UNITED STATES BANKRUPTCY COURT
For the Southern District of Iowa

In Re	:	**Case No. 96-04088-CH**
	:	
RICHARD E. SHANAHAN,	:	**Chapter 7**
	:	
Debtor.	:	
- -	:	
UNION PACIFIC RAILROAD COMPANY,	:	**Adv. No. 97-97005**
	:	
Plaintiff,	:	
	:	
v.	:	
	:	
RICHARD E. SHANAHAN and THE TRANSPORTATION COMPANY,	:	
	:	
Defendants.	:	

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ORDER—COMPLAINT TO DETERMINE DISCHARGEABILITY OF DEBT

On October 19, 1998, trial was held on the Plaintiff's Complaint to Determine Dischargeability of Debt. Debtor/Defendant, Richard E. Shanahan, was represented by attorneys Rick L. Olson and Ted H. Engel; Creditor/Plaintiff, Union Pacific Railroad Company ("Union Pacific"), was represented by attorney Bruce E. Johnson. At the conclusion of the trial, the Court took the matter under advisement upon a briefing schedule. Post-trial briefs have been filed and the Court now considers the matter fully submitted.

The Court has jurisdiction of this matter pursuant to 28 U.S.C. § 157(b)(1) and § 1334. This is a core proceeding. 28 U.S.C. § 157(b)(2)(I). The Court, upon review of the briefs, pleadings, evidence, and arguments of counsel, now enters its findings and conclusions pursuant to Fed. R. Bankr. P. 7052.

FINDINGS OF FACT

1. Richard E. Shanahan filed a voluntary Chapter 7 Petition on October 10, 1996.

2. His Schedule F, Creditors Holding Unsecured Nonpriority Claims, contains the following creditors and claims:

a. Chicago & North Western Railway Co.	$355,000.00
b. Union Pacific Railroad Company	$275,000.00
c. Union Pacific Railroad Company	$ 56,000.00

3. The consideration for each of those claims was shown to be a judgment. The claim of Chicago & North Western Railway Co. was scheduled as contingent whereas the other two claims were scheduled as fixed and liquidated.

4. The complaint, as amended, prays that debt owed by Shanahan to Union Pacific Railroad be determined as non-dischargeable pursuant to 11 U.S.C. §§523(a)(2)(A) and 523(a)(4).

5. The answer, as amended, generally denies the allegations of the amended complaint.

6. Plaintiff, The Union Pacific Railroad Company (hereinafter UP) is the successor-in-interest of Chicago & Northwestern Railway Company (hereinafter CNW).

7. Defendant, Richard E. Shanahan (hereinafter Shanahan) is the president, director and sole shareholder of The Transportation Company (hereinafter TC).

8. The issue of whether this debt is the corporate debt of TC or the personal debt of Shanahan is not before this court. This issue was resolved in The District Court of Iowa for Polk County, which held that TC as a corporate entity was a sham, the corporate veil was pierced, and the debts of TC were held to be the personal debts of Shanahan.

9. On January 1, 1992, TC, over the signature of Shanahan, entered into a contract with CNW.

10. TC was to administer a service to CNW by arranging transportation for CNW employees through the use of independent transportation vendors. One of these independent transportation vendors was Cimarron Coach.

11. The contract of January 1, 1992, provided that TC was to administer transportation services and pay the transportation vendors. The transportation vendors would bill TC for their services; TC would, in turn, invoice CNW for these services; CNW would pay TC; and, TC would pay the transportation vendors. CNW agreed to pay TC within 10 days for all authorized expenses incurred by CNW's employees and TC agreed to disburse the appropriate payments to the vendors promptly upon receipt of the payment from CNW.

12. TC was obligated to provide CNW with bi-monthly statements for the vendor billings it received from the vendors.

13. TC was obligated to pay the vendors with the funds received from CNW.

14. Upon the merger of CNW and UP on or about December 1, 1994, the contract was continued on a month-to-month basis.

15. On May 18, 1995, CNW gave notice to TC that effective June 1, 1995, the transportation agreement of January 1, 1992, would terminate at the end of the 60 day period.

16. Shanahan knew at that time that the contract with CNW would terminate on or about July 31, 1995.

17. Shanahan was living in Texas at the time and received the cancellation letter in Texas. He returned to Iowa, met with his attorney, and made a decision to pay some bills and pay himself a salary, which altered his prior course of conduct with CNW. Shanahan decided that TC owed

him $450,000 in compensation, although financial documentation verifying the accuracy of this figure was never provided.

18. TC thereafter sent two invoices to CNW: No. 120, dated June 30, 1995, and No. 121, dated July 16, 1995. These invoices detailed specific transportation vendor services rendered to CNW employees.

19. Shanahan never advised CNW upon the submission of the two invoices that he was going to use the proceeds from these invoices for a purpose other than to pay the transportation vendors.

20. CNW timely made full payment on these invoices by checks in the amounts of $258,125.58 and $250,315.68.

21. Rather than paying the transportation vendors, Shanahan paid off an unrelated corporate debt for a horse racing enterprise in which he had an interest; personal credit card debt; other personal debts; and, the tuition for his daughters advanced education.

22. He paid approximately $50,000 to only one of the transportation vendors, Cimarron Coach. This payment did not pay Cimarron Coach's billing in full.

23. Shanahan knew that by making the above-listed transfers, the transportation vendors who had sent him invoices would not be paid. TC's bank account from which Shanahan made the transfers was comprised solely of payments from CNW for transportation services and for the specific purpose of paying the transportation vendors.

24. TC was insolvent at the time in that it could not pay its existing creditors, including the transportation vendors, as well as Shanahan.

25. Cimarron Coach of Iowa, Ltd. commenced a legal action in the District Court of Iowa, Polk County, against TC and Shanahan, individually, on the contract between Cimarron

Coach and TC. This cause of action was for the balance due and owing on that transportation contract. Cimarron Coach assigned its interest in the judgment against The Transportation Company and Richard E. Shanahan to UP. The $48,931.09 judgment against the Defendant and in favor of the Plaintiff was filed July 11, 1996, in the Iowa District Court for Polk County, Case No. CL 66836.

26. UP and Shanahan entered into a Stipulation for Judgment against Richard Shanahan in the Iowa District Court for Polk County, Case No. CL 67021, filed August 26, 1996, in the amount of $255,000.00.

DISCUSSION

Judgment for $255,000.00

11 U.S.C. §523(a)(2)(A)

The Plaintiff must prove by a preponderance of the evidence that this debt was incurred through "false pretenses, a false representation, or actual fraud . . . ." 11 U.S.C. § 523(a)(2)(A); Grogan v. Garner, 498 U.S. 279, 286-87 (1991). The Eighth Circuit has adopted a five-part test to determine whether a debt will be excepted from discharge under § 523(a)(2)(A): A court asks whether: (1) the debtor made false representations; (2) the debtor knew these representations were false at the time they were made; (3) the debtor made these representations with the intention and purpose of deceiving the creditor; (4) the creditor justifiably relied on the representations; and, (5) the creditor sustained the alleged injury as a proximate result of the representations having been made. In re Van Horne, 823 F.2d 1285, 1287 (8th Cir. 1987), as modified by Field v. Mans, 516 U.S. 59, 74-75 (1995) (holding that § 523(a)(2)(A) requires "justifiable, but not reasonable, reliance").

In order for Plaintiff to carry its burden, it must demonstrate that Shanahan made some representation which induced Plaintiff to make payment on invoices 120 and 121. To meet the first three elements of the test, Shanahan must have, by sending the invoices, intended to falsely represent to CNW that he would pay the transportation vendors from the payments made by CNW to Shanahan..

The contract between CNW and TC clearly provided that TC was to pay the transportation vendors. "TC will receive and process all transportation bills. TC will prepare and disburse appropriate payment to said transportation companies promptly upon receipt of transportation services bills." Plaintiff's Exhibit 1, p. 3. "Upon receipt of transportation bills from TC, CNW agrees to pay TC within ten (10) days for all authorized transportation expenses incurred on behalf of CNW's employee's." Plaintiff's Exhibit 1, p. 6. Accordingly, TC was required to pay the transportation vendors with actual dollars paid to TC by CNW.

Shanahan received bills from the various vendors and then billed CNW based on these bills in a comprehensive bimonthly invoice which included service charges. CNW would make payment based on the invoices, and then Shanahan would pay the vendors. This had been the practice throughout the contractual period, and CNW expected that the payments they made would be used to pay the vendors. That was, after all, the primary purpose of using a go-between like TC: to handle the cumbersome administration of several cab vendor accounts, including acting as a conduit for distribution of the funds received from CNW.

A mere breach of contract does not constitute fraud under § 523(a)(2)(A). See Green Tree Financial Corp. v. Beasley (In re Beasley), 202 B.R. 979, 983 (Bankr. W.D. Mo. 1996). Statements of present intention as to future conduct, however, may be the basis for a fraud action if the statements misrepresent the actual intention of the speaker and were relied upon by the

recipient to his detriment. Matter of Allison, 960 F.2d 481, 484 (5th Cir. 1992); McEvoy Travel Bureau, Inc. v. Norton Co., 408 Mass. 704, 709, 563 N.E.2d 188 (1990). The sending of invoices 120 and 121 are the statements of intention in this case. By sending the invoices, Shanahan represented to CNW that he was going to pay the cab vendors as he had in the past. CNW had an expectation that business was being conducted as usual, and Shanahan gave CNW no indication to the contrary.

When a debtor is entrusted with money to use for a specific purpose and the debtor has no intention of using it in that manner, a misrepresentation exists upon which a debt can be held nondischargeable. In re Sheridan, 57 F.3d 627, 635 (7th Cir. 1995). See also In re Pappas, 661 F.2d 82, 86 (7th Cir. 1981). "Proof that the debtor never put the money toward the stated purpose allows a court to infer the requisite intent." Id.

The Court finds that Shanahan intended to deceive UP in sending invoices 120 and 121. Shanahan made the decision that he would divert funds from the transportation vendors to himself before he submitted invoice numbers 120 and 121. Sending the invoices was a representation of business as usual. The invoices summarized the charges of the various transportation companies and the service fees charged by TC. Shanahan knew that UP would remit payment upon receipt of those invoices based upon TC's contractual duty to pay the cab companies for their services. In fact, TC was insolvent and Shanahan had the intention to pay himself a "salary" and other personal expenses when he mailed the invoices. He knew this would result in an inability to pay the cab vendors what was owed them. He failed, however, to apprise UP of these facts. An omission of a material fact may constitute a false representation for purposes of section 523(a)(2)(A). See Caspers v. Van Horne (In re Van Horne), 823 F.2d 1285, 1288 (8th Cir. 1987), abrogated on other grounds, Grogan v. Garner, 498 U.S. 279, 111 S. Ct. 654 (1991).

There was a course of conduct over a long period of time which caused CNW to justifiably believe that Shanahan would disburse the funds to the respective transportation vendors. Shanahan knew this when he submitted the two invoices to CNW.

"The proximate cause element of § 523 requires simply that the action of the debtor was the act, without which the claimant would not have suffered the loss complained of." In re Van Horne, 823 F.2d at 1288-89. If the railroad company had known that Shanahan had the intention of diverting the payment on invoices 120 and 121 to his own purposes, it certainly would not have remitted payment. Indeed, Thomas Mulligan, director of operations at UP during 1995, so testified at trial. CNW would have remitted payment directly to the vendors who provided the services. Accordingly, CNW suffered damages in the amount of $255,000.00.

The Debtor/Defendant's obligation to the Creditor/Plaintiff arising from the Stipulation for Judgment in the Iowa District Court for Polk County, Case No. CL 67021 in the amount of $255,000.00 is nondischargeable under 11 U.S.C. § 523(a)(2)(A).

11 U.S.C. §523(a)(4)

Plaintiff also claims the debt is nondischargeable under 11 U.S.C. § 523(a)(4). That section excepts from discharge a debt arising from the debtor's "fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny." "Embezzlement," within meaning of the embezzlement exception to discharge, is fraudulent appropriation of property of another by a person to whom the property has been entrusted or into whose hands it has lawfully come. In re Belfry, 862 F.2d 661 (8th Cir. 1988), rehearing denied.

In the context of nondischargeability, embezzlement requires three elements: (1) property rightfully in the possession of a nonowner, (2) nonowner's appropriation of the property to a use

other than which it was entrusted, and (3) circumstances indicating fraud. Transamerica Commercial Finance Corp. v. Littleton (In re Littleton), 942 F.2d 551, 555 (9th Cir. 1991).

While embezzlement does not require the existence of a fiduciary relationship, courts have found that the payment of funds pursuant to [a] contract confers ownership of the funds and thus no embezzlement can be found. First Delaware Life Insurance Co. v. Wada (In re Wada), 210 B.R. 572, 576 (9th Cir. BAP 1997), citing Fraternal Order of Eagles, Aerie v. Mercer (In re Mercer), 169 B.R. 694, 697 (Bankr. W.D. Wash. 1994); In re Schultz, 46 B.R. 880, 889 (Bankr. D. Nev. 1985) (Where building contract provides for certain services at certain prices, and there is a transfer of money within the contract price, ownership as well as possession passes, and all that remains is a contractual obligation).

In the Wada case cited to above, the defendant/debtor travel agent failed to return money advanced pre-petition for arranging travel, food and lodging to her client (the plaintiff) after a business conference was canceled. Wada, 210 B.R. at 574. The court found that this debt was nondischargeable under §523(a)(4) in the travel agent's Chapter 7 bankruptcy on the basis of embezzlement. The court distinguished the case from the contract cases it cited to:

> Here, it is undisputed that the funds transferred to the Debtor within her role as travel agent did not contain compensation for her services. The Debtor had no contractual right to any part of the funds. Her only role was to act as a conduit of the funds; to apply them exclusively for the arrangement of travel accommodations. Money received by travel agents to be paid to travel providers is not income.

210 B.R. at 576 (9th Cir. BAP 1997).

In this case, TC's contractual duties included paying the various vendors, making suggestions to CNW concerning lowering costs and improving transportation services, monitoring the services of the vendors, conducting inspections, and receiving complaints, among other things.

Plaintiff's Exhibit 1, p.1. The contract also provides that "The parties agree that in consideration for the services provided herein, TC will receive a fee of $1.00 per road trip or terminal trip. Such amounts to be added to the net trip charge payable to TC." Plaintiff's Exhibit 1 p. 7. So here, unlike in Wada, the payments by CNW contained compensation to TC.

The Court finds that the payments received by Shanahan from CNW were the property of Shanahan, not of CNW. The 523(a)(4) analysis is therefore inapplicable since "[o]ne cannot embezzle one's own property." In re Belfry, 862 F.2d 661, 662 (8th Cir. 1988).

Judgment for $48,931.09

The evidence produced at trial does not permit the court to find the obligation arising from the Cimarron Coach judgment in the amount of $48,931.09, Case No. CL 66836, nondischargeable in bankruptcy under § 523(a)(2)(A) or §523(a)(4). That judgment was entered in favor of UP, which was substituted as the real party in interest by virtue of the assignment by Cimarron Coach of its interest in the lawsuit. The underlying obligation in that case was to Cimarron, and there must have been some actionable conduct perpetrated on Cimarron by TC or Shanahan in order for UP, which now stands in Cimarron's shoes, to assert actionable conduct against TC. UP has proven a breach of contract but has failed to prove a false pretense, false representation, fraud, defalcation while acting in a fiduciary capacity, embezzlement, or larceny on the part of Shanahan in that contractual relationship.

Accordingly, this judgment is dischargeable.

The court CONCLUDES that the debt of $255,000.00 is nondischargeable but the debt of $48,931.09 is dischargeable.

ORDER

IT IS THEREFORE ORDERED as follows:

(1) Plaintiff, Union Pacific Railroad Company, shall have judgment against Defendant, that the judgment in The Iowa District Court for Polk County, CL 67021, Union Pacific Railroad Company vs. Richard Shanahan and The Transportation Company, in the amount of $255,000.00, plus interest and costs, is nondischargeable.

(2) Defendant, Richard Shanahan, shall have judgment against Plaintiff, Union Pacific Railroad Company, that the judgment in The Iowa District Court for Polk County, CL 66836, Cimarron Coach of Iowa, Ltd., vs. The Transportation Company and Richard E. Shanahan, in the amount of $48,931.09, plus interest and costs, is dischargeable.

Dated this _____ day of September, 1999.

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