UNITED STATES BANKRUPTCY COURT
For the Southern District of Iowa

In the Matter of	:	
DANIEL JOHN GENESER MARGARETTA A. GENESER,	:	Case No. 88-00669-C H
Debtors.	:	Adv. No. 88-0133
---	:	
HUBBARD LEASING COMPANY, a Minnesota Corporation,	:	
Plaintiff,	:	
v.	:	
DANIEL JOHN GENESER MARGARETTA A. GENESER,	:	
Defendants.	:	

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FINDINGS OF FACT AND CONCLUSIONS OF LAW--
COMPLAINT TO DETERMINE DISCHARGEABILITY OF DEBT

On April 17, 1989, a trial was held on the complaint to determine dischargeability of debt. Joseph G. Betroche, Sr. appeared on behalf of Plaintiff and Donald F. Neiman appeared on behalf of Defendants. At the conclusion of said trial, the Court took the matter under advisement. Both parties have submitted written briefs and arguments, and the Court considers the matter fully submitted.

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

FINDINGS OF FACT

1. On March 29, 1988, Debtors filed a Chapter 7 Petition in this Court.

2. On June 23, 1988, Plaintiff filed a complaint objecting to the discharge of Debtors. Plaintiff asserted 11 U.S.C. §523(a)(4), §523(c), and 11 U.S.C. §727(a)(6) as grounds for nondischargeability. Plaintiff also alleged that Debtor/Defendants converted and sold leased property in violation of the terms of the lease and converted the money to their own use.

3. On the date of trial, Plaintiff orally moved to amend the complaint to allege 11 U.S.C. §523(a)(6) as an additional ground to deny discharge of the debt, and dismissed its allegation of a violation of 11 U.S.C. §727.

4. The Debtor, Daniel Geneser, was a vice president of Geneser Implement Store, Inc., Granger, Iowa (hereinafter "Geneser Implement"). Daniel Geneser was a managing officer of said corporation. Geneser Implement was an Allis-Chalmers dealer and all of the stock of said corporation was owned by Daniel Geneser's father. Geneser Implement has filed a Chapter 7 petition in this Court.

5. On November 15, 1984, Daniel and Margaretta Geneser entered into a transaction with Plaintiff whereby a lease was executed leasing a model 8070 Allis-Chalmers tractor and a model N5 Allis-Chalmers combine to Debtor/Defendants. Margaretta Geneser signed this lease as wife of Daniel Geneser.

6. Plaintiff purchased said tractor and combine on November 15, 1984, from Geneser Implement. The purchase price of the tractor

was $55,780.72, and the purchase price of the combine was $84,700.85, for a total of $140,481.57, which the parties rounded off to $140,500.00. Said machinery was delivered to Daniel Geneser but remained at Geneser Implement.

7. The lease commenced on November 15, 1984, for 60 months for a total rent consideration of $178,266.40. Defendants were given an option to purchase said machinery for a residual purchase price of $21,075.00 at the expiration of the original or extended term of lease.

8. The lease agreement specifically provided that title to the equipment remained in the Lessor/Plaintiff. The lease further provided that a default would occur if the Lessee/Defendants attempted to sell or transfer the machinery without the lessor/Plaintiff's prior consent.

9. The "lease" provides that upon the expiration of the lease, the equipment must be returned to Lessor; Lessee had no right to return the equipment prior to the expiration of the lease; Lessee selected the equipment; Lessee could make no alterations to the equipment without Lessor's prior written consent; Lessee bore all risk of loss, damage, theft, or destruction of the equipment; the fair market value of the equipment at the expiration of the lease was estimated to be 15% of the total cost of the equipment; in the event of default Lessor had the right to sell the equipment and Lessor was entitled to any surplus, but Lessee remained liable for any deficiency; the residual value of the equipment was set at $21,075.00; Lessor had a right in its sole discretion to treat the

lease as a sale regardless of how the lease was treated by Lessee; and a financing statement was filed. However, the financing statement stated that the transaction was a lease and was not intended as a security transaction. The filing of the financing statement made the lease a matter of public record. Further, the lease was to be interpreted according to the laws of the State of Minnesota.

10. On or about December 12, 1984, the tractor was sold by Geneser Implement to a third party for $41,442.00.

11. On or about December 12, 1985, the combine was sold by Geneser Implement to a third party for $53,000.00. Daniel Geneser signed the sale document on the combine as dealer's salesman.

12. None of the proceeds from the sale of the tractor and combine were forwarded to Plaintiff by either Geneser Implement or Daniel Geneser.

13. The money from the sale of the tractor and combine was credited to the account of Geneser Implement.

14. At the time of the sales of the tractor and combine, Daniel Geneser knew that he was not legally able to sell the equipment. Daniel testified that he did not convert the property to his own use as the funds were used to reduce the debt of Geneser Implement, which was in a precarious financial condition at the time. Geneser Implement and Daniel Geneser were unable to pay Plaintiff because Geneser Implement failed as a business and filed for protection under the Bankruptcy Code.

15. Defendants agreed to pay the lease in annual installments

of $35,653.28 on or before November 15, 1984, 1985, 1986, 1987, and 1988. Daniel Geneser prepaid the first annual installment on November 15, 1984. The second annual installment was not paid and Plaintiff contacted Defendants. Thereafter, Daniel paid Plaintiff $26,000.00 from his personal funds.

16. Plaintiff became aware of the fact that the tractor and combine had been sold in April 1986, when Geneser Implement filed for protection under the Bankruptcy Code on March 26, 1986.

17. Plaintiff then commenced an action in the District Court, Fifth Judicial District, Blue Earth County, State of Minnesota,against Defendants. This case was set for hearing on May 26, 1987. Defendants were not personally present and Defendants were not represented by counsel at the hearing and the issues were not actually litigated. Defendants' former counsel was present but only for the limited purpose of advising the court that he was no longer representing the Debtors and to request a continuance so Debtors could obtain substitute counsel.

18. On June 10, 1987, default judgment was entered against both Defendants for defaulted lease contract payments in the sum of $171,541.05, plus interest from May 20, 1986, in the sum of $14,512.67; for conversion of Plaintiff's equipment in the sum of $129,000.00, plus interest from May 20, 1986, in the sum of $10,913.67; for punitive damages in the sum of $25,000.00 plus interest from May 20, 1986, in the sum of $2,114.87; attorney's fees in the sum of $1,000.00; and costs and expenses in the sum of $179.68. The judgment was in the amount of $353,082.26 for damages,

principal and interest, plus $1,184.68 for costs, in the total amount of $354,266.94. This judgment recites that there were findings of facts and conclusions of law but these findings and conclusions are not part of this record.

19. Plaintiff transcribed the Minnesota judgment to Polk County, Iowa, and is seeking to render the judgment nondischargeable.

20. Daniel Geneser has plead guilty in Iowa District Court, Dallas County, Iowa, to the crime of Theft in the Second Degree by misappropriating property of another which he had in his possession or control, or appropriating property to his own use. The tractor was the subject matter of this charge. As a part of the sentence, Daniel Geneser is required to make restitution for the tractor in the approximate amount of $39,000.00.

21. During all times relevant herein Margaretta Geneser was a homemaker and not employed outside the home; she was not an officer, shareholder, or employee of Geneser Implement; and she did not have any knowledge of the sale of the tractor or combine until the commencement of the Minnesota action.

DISCUSSION

I. Pleading

Defendants claim that Plaintiff filed its complaint objecting to the discharge of the debt to Plaintiff on the basis of 11 U.S.C. §523(a)(4), and objecting to the discharge of the Debtors pursuant to 11 U.S.C. §727(a)(6). Defendants assert that Plaintiff did not raise the issue of willful and malicious injury under 11 U.S.C. §523(a)(6) until its pretrial brief. Defendants conclude that a failure to

raise the issues under 11 U.S.C. §523(a)(6) in the pleading constitutes a waiver of that theory.

Bankruptcy Rule 7008 incorporates by reference F.R.Civ.P. 8 and sets forth the general rules of pleading. Rule 8(f) provides: "All pleadings shall be construed as to do substantial justice." Rule 8(a) provides that a claim for relief shall contain (1) a short and plain statement of the jurisdictional grounds, (2) a short and plain statement of the claim showing that the pleader is entitled to relief, and (3) a demand for judgment for the relief that pleader seeks.

The Supreme Court in Conley v. Gibson, 355 U.S. 41, 47, 78 S.Ct. 99, ___, 2 L.Ed.2d 80, ___ (1957), stated:

> "... the Federal Rules of Civil Procedure do not require a claimant to set out in detail the facts upon which he bases his claim. To the contrary, all the Rules require is 'a short and plain statement of the claim' that will give the defendant fair notice of what the plaintiff's claim is and the grounds upon which it rests."

Plaintiff plead that Debtors converted and sold leased property. Further, the conversion sale and conversion of the money to their own use worked a fraud upon Plaintiff. The pleading of conversion constitutes a short and plain statement of this claim sufficient to give notice to Defendants that Plaintiff was relying upon conversion of property as a basis for recovery. Accordingly, Defendants' contention that Plaintiff has failed to properly plead willful and malicious injury under §523(a)(6) must be rejected. Accordingly, Plaintiff's motion to amend must be sustained and the complaint must

be thereby amended.

II. §523(a)(4) and §523(a)(6) Dischargeability of Debt

A. Collateral Estoppel

The Court must initially determine the collateral estoppel effect of the June 10, 1987 default judgment. The doctrine of collateral estoppel is applicable to cases to determine the dischargeability of debt in bankruptcy. In re Coover, 70 B.R. 554 (Bankr. S.D. Fla. 1987). Under the doctrine of collateral estoppel, a prior adjudication precludes relitigation of an issue if the following requirements are met: 1) the issue sought to be precluded must be the same as that involved in the prior action; 2) that issue must have been actually litigated; 3) it must have been determined by a valid and final judgment; and 4) the determination must have been essential to the prior judgment. Matter of Ross, 602 F.2d 604, 608 (3rd Cir. 1979).

In the case *sub judice*, the June 10, 1987 judgment was a default judgment. Therefore, any issues determined by this judgment were not actually litigated; the doctrine of collateral estoppel is not applicable; and, the Court will make its own determination of the issues involved under §523(a)(4) and §523(a)(6).

B. §523(a)(6) Willful and Malicious Injury by the Debtor to Another Entity or to the Property of Another Entity

Section 523(a) provides in pertinent part:

> A discharge under §727, 1141, 1228(a), 1228(b), or 1328(b) of this Title does not discharge an individual debtor from any debt--

> (6) for willful and malicious injury by the debtor to another entity or to the property of another entity.

It is well-settled that §523(a)(6) includes debts for willful and malicious conversion. In re Jacobs, 47 B.R. 526, 527 (Bankr. S.D. Fla. 1985). Plaintiff must prove by clear and convincing evidence the elements of a willful and malicious conversion under §523(a)(6). See America Honda Finance Corp. v. Loder, 77 B.R. 213, 214 (N.D. Iowa 1987).

Conversion is generally defined as a wrongfully assumed "dominion over personal property by one person to the exclusion of possession by the owner and in repudiation of the owner's rights." In re Hicks, 100 B.R. 576, 577 (Bankr. M.D. Fla. 1989); In re Pommerer, 10 B.R. 935 (Bankr. D. Minn. 1981).

In ruling on a transfer and breach of a security agreement, the Eighth Circuit Court established the definition of willful and malicious. In re Long, 774 F.2d 875, 881 (8th Cir. 1985). According to the Eighth Circuit Court, willful means headstrong and knowing (intentional). Malicious means targeted at the creditor, at least in the sense that the conduct is certain or almost certain to cause financial harm. In re Long, 774 F.2d at 881.

In the case *sub judice*, Daniel Geneser converted Plaintiff's equipment. The lease agreement establishes Plaintiff's ownership rights in the equipment, and Daniel Geneser knew that he was not legally able to sell the equipment. Therefore, by selling the equipment to a third party on behalf of Geneser Implement, Daniel

Geneser assumed dominion over Plaintiff's personal property to the exclusion of Plaintiff's possessory rights and in repudiation of Plaintiff's ownership rights. Daniel Geneser thus converted Plaintiff's equipment. Concerning the tractor, this conclusion is further supported by Daniel Geneser's plea of guilty to the crime of Theft in the Second Degree by misappropriating property of another which he had in his possession or control, or appropriating property to his own use.

Daniel Geneser's conversion of the equipment was willful and malicious. The conversion was willful in that Daniel Geneser knew that he was not legally able to sell the equipment. In addition, the sale of the equipment to a third party was malicious, because it was certain to cause financial harm to Plaintiff. None of the proceeds from the sale of the tractor and combine were forwarded to Plaintiff by either Geneser Implement or Daniel Geneser. Instead, the funds were used to reduce the debt of Geneser Implement. Therefore, Daniel Geneser's sale of the equipment to a third party constitutes a willful and malicious conversion, and the June 10, 1987 judgment is nondischargeable as to him under §523(a)(6).

The Court finds that Margaretta Geneser did not have any knowledge of the sale of the equipment by Daniel Geneser. Therefore she did not willfully and maliciously convert the equipment under §523(a)(6).

C. §523(a)(4) Fraud or Defalcation While Acting in a Fiduciary Capacity, Embezzlement, or Larceny.

1. §523(a)(4) Fraud or Defalcation While Acting in a Fiduciary Capacity

Section 523(a) provides in pertinent part:

> Discharge under §727, 1141, 1228, 1228(b), or 1328(b) of this Title does not discharge an individual debtor from any debt--
>
> (4) for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny.

The threshold requirement under §523(a)(4) to hold the debt nondischargeable for fraud or defalcation is a finding that the debtor was a fiduciary of the creditor plaintiff. Clark v. Taylor (In re Taylor), 58 B.R. 849, 852 (Bankr. E.D. Va. 1986). To be a fiduciary for dischargeability purposes, the debtor must be acting as a trustee under an express or technical trust. In re Gagliano, 44 B.R. 259 (Bankr. N.D. Ill. 1984), citing Davis v. Aetna Acceptance Co., 293 U.S. 328, 1934. The trust must exist prior to the act creating the debt. Gagliano, 44 B.R. at 261, citing In re Pedrazzini, 644 F.2d 756 (9th Cir. 1981).

In the case *sub judice*, Plaintiff has made no showing that Defendants were acting in a fiduciary capacity. Therefore, Plaintiff has not proven by clear and convincing evidence that the June 10, 1987 judgment is nondischargeable under §523(a)(4) for fraud or defalcation while acting in a fiduciary capacity.

2. §523(a)(4) Embezzlement or Larceny

Section 523(a) provides in pertinent part:

> A discharge under §727, 1141, 1228(b), or 1328(b) of this Title does not discharge an individual debtor from any debt--

> (4) for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny.

Colliers states the distinction between embezzlement and larceny:

> Embezzlement is the fraudulent appropriation of property by a person to whom such property has been entrusted, or into whose hands it is lawfully come. It differs from larceny in the fact that the original taking of the property was lawful, or with (t)he consent of the owner, while in larceny the felonious intent must have existed at the time of the taking. Larceny is a fraudulent and wrongful and taking and carrying away the property of another with intent to convert such property to his (the takers) use without the consent of the owner. As distinguished from embezzlement, the original taking of the property was unlawful.

Colliers 15th ed. ¶523.14 at p. 523-102; see In re Taylor, 58 B.R. 849, 854 (Bankr. E.D. Va. 1986).

The Court finds that it has not been shown by clear and convincing evidence that Defendants had the requisite fraudulent intent at the time of leasing the equipment from Plaintiff. Therefore, Defendants did not commit larceny under §523(a)(4).

Concerning §523(a)(4), embezzlement, the phrase, while acting in a fiduciary capacity, does not modify the word embezzlement. Funventures in Travel, Inc. v. Dunn, (In re Funventures), 39 B.R. 249 (E.D. Pa. 1984). Therefore, even though Plaintiff did not prove that Defendants were acting in a fiduciary capacity, the debt may still be nondischargeable if the debt arose as a result of embezzlement.

The elements of embezzlement are: 1) appropriation of funds by

Debtor for his or her benefit, and 2) appropriation with fraudulent intent or by deceit. Taylor, 58 B.R. at 855; In re Graziano, 35 B.R. 589, 593. The fraudulent intent and misappropriation elements of embezzlement may be proven by circumstantial evidence. Graziano, 35 B.R. at 596. The Plaintiff must prove each element of a cause of action for embezzlement by clear and convincing evidence. Taylor, 58 B.R. at 855; Graziano, 35 B.R. at 593.

In the case *sub judice*, the money from the sale of the tractor and combine was credited to the account of Geneser Implement. The stock of Geneser Implement was owned by Daniel Geneser's father, and Daniel Geneser was a vice president and managing officer of Geneser Implement. Therefore, Daniel Geneser's sale of the equipment to a third party, and use of the sale proceeds to reduce the debt of Geneser Implement, was an appropriation of funds by Daniel Geneser for his benefit.

Daniel Geneser sold the equipment and appropriated the funds with fraudulent intent or by deceit. Daniel Geneser knew that he was not legally able to sell the equipment. Despite this knowledge, Daniel Geneser sold the equipment to a third party. The money from the sale of the tractor and combine was credited to the account of Geneser Implement. None of the proceeds from the sale of the tractor and combine were forwarded to Plaintiff by either Geneser Implement or Daniel Geneser, and neither Daniel Geneser or Geneser Implement notified Plaintiff of the sale. Plaintiff did not become aware of the fact that the equipment had been sold until April 1986, after Geneser Implement filed for protection under the Bankruptcy Code.

Based on the above facts, the Court finds that Daniel Geneser sold the equipment to a third party and appropriated the equipment sale proceeds for his benefit with fraudulent intent or by deceit. The June 10, 1987 judgment is therefore nondischargeable under §523(a)(4), embezzlement, as to Daniel Geneser.

Margaretta Geneser was not an officer, shareholder, or employee of Geneser Implement; and she did not have any knowledge of the sale of the tractor or combine until the commencement of the Minnesota action. Therefore, the Plaintiff did not prove by clear and convincing evidence the elements of §523(a)(4), embezzlement, as to Margaretta Geneser.

D. Extent Judgement Nondischargeable

As stated, supra, the June 10, 1987 judgment is nondischargeable under §523(a)(6) and §523(a)(4), embezzlement, as to Daniel Geneser. The final issue is the extent to which the judgment is nondischargeable.

The appropriate measure of damages for breach of contract is that amount which will place the plaintiff in the same situation as if the contract had been performed. Peters v. Mutual Benefit Life Insurance Co., 420 N.W.2d 908, 915 (Minn. Ct. App. 1988); Christenson v. Milde, 402 N.W.2d 610, 613 (Minn. Ct. App. 1987). Due to Plaintiff's failure to provide proof concerning the findings of fact and conclusions of law for the June 10, 1987 judgment, the Minnesota District Court's explanation of its damage computation is not in this Court's record. The record does not contain any proof of expenses incurred by Plaintiff. The Court must therefore make its own

determination of the amount which will place the Plaintiff in the same situation as if the lease had been performed.

The following is the Court's determination of damages:

Total rent consideration	$178,266.40	
Equipment residual purchase price	21,075.00	
Total amount to be received by Plaintiff	$199,341.40	
Payment 11-15-84		$ 35,653.28
Partial payment	26,000.00	
Total payments made by Defendant		$ 61,653.28
Net amount due Plaintiff under lease	$137,688.12	
Interest computed at contract rate (8%) from 11/15/86 until 3/29/88	16,109.51	
TOTAL	$153,797.63	

This sum places the Plaintiff in the same situation as if the lease had been performed. $153,797.63 of the June 10, 1987 judgment, as filed in the Iowa District Court, Polk County, is thus nondischargeable under §523(a)(6) and §523(a)(4) as to Daniel Geneser. The remainder of the June 10, 1987 judgment is dischargeable as to Daniel Geneser.

That portion of the state court's judgment for punitive damages in the amount of $25,000.00, plus interest, against both Defendants will not be allowed as part of the nondischargeable debt as there is no basis under 11 U.S.C. §523 to make awards of punitive damages. In re Brown, 66 B.R. 13, 16 (Bankr. D. Utah 1986).

CONCLUSION AND ORDER

WHEREFORE, based on the foregoing analysis, the Court concludes:

1) Plaintiff has proven by clear and convincing evidence that

$153,797.63 of the June 10, 1987 judgment, as filed in the Iowa District Court, Polk County, is nondischargeable under §523(a)(4) and §523(a)(6) as to Daniel Geneser; and

2) Plaintiff has not proven by clear and convincing evidence that the June 10, 1987 judgment is nondischargeable as to Margaretta Geneser.

IT IS ACCORDINGLY ORDERED that the Clerk of Bankruptcy Court is directed to enter judgment for the Plaintiff, Hubbard Leasing Company, and against the Defendant, Daniel John Geneser, that the judgment entered June 10, 1987, in the District Court, Fifth Judicial District, Blue Earth County, State of Minnesota, Hubbard Leasing Company, Plaintiff, v. Daniel J. Geneser and Margaretta Geneser, Defendants, Judgment No. C-4861298, is nondischargeable as to Daniel Geneser to the extent of $153,797.63, and Plaintiff shall have judgment against said Defendant in said amount, and for the costs of this proceeding.

FURTHER, judgment shall be entered for the Defendant, Margaretta A. Geneser, and against the Plaintiff, Hubbard Leasing Company, dismissing the complaint as to said Defendant.

Dated this _____17th_____ day of January, 1990.

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RUSSELL J. HILL
U.S. BANKRUPTCY JUDGE