UNITED STATES BANKRUPTCY COURT
For the Southern District of Iowa

In re:	**:**	**Case No. 99-1005-CH**
TORY LINT CONSTRUCTION, INC.,	**:**	
	:	
	:	**Chapter 7**
Debtor.	**:**	
	:	

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ORDER— MOTION FOR TURNOVER OF PROPERTY AND OBJECTION THERETO

On January 31, 2000, hearing was held on Trustee's Motion for Turnover of Property and Objection Thereto. Trustee, Anita Shodeen, was represented by attorney Jerold Wanek. Tory Lint Construction, Inc., was represented by Julie Johnson McLean. Trent and Stacey Fugere were represented by G. Mark Rice. At the conclusion of the hearing, the court took the matter under advisement upon a briefing schedule. Post-trial briefs have been filed, and the court now considers the matters fully submitted.

The court has jurisdiction of these matters pursuant to 28 U.S. C. § 157(b)(1) and § 1334 and order of the United States District Court for the Southern District of Iowa pursuant to 28 U.S.C. § 157(a). This is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(E). Upon review of the pleadings, evidence, briefs, and arguments of counsel, the court now enters its findings and conclusions pursuant to Fed. R. Bankr. P. 7052.

FINDINGS OF FACT

1. On March 19, 1999, Tory Lint Construction, Inc., aka Five Star Garage Doors and Custom Designed Homes (hereinafter Debtor) filed a petition for Chapter 7 relief in the United States Bankruptcy Court, Southern District of Iowa.

2. On Schedule F, Creditors Holding Unsecured Nonpriority Claims, Debtor scheduled Trent and Stacy [sic] Fugere (hereinafter Fugeres) of 325 Julianna [sic] Ct., Polk City Iowa, holding a disputed claim of unknown amount. Debtor also scheduled Fugeres on Schedule G as parties to a lease or contract. The description of the lease or contract and the nature of Debtor's interest was scheduled as an escrow of $4,258.00 held by the Law Offices of Mark A Critelli (hereinafter Critelli).

3. Fugeres hired Debtor to construct their home. The home was financed by Liberty Bank and Trust, nka Commercial Federal Bank, 5721 Merle Hay Road, Johnston, Iowa (hereinafter Bank). Critelli was retained to act as a "closing agent" for Commercial Federal.

4. The closing of the real estate transaction occurred on January 23, 1998. At Line 508, the settlement statement included $5,273 for Escrow For Completion.

5. The Critelli firm drafted the Escrow Agreement between Debtor and Fugeres. The agreement was dated January 23, 1998, and entered as a part of the real estate closing. Its purpose was to ensure that certain items in the construction of the real property that were not finished at the closing would be completed by Debtor in the spring of 1998.

6. The agreement provided that $5,273.00 would be withheld from the purchase price of the real property known as 325 Juliana Court, Polk City, Iowa. Further, it designated the Law Offices of Mark A. Critelli or its agent to act as escrow agent and hold the funds. The amount escrowed represents one and one-half (1½) times the estimated cost to complete the a) exterior paint, $750.00; b) final grade and sod, $600.00; c) gutters, $265.00; d) concrete, $550.00; e) retaining walls, $500.00; f) landscaping, $350.00; g) deck + extension, $400.00; and h) basement stairs (drywall at end), $100.00. The total amount of the estimate to complete the listed items was $3,515.00. The one and one-half (1½) amount was to provide an "escrow cushion" in the event that the estimate was too low because the work was completed by a third party or some other unexpected cost arose.

7. The paragraph three (3) of the escrow agreement expressly provides:

> DISBURSEMENT- No monies shall be released by the Law Offices of Mark A. Critelli or their designated agent until receipt of a written inspection form from the original appraiser of the property and/or the contractor of work performed to the effect that all elements of such construction have been satisfactorily completed by Builder/Seller, and the Law Offices of Mark A. Critelli has written authorization from Liberty Bank & Trust to release such funds, in which case the Law Offices of Mark A. Critelli shall pay over all monies (less inspection fees) to Builder/Seller. If improvements are not completed by May 30, 1998, the Law Offices of Mark A. Critelli may select a builder to complete work and pay out of escrow sums. The Law Offices of Mark A. Critelli does not need to competitively bid the job and can disburse proceeds without Buyer/Builder approvals.

8. On July 2, 1998, Critelli received correspondence from Commercial Federal Bank instructing payment to Tory Lint Construction for work completed on the exterior paint and gutters. The correspondence requested that Critelli accept it as written

inspection for the disbursement of escrow funds for the completed items. The total amount of the payment was to be $1,015.00.

9. Critelli paid Debtor $1522.50 from the escrow funds by a check dated August 4, 1998. This amount included $750.00 for the exterior paint, $265.00 for the gutters, and $507.50 which represented the escrow cushion for these items.

10. On September 22, 1998, Critelli received a memo from Trent Fugere and an accompanying bill from Bill's Yard and Home Improvement, 120 15th Street, Altoona, IA 50009. Bill's Yard and Home Improvement did work on the retaining wall. Fugere requested that $750.00 be paid from the escrow account.

11. The escrow account contained $500.00 and a $250.00 cushion for the retaining walls. Critelli decided to release $750.00 to Bill's Yard and Home Improvement because the work on the retaining wall exceeded $500.00. Critelli paid Bill's Yard and Home Improvement $750.00 by a check dated September 23, 1998.

12. On March 19, 1999, Critelli received notice of the Tory Lint Construction, Inc. bankruptcy filing. At that time, he determined that he would not release any more of the bankruptcy funds without an order from the bankruptcy court. As of January 27, 2000, the escrow account under Critelli's control contained $3,000.50.

13. Critelli never received a written inspection form from the original appraiser or the contractor of work performed stating that all elements of such construction had been satisfactorily completed by Debtor.

14. Tory Lint, president of Debtor, testified that all of the items covered by the escrow agreement had been completed.

15. Trent Fugere testified that all of the items were completed with the exception of the basement stairs. However, Fugere was not satisfied with the quality of the work. Shortly after its construction, cracks formed in the concrete driveway. The side retaining wall was improperly built and required replacement. The house was damaged when the sod was put down. The sod and the rear retaining wall were not completed to Fugeres' satisfaction and washed out. Fugeres have thus far incurred expenses in excess of $12,000.00 to repair their home.

DISCUSSION

On November 19, 1999, counsel for Trustee filed a Motion for Turnover of Property held by Escrow Agent. Trustee contends $2,400.00 of the escrowed funds are property of Debtor, and argues that Bankruptcy Code § 543 "mandates" that the escrow account should be turned over as property of the bankruptcy estate. Trustee does not seek a specific judgment against the escrow agent, but rather asks for an order directing the payment of $2,400.00 to Trustee. For the following reasons, the court will not grant that request.

The Bankruptcy Code requires custodians, who have possession of property of the debtor, to turnover that property to the trustee. Section 543 provides in relevant part:

> (a) A custodian with knowledge of the commencement of a case under this title concerning the debtor may not make any disbursement from, or take any action in the administration of, property of the debtor, proceeds, product, offspring, rents, or profits of such property, or property of the estate, in the possession, custody, or control of such custodian, except such action as is necessary to preserve such property.
>
> (b) A custodian shall –

> (1) deliver to the trustee any property of the debtor held by or transferred to such custodian, or proceeds, product, offspring, rents, or profits of such property, that is in such custodian's possession, custody, or control on the date that such custodian acquires knowledge of the commencement of the case; and
>
> (2) file an accounting of any property of the debtor, or proceeds, product, offspring, rents, or profits of such property, that, at any time, came into the possession, custody, or control of such custodian.

11 U.S.C. § 543.

The initial question for the court is whether the escrow agent in this case qualifies as a custodian under § 543. The parties did not brief or argue this point. However, the court concludes that this escrow agent is not a custodian as envisioned by Congress.

The Bankruptcy Code defines a custodian as:

> (A) [a] receiver or trustee of any of the property of the debtor, appointed in a case or proceeding not under this title;
> (B) [an] assignee under a general assignment for the benefit of the debtor's creditors; or
> (C) [a] trustee, receiver, or agent under applicable law, or under a contract, that is appointed or authorized to take charge of property of the debtor for the purpose of enforcing a lien against such property, or for the purpose of general administration of such property for the benefit of the debtor's creditors.

11 U.S.C. § 101 (11).

The legislative history of the definition indicates that the term "custodian" was to encompass situations where prepetition agents took control of a debtor's assets for the benefit of creditors. Custodian '"means a prepetition liquidator of the debtor's property, such as an assignee for the benefit of creditors, a receiver of the debtor's property, or administrator of the debtor's property.'" Cash Currency Exchange, Inc. v. Shine (In re Cash Currency, Inc., 762 F.2d 542, 553 (7th Cir. 1985) quoting S.Rep. No. 989, 95th Cong., 2d Sess. 23 (1978), U.S.Code Cong. & Admin.News, pp. 5787, 5809. "Congress

defined the term broadly to include third parties who have taken charge of the debtor's assets for the general benefit of creditors." In re Cash Currency, 762 F.2d at 553.

In this case, Fugeres and Debtor entered into an escrow agreement whereby the funds were withheld from the purchase price of the home and deposited with the escrow agent to ensure that the listed items of the home would be finished in a satisfactory manner. Critelli is not an agent liquidating Debtor's assets. Cretilli was not appointed in a "case or proceeding," but rather pursuant to the escrow agreement. No general assignment of assets for the benefit of Debtor's creditors has taken place. Subsection C provides the only argument for Trustee, and it too is unavailing. Although Critelli was designated to take charge of the escrow funds, he was not appointed to enforce a lien or for the purpose of administering the funds for the benefit of all the creditors. See generally, Churchill Technology, Inc. v. Cribari (In re Churchill Technology, Inc.), 236 B.R. 580, 583 (Bankr. W.D.N.Y. 1999)(former corporation president who held shares of wholly-owned subsidiary pursuant to a trust agreement did not meet the definitional requirements to be a custodian). Because Critelli is not a custodian under the requirements of the Code, he is not subject to the turnover provisions of § 543. Id.

Even if Trustee pursued the escrow funds pursuant to § 542, she could not prevail. Section 542(a) states:

> Except as provided in subsection (c) or (d) of this section, an entity, other than a custodian, in possession, custody, or control, during the case, of property that the trustee may use, sell, or lease under section 363 of this title, or that the debtor may exempt under section 522 of this title, shall deliver to the trustee, and account for, such property or the value of such property, unless such property is of inconsequential value or benefit to the estate.

11 U.S.C. § 542(a). Section 363 provides that the trustee may use, lease, or sell property of the bankruptcy estate. 11 U.S.C. § 363(b)(1).

The bankruptcy estate is comprised of all "legal and equitable interests of the debtor in property..." 11 U.S.C. § 541(a)(1). Congress intended the scope of § 541(a) to be broad. United States v. Whiting Pools, Inc., 462 U.S. 198, 204 (1983); N.S. Garrott & Sons v. Union Planters Nat. Bank of Memphis, (In re N.S. Garrott & Sons), 772 F.2d 462, 466 (8th Cir. 1985). However, its reach is not limitless. The United States Supreme Court has determined that Congress intended to exclude from the estate some minor interests of the debtor in property of others such as a lien or bare legal title. Whiting Pools, 462 U.S. at 205 n.8.

"Property interests are created and defined by state law." Butner v. United States, 440 U.S. 48, 55 (1979). Once the debtor's interest in the property is determined, federal law dictates to what extent that interest is property of the estate. In re N.S. Garrot & Sons, 772 F.2d at 466. Therefore, Iowa law determines what interest Debtor has in the escrow fund.

An escrow is created when a grantor gives up possession and control over an instrument or money by delivering it to a third person or depository with instructions to turn the instrument or money to the grantee on the occurrence of specified conditions. 28 Am. Jur. 2d. Escrow §1 (1999); see also, Hoyt v. McLagan, 55 N.W. 18, 19-20 (Iowa 1893)(The authorities are uniform in holding that, to constitute a good delivery, the grantor must part with all power and control over the deed, and the right to revoke it). The purpose of the escrow is to assure that obligations incurred in an underlying contract

are carried out. 28 Am. Jur. Escrow § 2 (1999). The depositary has a duty not to deliver the escrowed instruments or funds except upon strict compliance with the conditions set forth in the escrow agreement. 28 Am. Jur. Escrow § 2 (1999). If the conditions do not occur, the depositary is obligated to redeliver the instrument or money to the grantor. 28 Am. Jur. Escrow § 29 (1999). Exact performance of the escrow agreement is required. 28 Am. Jur. Escrow § 32 (1999); but see, Downey v. Gifford, 218 N.W. 488, 490 (Iowa 1928)(In a case where the "so-called" escrow arrangements were "quite defective as a strict escrow," substantial performance entitled the grantee to delivery even though actual delivery was not made to him but "wrongfully" refused).

It is well settled in Iowa, that title to property placed in escrow does not pass until full performance of the conditions required by the escrow agreement. Mohr v. Joslin, 142 N.W. 981, 983 (Iowa 1913). Title remains with the grantor until performance of the conditions. Bolte v. Schenk, 210 N.W. 797, 800 (Iowa 1926). The rule is the same for money that is held in escrow. 28 Am. Jur. § 17 (1999). When the instrument or money is delivered to the depositary, the grantee receives an equitable interest in the property. 28 Am. Jur. § 18 (1999). This interest can be termed a contingent right. See, Cedar Rapids Meats, Inc., v. Hager (In re Cedar rapids Meat, Inc.), 121 B.R. 562, 567-68 (Bankr. N.D. Iowa 1990). Upon full performance of the specified conditions, title vests in the grantee. 28 Am. Jur. § 18 (1999).

In this case, the escrow agreement provides that the amount of $5,273.00 was to be withheld from the purchase price of the real property known as 325 Juliana Court, Polk City, Iowa. Those funds were placed in escrow with Critelli as the escrow agent.

The sum represented one and one-half (1½) times the estimated cost to complete the a) exterior paint; b) final grade and sod; c) gutters; d) concrete; e) retaining walls; f) landscaping; g) deck + extension; and h) basement stairs (drywall at end). Fugeres provided the funds to purchase the property, therefore, under Iowa law, title to these funds remains with Fugeres until the performance of the conditions occurs.

The agreement provides that no money will be released until certain conditions are performed. The conditions contemplated by the parties are that Critelli will receive "a written inspection form from the original appraiser of the property and/or the contractor of work performed to the effect that all elements of such construction have been satisfactorily completed by Builder/Seller, and [Cretilli] has written authorization from Liberty Bank & Trust to release such funds." The agreement further provides that "if improvements are not completed by May 30, 1998, [Critelli] may select a builder to complete work and pay out of escrow sums."

These conditions require "all elements" of the construction be completed before any funds are released. The agreement does not envision piece work performance nor multiple payments to Debtor. Further, payment will not be made until the construction is satisfactorily completed. While the agreement does not state to whose satisfaction, it does require that an inspection of the work take place and a written inspection form be submitted by either the original appraiser or the contractor of the work performed. Additionally, Bank must provide written authorization to Critelli allowing the funds to be released. May 30, 1998, is the deadline for performance by Debtor. After that time,

Critelli may select someone else to complete the work without Debtor's approval and without soliciting competitive bids.

It is apparent from the record that the conditions of the escrow agreement have not been met. First, there is some question as to whether all the elements of construction covered in the escrow agreement have been completed. Fugeres argue that the basement stairs have never been completed. In her post-trial brief, Trustee at least tacitly concedes this point when she credits Fugeres with $600.00 from the escrow fund.

Second, the agreement requires that the work must be satisfactorily done. While the agreement does not state to whose satisfaction, it is apparent from the testimony and other evidence that Fugeres are not satisfied with the work done by Debtor. Trustee's characterization that Fugeres are "somewhat satisfied" with Debtor's work is strained at best. The agreement provides for inspection by the original appraiser or the contractor who performs the work. It is unclear from the face of the agreement whether the parties envisioned Debtor inspecting its own work and completing it to its own satisfaction. However, the requirement of authorization from Bank to release funds suggests that Bank must be satisfied with the work. Presumably, any dissatisfaction expressed by Fugeres would give Bank pause in providing the authorization. Since Trustee has not provided evidence of such authorization, the court concludes that the work was not satisfactorily done.

Third, Trustee has provided no evidence that anyone inspected the work that Debtor allegedly performed. No document that remotely resembles an inspection form has been submitted to the court. The only document offered is a letter from Commercial

Federal Bank which states simply, "Please accept this as written inspection for the disbursement of funds held in escrow for Trent and Stacey Fugere for work completed by Tory Lint Construction." The letter states that Debtor needed payment for the exterior paint and gutters. The court cannot stretch an interpretation of "inspection form" so far as to encompass this letter. Even if it could, the letter is from Commercial Federal Bank and not the original appraiser or the contractor who performed the work. Further, it is only for partial performance and not all the construction elements listed in the agreement. Finally, the letter is dated July 2, 1998, well outside the May 30, 1998 deadline for performance by Debtor.

Fourth, there is no evidence that the work was performed prior to the May 30, 1998, deadline. Trustee argues that the parties have established a course of performance that varies from the conditions set forth in the escrow agreement. While it is true that an escrow agreement may be modified after the delivery of the instrument or funds, such modification must be done by a provision in the agreement or mutual consent by the parties. 28 Am. Jur. § 12 (1999). A modification by mutual consent need not be in writing, however, the burden is on the proponent to prove an oral modification by clear and convincing evidence. Byers v. Byers, 46 N.W. 2d 800, 809-10 (Iowa 1951).

In this case, there is no modification provision written into the agreement, and the court finds that Trustee has not proven the modification by clear and convincing evidence. There was no testimony indicating that Fugeres and Debtor discussed modifying the terms of the escrow agreement to allow partial performance and payment, or to waive the inspection requirement. Payment was released to Debtor for paint and

gutter work after May 30,1998, but there is no evidence that the parties agreed to such an extension. Rather, it appears from the record that Critelli made the decision of when and to whom to release funds without strictly complying to the terms of the escrow agreement. The court concludes that the parties did not intend to modify the escrow agreement and no valid modification occurred.

Finally, an escrow agreement cannot last indefinitely. It should include a provision stating the duration of the escrow agreement. 28 Am. Jur. § 25 (1999). If a durational limitation is not included in the agreement, then the performance must be made in a reasonable time. 28 Am. Jur. § 33 (1999).

In this case Fugeres closed on the property on January 23, 1998, and the escrow agreement was formed pursuant to the closing. The agreement provided that if Debtor had not completed the improvements by May 30, 1998, then Critelli could hire someone else to do the work. Although Bill's Yard and Home Improvement was paid $750.00 on September 23, 1998, from the escrow funds, there is no evidence that Critelli actually hired anyone to complete the improvements. On March 19, 1999, Debtor filed a petition for liquidation under Chapter 7, and Critelli decided not to release any more of the funds pending an order from the court.

Presumably, because the closing took place in January, the potential for inclement weather prevented Debtor from immediately completing the designated items. The purpose of the escrow was to ensure that those items were completed in the spring of 1998. Because the escrow agreement provided that Critelli could hire other contractors to complete the improvements after May 30, it is clear that the parties envisioned the

possibility that the work could be delayed into the summer months. The court does not believe that the parties anticipated that the work would extend past the 1998 construction season and certainly not into 1999.

The court finds that a reasonable length of time for the escrow agreement to last was until December 31, 1998. Because the conditions were not strictly performed by that time, Fugeres proceeded to independently contract for the completion of the improvements, Debtor has not obtained the inspection form and authorization, and Debtor filed for Chapter 7 liquidation on March 19, 1999, the court holds that the escrow has been abandoned. See 28 Am. Jur. § 8 (1999). Title to the funds remained with Fugeres throughout the duration of the escrow, and the right to possession of the funds re-vests in them.

The court concludes by stating that this decision is confined to the issue before the court, Trustee's Motion to Turnover Property. The court expresses no opinion as to the merits of any cause of action that Debtor may have for work performed. Likewise, the court expresses no opinion as to any claim Fugeres may have.

ORDER

IT IS ACCORDINGLY ORDERED as follows:

1. Trustee's Motion for Turnover of Property is DENIED.

2. Trent and Stacey Fugere's Objection to Trustee's Motion for Turnover of Property is SUSTAINED.

3. The Escrow Agreement dated January 23, 1998, between Trent and Stacey Fugere and Tory Lint Construction has been abandoned. Legal title and right to possession of the remaining $3000.50 in the possession of the Law Offices of Mark A. Critelli lie with Trent and Stacey Fugere.

4. The Law Offices of Mark A. Critelli shall release the remaining escrow funds to Trent and Stacey Fugere.

Dated this _____ day of July, 2000.

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RUSSELL J. HILL, CHIEF JUDGE
U.S. BANKRUPTCY COURT