateral, when he sells the collateral and fails to remit the proceeds to the lienholder, has not embezzled funds from the lienholder"); Bank Calumet v. Whiters (*In re* Whiters), 337 B.R. 326, 333 (Bankr. N.D. Ind. 2006) (finding "a security interest in secured collateral continues in identifiable proceeds, but the interest in those proceeds is still only a security interest and not an ownership interest.").

[90] Deere & Co. v. Contella (*In re* Contella), 166 B.R. 26, 30 (Bankr. W.D. N.Y. 1994); *see also* Johnson v. Steen (*In re* Steen), 626 B.R. 469, 478-79 (Bankr. N.D. Tex. 2021); Arvest Mortgage Co. v. Nail (*In re* Nail), 680 F.3d 1036, 1042 (8th Cir. 2012); First Nat'l Bank of Fayetteville, Ark. v. Phillips

The second approach recognizes that a UCC security interest can satisfy the property requirement of embezzlement.[91] For example, one court found embezzlement where the debtors spent crop proceeds that were subject to a UCC security interest.[92] A transferee of money or funds takes the money or funds free of a UCC security interest.[93]

These two approaches are analogous to the dichotomy that divides courts in determining possession and rents of real property subject to a mortgage.[94] State courts have adopted two understandings of a lender's rights in real property subject to a mortgage: lien theory and title theory.[95] The next section examines the nature of a UCC security interest to show that, regardless of whether a lien theory or title theory analogy is applied, a UCC security interest satisfies the property requirement of embezzlement.

(*In re* Phillips), 882 F.2d 302, 304 (8th Cir. 1989); Kraus Anderson Capital, Inc. v. Bradley (*In re* Bradley), 507 B.R. 192, 200 (B.A.P. 6th Cir. 2014) (stating "[t]his Panel agrees with this line of cases.").

[91] Jones v. Hall (*In re* Hall), 295 B.R. 877, 882 (Bankr. W.D. Ark. 2003) (noting that "[m]any courts hold that a debtor commits an embezzlement under section 523(a)(4) when the debtor sells mortgaged property and fails to remit the proceeds to a properly perfected, secured creditor or consignor."); General Motors Acceptance Corp. v. Cline, No. 4:07cv2576, 2008 U.S. Dist. LEXIS 109322 *17, 2008 WL 2740777 (N.D. Ohio 2008) (finding that "by using GMAC's property for a purpose other than to first pay GMAC what it was owed, in contravention of GMAC's security interest, Cline put the vehicles to a use for which they were not commended."); National City Bank, Marion v. Imbody (*In re* Imbody), 104 B.R. 830, 842 (Bankr. W.D. Ohio 1989) (finding embezzlement occurred when a debtor used crop proceeds that were subject to a security interest in an unauthorized manner); *In re* Beasley, 62 B.R. 653, 655 (Bankr. W.D. Mo. 1986) (finding debtors' sale of secured grain in the debtors' possession and the deposit of the resulting funds in an account accessible only to the debtor constituted embezzlement); Chrysler Credit Corporation v. Rebhan (*In re* Rebhan), 45 B.R. 609, 611 (Bankr. S.D. Fla. 1985) (finding the debtor embezzled sales proceeds and noting Chrysler Credit Corporation was given a security interest in each car it financed as well as the proceeds of its sale); Ford Motor Credit Co. v. Marinko (*In re* Marinko), 148 B.R. 846, 850-51 (Bankr. N.D. Ohio 1992) (finding a debtor's "failure to properly remit sales proceeds was both fraudulent and also constituted embezzlement of [a secured party's] proceeds."); National Bank of Commerce of Pine Bluff v. Hoffman (*In re* Hoffman), 70 B.R. 155, 162-63 (Bankr. W.D. Ark. 1986) (finding that "[b]y taking possession and using the proceeds of [the secured party's] collateral, [the debtor] exercised the requisite dominion over the property in violation of the rights of the owner entitled to possession to constitute conversion of the proceeds.") (internal quotation and citation omitted).

[92] National City Bank, Marion v. Imbody (*In re* Imbody), 104 B.R. 830, 841 (Bankr. W.D. Ohio 1989) (noting the debtors converted the proceeds in order to pay their tax obligations and that they did not have a good faith belief that they were acting properly under the terms of the security agreement); *see also* Peavey Electronics Corp. v. Sinchak (*In re* Sinchak), 109 B.R. 273, 276-77 (Bankr. N.D. Ohio 1990) (finding the creditor held a perfected security interest in all of the Peavey merchandise in the debtor's inventory, including after-acquired property).

[93] U.C.C. § 9-332(a) and (b) (2010).

[94] Robert Kratovil, *Mortgages – Problems in Possession, Rents, and Mortgagee Liability*, 11 DEPAUL L. REV. 1, 4-9 (1961) (explaining that in title theory states a mortgage is a conveyance of land and that immediately on the signing of the mortgage, the mortgagee has the right to take possession of the land and collect rents while in lien theory states, the mortgage merely creates the right to acquire the land through foreclosure of the mortgage).

[95] *Id.*

2. The Nature of a UCC Security Interest

Before the Uniform Commercial Code ("UCC") was widely adopted in the United States, many different types of security devices were used for personal property such as the common law pledge, statutory chattel mortgage, conditional sale, trust receipt, factor's lien, field warehousing, and consignment.[96] These devices involved a variety of structures and creditor interests in the personal property that functioned as security.

For example, the common law pledge involved the creditor/pledgee being given possession of the pledged property "for the purpose of securing the payment of a debt or the performance of some other duty."[97] The creditor/pledgee held the pledged property "only as security for some act to which [it was] entitled."[98] The creditor/pledgee held a legal interest[99] that upon default gave it the right to sell the pledged property after giving reasonable notice or maintain an action for foreclosure and sale of the pledged property.[100]

A chattel mortgage was a statutory security device where the creditor/mortgagee did not take possession of the mortgaged personal property.[101] A chattel mortgage was "a present transfer of the title to the property mortgaged, subject to be defeated on payment of the sum or

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[96] NEGOTIABLE INSTRUMENTS LAW OF 1896; UNIF. SALES ACT OF 1906, UNIF. WAREHOUSE RECEIPTS ACT OF 1906; UNIF. STOCK TRANSFER ACT OF 1909; UNIF. BILLS OF LADING ACT OF 1909; UNIF. CONDITIONAL SALES ACT OF 1918; UNIF. TRUST RECEIPTS ACT OF 1933. *See also GRANT GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY*, 5-250 (1965).

[97] RESTATEMENT OF THE LAW OF SECURITY § 1 cmt. a (Am. Law Inst. 1941). Comment a to § 1 explains that "[t]he pledge is one of the simplest of the security devices. The fundamental idea of the pledge is possession by the pledgee. If the creditor's security interest depends upon possession obtained and held primarily for security, he has a pledge." *See also* Doak v. Bank of State, 28 N.C. 309, 321 (1846) (stating "A mortgage of personal property in law differs from a pledge; the former is a conditional transfer or conveyance of the property itself; and if the condition is not duly performed, the whole title vests absolutely at law in the mortgagee, exactly as it does in a mortgage of lands; the latter, a pledge, only passes the possession, or at most is a special property in the pledge, with the right of retainer, until the debt is paid."); Bundy v. Commercial Credit Co., 202 N.C. 604, 609, 163 S.E. 676, 678 (1932) (defining a pledge to require "(1) The pledged property must be actually delivered to the pledgee; (2) If the pledged property is returned to the pledgor, it must not be commingled or mixed with other property of the pledgor, but it must be understood that the pledgor holds it as agent for the pledgee; (3) If the pledged property consists of notes, accounts or other evidence of indebtedness, and the pledgee places such accounts or notes in the hands of the pledgor for collection, the funds arising from the collection of the pledged property must be kept separate, distinct and intact.").

[98] RESTATEMENT OF THE LAW OF SECURITY § 22 cmt. a (Am. Law Inst. 1941).

[99] *Id.* at § 1 cmt. a (stating the noun "pledge" means a legal interest and the adjective "pledged describes personalty in which the pledgee has a pledge interest.).

[100] *Id.* at § 48.

[101] Garrard Glenn, *The Chattel Mortgage as a Statutory Security*, 25 VA. L. REV. 316, 321 (1939); *GRANT GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY*, § 2.2 (1965); Gandy v. Collins, 214 N.Y. 293, 298, 108 N.E. 415, 416 (1915) (stating "the transaction was intended, not as a pledge of chattels, but as a mortgage, with the result that the trust company after default had the legal title and with it the right to regain possession through replevin.").

instrument it [was] given to secure."[102] If the debtor/mortgagor defaulted, the title of the creditor/mortgagee became absolute.[103] Some states treated chattel mortgages as vesting the creditor/mortgagee with title to the mortgaged property while others viewed the creditor/mortgagee as having only a lien on the mortgaged property that required foreclosure and sale to become absolute title.[104]

The original text on the scope of UCC Article 9 clarified that it applied to security interests "created by contract including pledge, assignment, chattel mortgage, chattel trust, trust deed, factor's lien, equipment trust, conditional sale, trust receipt, other lien or title retention contract and lease or consignment intended as security."[105] This broad scope had far-reaching implications. Pre-UCC terminology such as pledgee, mortgagee, conditional vendor, or factor were collectively distilled into the defined term "secured party."[106] More importantly, the wild assortment of security structures and creditor interests were largely supplanted by the delineated rights and duties of a UCC Article 9 secured party.

Those rights and duties do not depend on whether the secured party or the debtor has title to the property that is subject to the UCC security interest. UCC section 9-202 clarifies that "the provisions of this article with regard to rights and obligations apply whether title to collateral is in the secured party or the debtor."[107] The Official Comment explains:

> The rights and duties of parties to a secured transaction and affected third parties are provided in this Article without

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[102] Parshall v. Eggert, 54 N.Y. 18, 23 (1873).

[103] *Id.*

[104] Phifer v. Gulf Oil Corp. 218 Tenn. 163, 169 (1966) (stating "a chattel mortgage is a conveyance from the mortgagor to the mortgagee of the title to the property mortgaged, subject to defeasance on payment by the mortgagor of the mortgage debt"); *In re* Herkimer Mills Co., 39 F.2d 625, 627 (N.D. N.Y. 1930) (stating "[a] chattel mortgage is in essence a transfer of title as security subject to the reversion of the title upon payment of the debtor performance of the obligation. A transfer of possession is not usual or necessary, but, when there is not an immediate and continuous change of possession, the chattel mortgage must be filed to meet the requirements of the state statute."); Illinois Trust & Sav. Bank v. Alexander Stewart Lumber Co., 119 Wis. 54, 65 (1903) (stating "a mortgagee of chattel property holds the legal title thereto, but nevertheless, till default and actual possession of the property in himself, his interest, as against the mortgagor or any person claiming under him, is special. It is limited to the amount of the mortgage indebtedness."); Shoobert v. De Motta, 112 Cal. 215, 219 (1896) (determining that under the 1873 California Civil Code, the mortgagor is not, by the execution of the chattel mortgage, divested of his title to the property, but still remains its owner, while the mortgagee has only a lien thereon); Hannah & Hogg v. Richter Brewing Co., 149 Mich. 220, 221 (1907) (stating the title of a mortgagee of chattels does not become absolute until foreclosure and sale).

[105] U.C.C. § 9-102(2) (Proposed Final Draft 1950).

[106] U.C.C. § 9-105(1)(i) (Proposed Final Draft 1950) (defining a secured party to mean "a lender, seller or other person in whose favor there is a security interest, including a person to whom accounts, contract rights or chattel paper have been sold.").

[107] U.C.C. § 9-202 (2010).

> reference to the location of "title" to the collateral. For example, the characteristics of a security interest that secured the purchase price of goods are the same whether the secured party appears to have retained title or the debtor appears to have obtained title and then conveyed title or a lien to the secured party.
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> . . .
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> This Article does not determine which line of interpretation (e.g., title theory or lien theory, retained title or conveyed title) should be followed in cases in which the applicability of another rule of law depends upon who has title. If, for example, a revenue law imposes a tax on the "legal" owner of goods or if a corporation law makes a vote of the stockholders prerequisite to a corporation "giving" a security interest but not if it acquires property "subject" to a security interest, this Article does not attempt to define whether the secured party is a "legal" owner or whether the transaction "gives" a security interest for the purpose of such laws. Other rules of law or the agreement of the parties determines the location and source of title for those purposes.[108]

Under the UCC, both the debtor and secured party have an interest in the property that serves as collateral.[109] Collateral is "the property subject to a security interest."[110] A debtor is "a person having an interest, other than a security interest or other lien, in the collateral."[111] A debtor's interest may amount to only "limited rights in collateral, short of full ownership" but that situation does not prevent a security interest from attaching "to whatever rights a debtor may have, broad or limited as those rights may be."[112] A secured party is "a person in whose favor a security interest is created or

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[108] U.C.C. § 9-202 cmts. 2 and 3(b) (2010); *see also GRANT GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY*, § 11.8 (1965) (stating "This provision would have been more interesting seventy-five years ago than it is today. The distinction between lien and title, although it has never bulked as large in the personal property security field as it has, and perhaps still does, in the field of real property mortgages, was relevant in the nineteenth century in a number of situations. In our century the only relevance of title theory with respect to security transactions has been in connection with petitions for reclamation in bankruptcy proceedings—that is, demands that the trustee in bankruptcy physically deliver to the claimant the property covered by the petition.").

[109] U.C.C. §§ 9-102(a)(28) and 73 (2010).

[110] U.C.C. § 9-102(a)(12) (2010).

[111] U.C.C. § 9-102(a)(28) (2010).

[112] U.C.C. § 9-203(b)(2) cmt. 6 (2010). A debtor might have no rights in the collateral provided the debtor has the power to convey rights in it. *See* U.C.C. § 9-204.

provided for under a security agreement."[113] A security agreement is "an agreement that creates or provides for a security interest."[114]

Like many other types of property, a UCC security interest as well as its attributes come from a contract and applicable law.[115] For a UCC security interest, the sources include the parties' security agreement, the UCC, and other applicable law.[116] The Supreme Court has recognized that a secured party's UCC security interest is a private property right that merits protection under the Fifth Amendment of the U.S. Constitution:

> The "bundle of rights" which accrues to a secured party is obviously smaller than that which accrues to an owner in fee simple, but the government cites no cases supporting the proposition that differences such as these relegate the secured party's interest to something less than property.[117]

The UCC defines a security interest as "an interest in personal property or fixtures which secures payment or performance of an obligation."[118] An interest is any one of the "varying aggregates of rights, privileges, powers and immunities" with regard to property.[119] Although there are countless ways to describe property, for purposes of this Article, it is sufficient to

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[113] U.C.C. § 9-102(a)(73) (2010).

[114] U.C.C. § 9-102(a)(74) (2010).

[115] Butner v. U.S., 440 U.S. 48, 55 (1979) (stating "[p]roperty interests are created and defined by state law.").

[116] For example, consider the Bankruptcy Code's treatment of adequate protection (11 U.S.C. § 361), cash collateral (11 U.S.C. § 363(a)), and secured claims (11 U.S.C. § 506).

[117] United States v. Security Indus. Bank, 459 U.S. 70, 76 (1982) (noting in footnote 6 that one of the parties had conceded at oral argument that the security interests at issue in the case were treated as property under state law). The case involved a non-purchase-money, non-possessory UCC security interest and the application of § 522(f)(2) of the Bankruptcy Law Reform Act of 1978.

[118] U.C.C. § 1-201(b)(25) (2010).

[119] RESTATEMENT (FIRST) OF PROPERTY, § 5 (Am. Law Inst. 1936); *see also* RESTATEMENT (FIRST) OF PROPERTY, § 5 cmt. C ("There are rights, privileges, powers and immunities with regard to specific land, or with regard to a thing other than land, which exist only in a particular person. By virtue of the fact that a person has these special interests, other than and in addition to those possessed by members of society in general, he occupies a peculiar and individual position with regard thereto."); *JOHN A. BORRON, JR., 1 SIMES AND SMITH THE LAW OF FUTURE INTERESTS* § 359 (3d ed.) (January 2021 Update) (stating "The recognized estates in land are the fee simple, the fee tail, the life estate, and the term of years. To this may be added the tenancy at will. Do estates exist in chattels, which are identical with these, at least as to the duration of the privilege of enjoyment? Obviously, there may be an absolute transfer of the chattel. The interest which then arises is certainly analogous to the fee simple estate in land so far as its potential duration or the privilege of enjoyment is concerned. Whether it should be called a fee simple estate or by some other term may be questionable. It would be inappropriate, however, to assert that such an interest has all the characteristics of the fee simple estate in land. … It needs no citation of authority to show that possession of a chattel may be granted for a specific term or at will. Such transactions are commonly called bailments. It should be further noted that there are other present interests in chattels which do not come within any of the types mentioned. Among these are the interests of lienors, pledgees, and conditional vendors.").

assume that property is the totality of all interests in a thing and that the fundamental interests in a thing include the right to transfer, the right to possess (or control for intangible personal property), and the right to use.[120]

A security interest gives a secured party an interest "which secures payment or performance of an obligation."[121] The specific attributes of that interest are contoured by Parts 2 and 6 of UCC Article 9 and more often than not a security agreement between the debtor and secured party. Section 9-201 explains that "[e]xcept as otherwise provided in [the UCC], a security agreement is effective according to its terms between the parties, against purchasers of the collateral, and against creditors."[122] Further, upon a debtor's default, a perfected security interest is enforceable against not only the debtor but also against third parties.[123]

Property interests in collateral, including a UCC security interest, are like sand in an hourglass. The sand represents the totality of all interests in a particular item of property. The hourglass has three bulbs. The first bulb represents the property interests of the debtor. The second bulb represents the property interests of the secured party. The third bulb represents the property interests of a transferee of the debtor who takes free of a UCC security interest. Before granting a security interest, a debtor has the totality of all interests in the property, meaning all of the sand is in the debtor's bulb of the hourglass. When a debtor grants a UCC security interest to a secured

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[120] Henry T. Terry, *Legal Duties and Rights*, 12 YALE L.J. 185, 199 (1903); *see also* Wesley N. Hohfeld, *Fundamental Legal Conceptions as Applied in Judicial Reasoning*, 26 YALE L.J. 710, 714-70 (1917); Arthur L. Corbin, *Rights and Duties*, 33 YALE L.J. 501, 509 n.11 (1924); Morris R. Cohen, *Property and Sovereignty*, 13 CORNELL L. REV. 8, 12 (1927); RESTATEMENT (FIRST) OF PROPERTY, Introductory Note (Am. Law Inst. 1936) (stating property denotes "legal relations between persons with respect to a thing. The thing may be an object having physical existence or it may be any kind of an intangible such as a patent right or a chose in action."); RESTATEMENT (FIRST) OF PROPERTY, § 10 cmt. b (Am. Law Inst. 1936) (stating "A person who has the totality of rights, powers, privileges and immunities which constitute complete property in a thing is the 'owner' of the 'thing,' or 'owns' the 'thing.'"); Felix S. Cohen, *Dialogue on Private Property*, 9 RUTGERS L. REV. 357 (1954); A.M. Honore, *Ownership*, in OXFORD ESSAYS IN JURISPRUDENCE (A.G. Guest ed., 1961); Frank I. Michelman, *Property, Utility, and Fairness: Comments on the Ethical Foundations of "Just Compensation" Law*, 80 HARV. L. REV. 1165 (1967); Guido Calabresi & A. Douglas Melamed, *Property Rules, Liability Rules and Inalienability: One View of the Cathedral*, 85 HARV. L. REV. 1089 (1972); *LAWERENCE C. BECKER, PROPERTY RIGHTS: PHILOSOPHIC FOUNDATIONS* 18-20 (1977); Kenneth J. Vandevelde, *The New Property of the Nineteenth Century: The Development of the Modern Concept of Property*, 29 BUFF. L. REV. 325 (1980); *STEPHEN R. MUNZER, A THEORY OF PROPERTY* 22-28 (1990); Richard A. Epstein, *Property and Necessity*, 13 HARV. J. L. & PUB. POL'Y 2, 3 (1990); J.E. Penner, *The Bundle of Rights Picture of Property*, 43 UCLA L. REV. 711 (1996); Thomas W. Merrill, *Property and the Right to Exclude*, 77 NEB. L. REV. 730 (1998); Thomas W. Merrill & Henry E. Smith, *The Property/Contract Interface*, 101 COLUM. L. REV. 773 (2001); Anna di Robilant, *Property: A Bundle of Sticks or a Tree?*, 66 VAND. L. REV. 869, 903-918 (2013).

[121] U.C.C. § 1-201(b)(25) (2010).

[122] U.C.C. § 9-201(a) (2010).

[123] U.C.C. § 9-203(b) (2010).

party, the debtor transfers a measure of sand to the secured party's bulb.[124] Collateral, meaning "property subject to a security interest," is simply an hourglass with most of the sand in the debtor's bulb but some of it in the secured party's bulb.[125]

Eventually, all sand will move to one of the three bulbs. In other words, the totality of all property interests in collateral will inevitably pass to either the debtor (upon satisfaction of the obligation and release of the UCC security interest), the secured party (upon default and either disposition, collection, or acceptance of collateral), or a transferee who takes free of the UCC security interest. In situations where a UCC security interest continues in collateral notwithstanding a debtor's sale, lease, license, exchange, or other disposition to an initial transferee, the collateral so disposed will continue to be subject to the security interest until either the secured party disposes, collects, or accepts the collateral or another transferee takes the property free of the security interest.[126]

In most secured transactions, the debtor fully performs its obligations under the security agreement and the secured party's UCC security interest lays dormant with respect to the property that serves as collateral until it is released, terminated, or disclaimed.[127] In that scenario, all sand in the secured party's hourglass bulb moves back to the debtor's bulb. In other situations, a debtor's uncured default and secured party's subsequent exercise of remedies triggers the movement of sand from the debtor's bulb to the bulb of the secured party (or a person taking the property by and through the secured party's disposition of collateral). Under the UCC, a disposition, collection, or acceptance of collateral eliminates all of a debtor's interests in the property that was subject to the UCC security interest.[128]

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[124] Although personal property analogies to estates and future interests in land are sometimes clunky and inapt, in some ways a security interest is similar to a present estate in the collateral where the debtor grants a determinable fee to the secured party while retaining the right to possession and a possibility of reverter with the condition terminating the determinable fee being full payment and performance of the debtor's obligations. *See JOHN A. BORRON, JR., 1 SIMES AND SMITH THE LAW OF FUTURE INTERESTS* §§ 351-363 (3d ed.) (Jan. 2021 Update) (stating the interest of a pledgor and the interest of a lienee as a future privilege of enjoyment of chattels is similar to those involved in future interests in land: "The extent and character of the future enjoyment depends ordinarily upon certain types of contracts. It is true that these interests are not ordinarily spoken of as future interests, but there is a future privilege of enjoyment which would seem to be somewhat like that involved in the usual types of future interests.") *But see* U.C.C. § 9-402 (2010) (stating "[t]he existence of a security interest, agricultural lien, or authority given to a debtor to dispose of or use collateral, without more, does not subject a secured party to liability in contract or tort for the debtor's acts or omissions.").

[125] U.C.C. § 9-102(a)(12) (2010).

[126] U.C.C. §§ 9-315(a)(1), 9-317, 9-320, 9-321, 9-330, 9-331, and 9-332 (2010).

[127] U.C.C. §§ 9-210 and 9-513 (2010).

[128] U.C.C. §§ 9-601-624 (2010). For example, § 9-617(a)(1) states that a secured party's disposition of collateral after default "transfers to a transferee for value all of the debtor's rights in the collateral."

Until the time that all of the sand has moved to one bulb, the interests of a debtor in collateral and the interests of a secured party in collateral are intertwined. A UCC security interest is not merely dependent on the property that serves as collateral, it is literally part of the property—an interest in it.[129] Thus, a UCC security interest has an interwoven relationship with the property that serves as collateral.[130] Considering the fundamental property interests of the right to transfer, possess (or control), and use provides helpful insight into the nature of a UCC security interest.

a. Right to Transfer

A transfer is the "extinguishment of [interests in a thing] existing in one person and the creation of such interests in another person."[131] A secured party's right to transfer its UCC security interest is typically addressed in the security agreement and UCC security interests are often freely assignable.[132] Unless otherwise agreed in a security agreement, a secured party has the full unfettered right to transfer its UCC security interest.[133]

Security agreements also address and typically limit or prohibit a debtor's right to transfer its interest in the collateral.[134] Section 9-401 of the

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[129] U.C.C. § 1-201(b)(35) (2010). *See* Danielle D'Onfro, *Limited Liability Property*, 39 CARDOZO L. REV. 1365, 1396 (2018) (observing that "security interests have too many attributes of property interests to fit comfortably within a contractual framework.").

[130] *See* D'Onfro, *Limited Liability Property*, *supra* note 129, at 1426 (noting "the awkward fit between secured lenders' direct ownership claim—and therefore their priority right—and limited liability.").

[131] RESTATEMENT (FIRST) OF PROPERTY, § 13 (Am. Law Inst. 1936). *See also id.* § 13 cmt. a (stating "[a] transfer as thus defined may be either of one or more specified interests or of an aggregate of interests.").

[132] *See* § 6.5 of the ABA Model Intellectual Property Security Agreement (stating "Secured Party may assign the Secured Obligations to one or more assignees on such terms and conditions as Secured Party deems advisable"), *HOWARD RUDA, ASSET BASED FINANCING: A TRANSACTIONAL GUIDE*, Vol. 1A, Form 3-2 Security Agreement § 10(a) (2016) (stating "Secured Party may assign any or all of the Obligations together with any or all of the security therefor and any transferee shall succeed to all of Secured Party's rights with respect thereto" and § 6 of Form 3-6 Pledge Agreement (Investment Property) stating "Lender reserves the right at any time to create ad sell participations in the Loans and the Loan Documents and to sell, transfer or assign any or all of its rights in the Loans and under the Loan Documents."); U.C.C. § 9-514 (2010); U.C.C. § 9-210 cmt. 5 (2010) (stating "[a] debtor may be unaware that a creditor with whom it has dealt has assigned its security interest or the secured obligation. Subsections (d) and (e) impose upon recipients of requests under this section the duty to inform the debtor that they claim no interest in the collateral or secured obligation, respectively, and to inform the debtor of the name and mailing address of any known assignee or successor."); *see also* David G. Epstein, *Security Transfers by Secured Parties*, 4 GA. L. REV. 527 (1969-1970).

[133] For example, consider UCC provisions addressing chattel paper.

[134] *See* § 3.1 of the ABA Model Intellectual Property Security Agreement (stating "Debtor will not Transfer any Collateral except in a Permitted Transfer") and RUDA, *supra* note 132, Vol. 1A, Form 3-2 Security Agreement § 4(a) (stating "Company covenants that until the Obligations are paid in full it shall: (a) not dispose of any of the Collateral whether by sale, lease or otherwise except for (i) the sale of Inventory in the ordinary course of business, and (ii) the disposition or transfer of obsolete and worn-out Equipment in the ordinary course of business….").

UCC addresses the alienability of the debtor's rights in collateral and validates the effect of such transfers even if the transfer breaches a debtor's obligations under a security agreement.[135] If a debtor makes a prohibited transfer of its rights in the collateral, depending on the type of transferee and the nature of the transaction, the transferee of the debtor's rights in the collateral takes the collateral subject to the secured party's UCC security interest.[136]

Significantly, upon a debtor's default a secured party may enforce its UCC security interest in the collateral by exercising several different remedies delineated in UCC Article 9 and the security agreement.[137] Such rights include the secured party accepting the collateral in satisfaction of the obligation that is owed or the secured party disposing of the collateral and applying the proceeds of the disposition toward the obligation that is owed.[138] In these situations, a secured party's election to enforce its UCC security interest gives the secured party a premier right to forcibly transfer the debtor's rights in the collateral.[139]

Accordingly, a secured party nearly always has an absolute right to transfer its UCC security interest. In some situations, such as when a debtor defaults, a secured party may, by virtue of its UCC security interest, also have the right to transfer the debtor's interest in the collateral.

b. Right to Possess (or Control)

Possession is "having or holding property in one's power; the exercise of dominion over property" and may include control or dominion over property without actual physical possession or custody of it.[140] Similarly, the concept of control applies to intangible personal property. Control

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[135] U.C.C. § 9-401(b) (2010) (stating "[a]n agreement between the debtor and secured party which prohibits a transfer of the debtor's rights in collateral or makes the transfer a default does not prevent the transfer from taking effect.").

[136] *But see* U.C.C. §§ 9-317, 9-320, 9-321, 9-330, 9-331, and 9-332 (2010) (addressing situations where a lien creditor, buyer in ordinary course of business, licensee in ordinary course of business, lessee in ordinary course of business, purchaser of chattel paper, holder in due course of a negotiable instrument, holder to which a negotiable document of title has been duly negotiated, protected purchaser of a security, transferee of money, or transferee of funds from a deposit account takes free of or has priority over a security interest).

[137] U.C.C. § 9-601(a) (2010) (stating "[a]fter default, a secured party has the rights provided in this part and, except as otherwise provided in Section 9-602, those provided by agreement of the parties.").

[138] U.C.C. §§ 9-620, 9-610, 9-615 (2010). Note however, that in eliminating a debtor's rights in collateral through a disposition, a debtor is entitled to be paid for any equity it may have that is realized through the disposition of the collateral. *See* U.C.C. § 9-615(d)(1) (2010).

[139] U.C.C. § 9-617(a)(1) (2010) (stating "[a] secured party's disposition of collateral after default transfers to a transferee for value all of the debtor's rights in the collateral") and U.C.C. § 9-620 Comment 2 (2010) (stating "[t]his section and the two sections following deal with strict foreclosure, a procedure by which the secured party acquires the debtor's interest in the collateral without the need for a sale or other disposition under Section 9-610.").

[140] *Possession and constructive possession*, BLACK'S LAW DICTIONARY (10th ed. 2014).

involves the exercise of dominion over property and may include the power to avail the person with control of "substantially all the benefits from" the property and "the exclusive power to prevent others from availing themselves" of such benefits along with the exclusive power to "transfer control" of the property to another person.[141]

Because of its intangible nature, a UCC security interest cannot be physically possessed even though it is an interest in other personal property that may be tangible and intangible. A secured party has the right to control its UCC security interest. Under UCC Article 9 and the typical security agreement, upon a debtor's default, a secured party may exercise several different remedies against the collateral. A secured party's ability to exercise discretion with respect to remedies demonstrates a secured party's right to control its UCC security interest.[142] A secured party has power to avail itself of substantially all the benefits from a UCC security interest. The prior discussion about a secured party's right to transfer its UCC security interest is also an indication of a secured party's right to control its UCC security interest, including the decision of whether a secured party will assign, retain, or encumber its UCC security interest.

In addition to the right to control its UCC security interest, in some transactions a secured party has the right to possess the collateral even before a debtor defaults.[143] In other transactions, the debtor has possession of the collateral and the secured party "may take possession of the collateral" only after a default by the debtor."[144] Depending on the type of collateral, a secured party has the right to "require the debtor to assemble the collateral and make it available to the secured party."[145] The UCC specifically

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[141] Uniform Commercial Code Amendments (2022), § 12-105(a).

[142] U.C.C. §§ 9-601, 9-607, 9-609, 9-610 (2010) (each stating a secured party "may" exercise a given remedy); § 4.2 of the ABA Model Intellectual Property Security Agreement (stating "The remedies provided to Secured Party in this Agreement are cumulative and in addition to the other rights and remedies available under applicable law. Remedies may be exercised separately or concurrently, without demand on or notice to Debtor, except as required (A) expressly by this Agreement or (B) by applicable law, and the exercise or partial exercise of any such right or remedy will not preclude the exercise of any other right or remedy."); and RUDA, *supra* note 132, Vol. 1A, Form 3-10 Security Agreement § 5.2(a) (stating "If any Default shall have occurred and be continuing, then Lender may exercise any rights and remedies provided to Lender under the Loan Documents or at law or equity, including all remedies provided under the Code….").

[143] U.C.C. §§ 9-203(b)(3)(B), 9-207, 9-313 (2010); *see also GRANT GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY*, 1128 § 42.1 (1965) (stating that "[a] lender in possession of his borrower's property, before or after default, does not hold it as absolute owner. If the loan is repaid at maturity or if the delinquent borrower cures his default, the property will have to be returned. From one point of view, the lender in possession is merely a custodian or bailee for the true owner and owes duties of preservation and care with respect to the property temporarily entrusted to him. From another point of view, he is holding property in which he has an interest and which may become his own.").

[144] U.C.C. § 9-609(a)-(b) (2010).

[145] U.C.C. § 9-609(c) (2010).

addresses how a secured party obtains control of several different types of collateral that are intangible personal property.[146] It also places duties on a secured party who has possession or control.[147] Accordingly, subject to the terms of the security agreement, a secured party has the right to control its UCC security interest and in some situations also has the right to possess or control the collateral.

c. Right to Use

A use is "[t]he application or employment of something … for the purpose for which it is adapted."[148] From the perspective of a secured party, the purpose of a UCC security interest is to increase the likelihood of payment or other performance of obligations. UCC Article 9 and the typical security agreement outline various ways a secured party may use its UCC security interest.

A secured party's use of collateral is also commonly addressed in a security agreement and generally relates to maintaining or enforcing a UCC security interest in the collateral.[149] UCC Article 9 gives a secured party in possession of collateral permission to use or operate collateral "for the purpose of preserving the collateral or its value" or "except in the case of consumer goods, in the manner and to the extent agreed by the debtor."[150] Use of collateral by the debtor is also typically addressed in a security agreement.[151]

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[146] U.C.C. §§ 9-104, 9-105, 9-106, and 9-107 (2010) (addressing control of a deposit account, electronic chattel paper, investment property, and letter-of-credit rights). *See also* Uniform Commercial Code Amendments (2022), §§ 9-104, 9-105, 9-105A, 9-107A, and 12-105.

[147] U.C.C. §§ 9-207 and 9-208 (2010) (imposing various duties).

[148] *Use*, BLACK'S LAW DICTIONARY (10th ed. 2014).

[149] *See* RUDA, *supra* note 132, Vol. 1A, Form 3-2 Security Agreement § 13 (stating that after default and "[u]ntil Secured Party is able to effect a sale, lease, or other disposition of Collateral, Secured Party shall have the right to use or operate Collateral or any part thereof, to the extent that it deems appropriate for the purpose of preserving Collateral or its value or for any other purpose deemed appropriate by Secured Party."); § 3.6.2 of the ABA Model Intellectual Property Security Agreement (stating "Solely to enable Secured Party to exercise its rights and remedies under this [agreement] during and after an Event of Default, Debtor grants Secured Party a nonexclusive, irrevocable, worldwide license (or sublicense) to use and exercise Debtor's rights in or to any of Debtor's Intellectual Property … without payment of royalty or other compensation to Debtor.").

[150] U.C.C. § 9-207(b)(4) (2010).

[151] RUDA, *supra* note 132, Vol. 1A, Form 3-2 Security Agreement § 4 (containing a debtor's covenant to not dispose of any collateral other than inventory in the ordinary course of business, to not encumber or assign any collateral to anyone other than the secured party, to not alter the payment terms of any receivable, and to keep and maintain the equipment in good operating condition); § 3.6.2 of the ABA Model Intellectual Property Security Agreement (stating "[w]ith respect to Collateral that is necessary to the conduct of Debtor's business as currently conducted, Debtor will take all reasonable steps to maintain the registrations of all such registered Collateral in full force and effect … and prevent any such Collateral from being abandoned, forfeited, or dedicated to the public.").

In summary, a UCC security interest embodies the fundamental property interests of the right to transfer, the right to control, and the right to use.[152] It is intangible personal property that satisfies the "property" requirement of embezzlement under § 523(a)(4) of the Bankruptcy Code.

C. THE REQUIREMENT OF "ENTRUSTMENT" OF PROPERTY

The final element of embezzlement requires the fraudulent appropriation of property to have been done "by a person to whom such property has been entrusted, or into whose hands it has lawfully come."[153] For collateral that is tangible property, entrustment involves the transfer of (or acquiescence in) possession of the collateral to the debtor for a specific purpose.[154] For intangible property, entrustment involves giving or allowing the debtor to retain power or control for a specific purpose. A secured party entrusts its UCC security interest to the debtor in situations where the debtor has power or control over the collateral.

A debtor may acquire power or control over property in a variety of ways. For example, proprietary information and trade secrets were lawfully in the hands of a debtor when, acting as vice president and director of a highway and road contractor, he became privy to "management policies, customer lists, pricing and bidding strategies, and profit margins and cost projections on specific projects."[155] In another situation, a debtor was in

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[152] *See also* Steven L. Harris and Charles W. Mooney, Jr., *A Property-Based Theory of Security Interests: Taking Debtors' Choices Seriously*, 80 VA. L. REV. 2021, 2051 (1994) (stating "[a] security interest affords the secured party an amalgam of rights that traditionally have constituted 'property'").

[153] Moore v. United States, 160 U.S. 268, 269-70 (1895).

[154] Palisades Tickets, Inc. v. Daffner (*In re* Daffner), 612 B.R. 630, 636 (Bankr. E.D. N.Y. 2020) (finding entrustment when a debtor who was an attorney received money from his client and deposited the funds in the attorney's Interest on Lawyer Account); Kontos v. Manevska (*In re* Manevska), 587 B.R. 517, 534 (Bankr. N.D. Ill. 2018) (finding entrustment when a debtor who acted as a caregiver was given a patient's checkbook and ATM card to pay living expenses for the patient); Strause v. Atmadjian (*In re* Atmadjian), 577 B.R. 875, 887 (Bankr. C.D. Cal. 2017) (finding entrustment when a creditor delivered a white gold watch to a jeweler to sell on the creditor's behalf); Koressel v. Bowman (*In re* Bowman), 607 B.R. 614, 620 (Bankr. W.D. Ky. 2019) (finding that the LLC manager's "power over the use of [LLC's] funds—100% of which, at the company's inception, came from [the creditor's] contribution and loans—establish that [the debtor] was "entrusted" with those funds as required by the first element of embezzlement under § 523(a)(4)."); United States v. Reid (*In re* Reid), 598 B.R. 674, 678 (Bankr. S.D. Ala. 2019) (finding the secured party "entrusted property to the Debtor" when a debtor granted a purchase money security interest to a secured party in a New Holland tractor that the debtor kept in her possession). On the other hand, a creditor who made an unsecured personal loan to a debtor with no conditions on how the money would be spent did not entrust property. *See* Sheen Falls Strategies, LLC v. Keane (*In re* Keane), 560 B.R. 475, 493 (Bankr. N.D. Ohio 2016) (finding creditor had not "proved by a preponderance of the evidence that the debtor agreed to use the money for only specific purposes or that the debtor had to report to the creditors if he used the money for something else."). *See also* U.C.C. §§ 9-315 cmt 2 and 9-320 cmt 3, ex.2 (2010).

[155] Miller v. J.D. Abrams Inc. (*In re* Miller), 156 F.3d 598, 600 (5th Cir. 1998) (concluding that a jury's finding that a debtor "acted wrongfully in misappropriating or misusing Abrams's proprietary information does not include a finding of fraudulent intent.").

lawful control when he was made an authorized signatory on a corporate checking account at a bank.[156] One of the most common ways a debtor acquires power or control over the property of another is by contract.[157]

In a typical security agreement, the secured party and debtor agree on a variety of matters such as a description of the collateral, the obligations that the collateral secures, the location of the collateral, use of the collateral, insurance on the collateral, maintenance of the collateral, whether and under what conditions the debtor may sell the collateral, events of default, remedies, and a host of other topics.[158]

Security agreements commonly provide that the debtor has authority and control over collateral for specific, authorized purposes. Because of the interwoven relationship between a UCC security interest and the property that serves as collateral, a debtor should not be immune from an embezzlement claim relating to a secured party's UCC security interest simply because the debtor has ownership rights in the collateral.[159] The subject of the embezzlement claim is the UCC security interest, not the debtor's interest in the collateral. A secured party entrusts its UCC security interest to the debtor in transactions where the debtor has authority and control over the collateral.[160] This is especially so when a debtor transfers collateral or proceeds of collateral to a transferee who takes free of the UCC security interest. This type of transfer shows the vulnerability of a secured party's UCC security interest arising from the entrustment, which is a fundamental characteristic of embezzlement.[161]

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[156] Hathaway v. OSB Mfg., Inc. (*In re* Hathaway), 364 B.R. 220, 240 (Bankr. E.D. Va. 2007) (involving a situation where the debtor acted "as a Manager who ran the day-to-day operations of OSB, including the handling of all finances and disbursements of money.").

[157] Werner v. Hofmann (*In re* Hofmann), 144 B.R. 459, 464 (Bankr. N.D. 1992) (*aff'd,* Werner v. Hofmann, 5 F.3d 1170 (8th Cir. 1993) (involving cattle lease agreements).

[158] When collateral is inventory, security agreements commonly limit the debtor to selling the collateral only in its regular course of business and impose limitations on the use of the proceeds of the sale of collateral.

[159] U.C.C. § 9-102(a)(28) (2010) (defining a debtor as "a person having an interest, other than a security interest or other lien, in the collateral.").

[160] U.C.C. § 9-203(b)(2) (2010). A debtor who has been entrusted with collateral has been entrusted with a UCC security interest.

[161] U.C.C. §§ 9-315(a)(1), 9-315 cmt. 2, 9-317, 9-320, 9-321, 9-330, 9-331, and 9-332 (2010).

IV. CONCLUSION

The "embezzlement" exception to discharge requires a debtor fraudulently appropriate entrusted property. A secured party entrusts its UCC security interest to a debtor in situations where a debtor has power or control over collateral. A UCC security interest satisfies the property element of embezzlement because it embodies the fundamental property interests of the right to transfer, the right to control, and the right to use. A debtor fraudulently appropriates a UCC security interest when the debtor, in conjunction with circumstances indicating fraud, transfers collateral or proceeds of collateral to a transferee who takes free of the UCC security interest. A debtor can embezzle a UCC security interest. Debt related to such embezzlement should not be discharged.