

UNITED STATES BANKRUPTCY COURT
For the Southern District of Iowa

In the Matter of :
:
ARTHUR M. KAGIN, : Case No. 88-796-C H
: Chapter 7
Debtor. :
:

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STEVEN B. STERN, :
: Adv. No. 88-0190
Plaintiff, :
:

v. :
:

ARTHUR M. KAGIN, :
:
Defendant. :
:

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RCPM INVESTMENT ASSOCIATES :
LIMITED PARTNERSHIP, an Illinois :
Limited Partnership, : Adv. No. 88-0191
Plaintiff, :
:

v. :
:

ARTHUR M. KAGIN, :
:
Defendant. :
:

ORDER--FINDINGS AND CONCLUSIONS
DISCHARGEABILITY OF DEBT

On March 5, 1990, a trial was commenced in these adversary proceedings which were consolidated for trial. The following attorneys appeared on behalf of their respective clients: Michael P. Mallaney, Smith, Schneider, Stiles, Mumford, Schrage, Zurek, Wimer & Hudson, P.C., for the Plaintiffs, Steven B. Stern ("Stern"), and RCPM Investment

Associates Limited Partnership ("RCPM"); and Richard F. Stageman and Elizabeth E. Goodman, Davis, Hockenberg, Wine, Brown, Koehn & Shors, P.C., for the Defendant, Arthur M. Kagin ("Kagin"). At the conclusion of said trial, the Court took the matter under advisement upon a briefing deadline. Proposed findings and conclusions were timely filed and the Court considers the matter fully submitted.

The Court, upon review of the pleadings, arguments of counsel, evidence admitted, and briefs submitted now enters its findings and conclusions pursuant to Fed.R.Bankr.P. 7052.

FINDINGS

1. The Debtor filed a voluntary petition under Chapter 7 of the Bankruptcy Code on April 13, 1988.

2. These adversary proceedings involve agreements relating to the purchase of rare coins and silver bullion by Stern as buyer and Kagin as seller.

3. Stern's complaint is based upon two agreements for the sale of rare coins and prays that the debt be declared nondischargeable pursuant to 11 U.S.C. §523(a)(2)(A).

4. RCPM's complaint is in four counts. Count I is based on the rare coin transactions and prays that the debt be declared non-dischargeable pursuant to 11 U.S.C. §523(a)(2)(A). Count II is based on the silver sales and is based on 11 U.S.C. §523(a)(2)(A). Counts III and IV are based

on the silver sales and are based on 11 U.S.C. §523(a)(6) and 11 U.S.C. §523(a)(4) respectively.

5. These adversary proceedings were consolidated for trial by previous order herein.

6. Prior to the filing of the petition, Kagin owned and operated a corporation known as Kagin's, Inc., which dealt nationally in the sale and purchase of coins. He is a recognized expert in the grading and evaluation of coins and a leader in the field of numismatics in the United States.

7. Stern is a practicing lawyer in Chicago, Illinois, where he specializes in tax and pension law.

8. Stern organized RCPM in 1980 to invest pension plan assets in rare coins and precious metals.

9. Stern recognized that such an investment was very risky and selected Kagin as a reputable dealer to assist him in making this investment.

Coin Transactions

10. Kagin and Stern reached an agreement on March 1, 1981. Kagin's, Inc. was to offer investment-grade rare coins to RCPM at dealer's cost. RCPM would hold the coins and each year Kagin was to value the coins and furnish RCPM with a price for each coin that would represent its "replacement value" and another price for each coin that would represent the amount Kagin's, Inc. would pay for the repurchase of each coin, the "liquidation" value.

During February of each year, RCPM had three options: (1) continue the agreement for another year; (2) sell the coins to Kagin's, Inc. for at least the liquidation value; or (3) require Kagin's, Inc. to refund RCPM's money in exchange for the coins.

RCPM also had the right to inspect all coins submitted by Kagin and reject any coin within 21 days.

11. On May 1, 1984, RCPM and Kagin's, Inc. entered into another coin purchase agreement. In this agreement Kagin became a contracting party, and Kagin's, Inc. and Kagin were collectively designated the dealer.

Kagin, in the May 1, 1984 agreement, agreed to repurchase the coins at RCPM's option under the following formula: (1) the actual price plus 10 percent; (2) actual price plus 50 percent of any profit on the dealer's sale; or (3) the Coin Dealer's Newsletter ("Gray Sheet") bid price as of the Monday morning preceding August 31, 1985. If the coins were sold prior to August 31, 1985, RCPM and Kagin were to share the profit equally.

12. Several agreements were entered into over the years but commencing with the agreement of January 10, 1985, the third repurchase option based on the bid price in the Coin Dealer's Newsletter was omitted. All of the agreements were drafted by Stern.

13. On April 4, 1985 and June 6, 1985, Stern,

personally, entered into similar agreements with Kagin. Kagin warranted the grade of the coins and agreed to repurchase them at cost. In addition, Stern had a right to reject any coin within 10 days.

14. Kagin's procedure was to invoice a list of coins to RCPM and state his grade and value of each coin. Kagin shipped these coins directly to one Harry Boosel ("Boosel").

15. Boosel was not a dealer but a long-time collector of rare coins and active numismatist for over 50 years. He was qualified to grade and value the rare coins. Boosel was paid by RCPM to inspect the coins and make recommendations to Stern.

16. Upon receipt of the coins from Kagin, Boosel would inspect the coins. He would then deliver the coins to Stern and advise Stern as to which coins should be retained and which should be returned to Kagin. Stern would then make his choice, and the rejected coins were returned to Kagin. Only the retained coins became the subject matter of the written sales contracts.

17. Kagin personally selected the coins to be submitted to RCPM and Stern. He graded each coin and priced them at dealer's cost based on the current Gray Sheet "bid" price for like coins.

18. Coins are graded under a point system arranging from 1 to 70. This grading system dates from the 1970s. Coins are

valued upon the basis of the assigned grade. Investment grade coins are ordinarily in the MS 60 to 67 range. Grade 63 qualifies a coin as a rare coin. Generally, the higher the grade, the higher the value. A slight variance in the grading can be significant as the value may increase geometrically as the grade increases.

19. Grading is not an exact science and professional numismatists can disagree upon the grade of a coin.

20. The grading standards tightened in 1986 and both Boosel and Kagin advised Stern of this change. This tightening of standards had an adverse effect upon the value of coins.

21. Stern became concerned about this tightening of standards, and in December 1986, Stern asked Kagin to inflate the "liquidation" value of the coins. Kagin did so and in return was given the right, in the event of a repurchase of the coins, to repurchase them as Kagin saw fit depending upon market conditions.

22. The coins sold by Kagin to RCPM and Stern were all graded by Kagin at MS 65 except six coins that were graded at MS 63 and one at MS 67.

23. Kagin took back all rejected coins after Boosel and Stern had examined them. Kagin also repurchased coins from RCPM that had been sold to RCPM under the 1981 and 1982 contracts.

24. In December 1988, Stern hired other experts to

establish a grade for each coin held by RCPM and Stern. These experts established a grade in 1988 for the time they were originally sold by Kagin to RCPM and Stern. The two experts hired by Stern disagree with each other as to the value of specific coins.

25. Kagin was not asked and he did not regrade the coins after the change in grading standards.

26. RCPM and Stern still have most of the coins in their possession. Coins were resold to Kagin at a profit, and other coins were sold through Boosel at a profit.

27. In 1987, Stern requested Kagin to repurchase all of the remaining coins. Kagin did not repurchase these coins.

SILVER BULLION TRANSACTIONS

28. In 1981, Kagin, upon Stern's request, agreed to enter into a transaction whereby silver bullion was sold to RCPM. Kagin advised Stern that he was not a silver dealer or broker but would charge a commission to cover Kagin's costs.

29. Between June 1981 and March 1982, RCPM ordered 7,000 ounces of silver in three different orders for a total purchase price of \$60,285.00. Kagin receipted each payment and advised RCPM that the silver was being held on account.

30. Kagin had been doing business with a company called SilverTowne for some time and had an established account with that firm. The price at which RCPM purchased the silver was established when Kagin ordered the silver from SilverTowne

upon RCPM's account. Kagin was obligated to deliver or sell at RCPM's option.

31. The oral agreement was that RCPM was purchasing silver at a quoted market price. There was no agreement that the funds or silver bullion be segregated.

32. Kagin asked Stern if he wanted the silver shipped to him, and Stern declined as he had no place to store the silver. Kagin did not have a place to store the silver either.

33. The agreement between Stern and Kagin is not evidenced by any writing except the checks for payment and the receipts.

34. Three thousand ounces of silver were sold in January 1985, for \$18,000.00. Pursuant to agreement of the parties, Kagin paid RCPM \$18,000.00 in the form of rare coins at cost.

Kagin and Kagin's, Inc. continued to maintain an account for the 4,000 ounce balance at RCPM's option.

35. In the spring of 1987, on a weekend, the price of silver bullion rose to \$11.00 an ounce in foreign markets. Stern tried to reach Kagin by telephone but was unable to do so. Upon reaching Kagin at a later time, Stern wanted to establish a procedure whereby Stern could take advantage of any rise in the silver market without being required to proceed through Kagin.

36. Kagin advised Stern that arrangements would be made

with SilverTowne authorizing sale of silver from the account upon Stern's direct order. This was the first time that Stern became aware of the SilverTowne account and the first time a direct sale could be authorized by Stern.

37. All of the silver bullion was eventually sold but at prices substantially lower than \$11.00 an ounce. All of the sales proceeds for 7,000 ounces of silver bullion were paid to RCPM.

DISCUSSION

I. Coin Transactions

11 U.S.C. §523 lists ten exceptions to discharge and provides in relevant part:

(a) A discharge under section 727. . . does not discharge an individual debtor from any debt--

. . .

(2) for money, property, services, or an extension, renewal, or re-financing of credit, to the extent obtained by--

(A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition. . .

To prevent discharge because of fraud under 11 U.S.C. §523(a)(2)(A), a plaintiff must prove actual fraud, not fraud implied in fact. In re Simpson, 29 B.R. 202, 209 (Bankr.N.D.Iowa 1983). The elements of actual fraud include:

(1) the debtor made false representations; (2) at the time the representations were made the debtor knew they were false; (3) the debtor made the representations with the intent to deceive the creditor; (4) the creditor relied upon such representations; and (5) the creditor sustained the alleged loss and damages as a proximate result of the false representation. Matter of Van Horne, 823 F.2d 1285, 1287 (8th Cir. 1987); Simpson, 29 B.R. at 209.

The plaintiff has the burden of proving each of the elements of actual fraud by clear and convincing evidence. Id. Regarding the evidence presented, the Eighth Circuit has stated that it:

must be viewed consistent with the congressional intent that exceptions to discharge be narrowly construed against the creditor and liberally against the debtor, thus effectuating the fresh start policy of the Code. These considerations, however, "are applicable only to honest debtors."

Van Horne, 823 F.2d at 1287 (citations omitted).

The first two elements of actual fraud are self-explanatory. Concerning the third element, intent to deceive the creditor, the Eighth Circuit recently stated:

Because direct proof of intent (i.e., the debtor's state of mind) is nearly impossible to obtain, the creditor may present evidence of the surrounding circumstances from which intent may be inferred. When the creditor introduces circumstantial evidence proving the debtor's

intent to deceive, the debtor "cannot overcome [that] inference with an unsupported assertion of honest intent." The focus is, then, on whether the debtor's actions "appear so inconsistent with [his] self-serving statement of intent that the proof leads the court to disbelieve the debtor."

Id. at 1287-88 (citations omitted).

Although intent to deceive may be inferred from the circumstances of the case, such a finding of intent generally requires a showing that the defendant knew or should have known of the falsity of his statement. In re Valley, 21 B.R. 674, 679-80 (Bankr. D. Mass. 1982). In assessing the defendant's knowledge and liability for fraud, the court will scrutinize the acumen and experience of the defendant. Matter of Newark, 20 B.R. 842, 857 (Bankr. E.D.N.Y. 1982).

The fourth element of actual fraud is the creditor's reliance on a false representation. The Eighth Circuit does not require that the creditor's reliance be shown to be reasonable. In re Ophaug, 827 F.2d 340 (8th Cir. 1987). In Ophaug the Court stated that the statute was clear on its face and that 11 U.S.C. §523(a)(2)(A) does not require a creditor to prove that his reliance on the debtor's fraudulent misrepresentations was reasonable. The creditor need only prove that he relied on the debtor's fraudulent misrepresentations in extending credit to the debtor.

The fifth and final element, proximate cause, requires that the debtor's action was the act, without which the

plaintiff would not have suffered the alleged loss and damages. Van Horne, 823 F.2d at 1288-89.

In the instant cases, Plaintiff must prove by clear and convincing evidence that Kagin's grading of the coins sold to RCPM and Stern under each separate but related contract with RCPM or Stern constituted actual fraud. Applying the Van Horne elements, the Court finds the Plaintiff has not met this burden.

Initially, Plaintiff has not proven by clear and convincing evidence that Kagin made a false representation in grading the coins sold to RCPM and Stern. Grading is not an exact science and professional numismatists can disagree upon the grade of a coin. The Court accepts Kagin's testimony that the coins were of the grade represented to RCPM and Stern at the time of purchase.

The Court also finds that RCPM and Stern did not rely upon Kagin's representations as to the grade of the coins. After Kagin stated his grade and value of each coin, Kagin shipped the coins directly to Boosel, who was paid by RCPM and Stern to inspect the coins and make recommendations to Stern.

Boosel would then deliver the coins to Stern and advise Stern as to which coins should be retained and which should be returned to Kagin. Stern would then make his choice, and the rejected coins were returned to Kagin. Only the retained coins became the subject matter of the written sales

contracts. Kagin took back all rejected coins after Boosel and Stern had examined them. Because of this independent inspection procedure, the Court cannot find the requisite reliance required to prevent discharge under 11 U.S.C. §523(a)(2)(A).

The Court rejects claimant's assertion that Kagin somehow falsely represented the grade of the coins after the initial inspection by Boosel and purchase. The grading standards tightened in 1986 and both Boosel and Kagin advised Stern of this change. However, Kagin was not asked to regrade, and he did not regrade, the coins after the change in grading standards. The contract "liquidation" value was changed, but Kagin did not regrade the coins.

Plaintiff has not proven by clear and convincing evidence that Kagin's grading of the coins sold to RCPM and Stern constituted actual fraud rendering a debt to Stern and RCPM nondischargeable under 11 U.S.C. §523(a)(2)(A). The Court denies Stern's complaint and Count I of RCPM's complaint, and this count must be dismissed.

II. Silver Bullion Transactions

A. 11 U.S.C. §523(a)(2)(A)

In Count II of RCPM's complaint, RCPM asserts that Kagin falsely represented that he would purchase silver on behalf of RCPM, but failed to purchase said silver when he received the

funds in 1981 and 1982. The Court rejects this assertion and finds that Kagin purchased the silver as agreed by Kagin and RCPM. The oral agreement between Kagin and RCPM was that RCPM was purchasing silver at a quoted market price. There was no agreement that funds received from RCPM or silver bullion would be segregated. The agreement between RCPM and Kagin is not evidenced by any writing except checks for payment by RCPM and receipts provided by Kagin. Kagin complied with the agreement by purchasing the silver on account at SilverTowne.

The price at which RCPM purchased the silver was established when Kagin ordered the silver from SilverTowne upon RCPM's account. Kagin was obligated to deliver or sell at RCPM's option. Stern, acting on behalf of RCPM, did not become aware of the SilverTowne account until he could not take advantage of the rise in the silver market in the spring of 1987. However, Kagin did not make a false representation concerning the manner in which the silver would be purchased, and the arrangement complied with the agreement between RCPM and Kagin. All of the silver bullion was eventually sold and the proceeds were paid to RCPM. The Court denies Count II of RCPM's complaint, and this count must be dismissed.

B. 11 U.S.C. §523(a)(6)

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). The burden of proving these allegations is upon the Plaintiff.

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 in 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 instant case, RCPM has not proven that Kagin converted RCPM funds, let alone whether such an act was willful and malicious. As discussed, supra, Kagin purchased silver for RCPM at a quoted market price pursuant to the oral agreement. All of the silver bullion was eventually sold, and all of the sale proceeds were paid to RCPM. RCPM has not proven that Kagin willfully and maliciously converted RCPM funds pursuant to 11 U.S.C. §523(a)(6). Count III of RCPM's complaint is denied and must be dismissed.

C. 11 U.S.C. §523(a)(4)

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--

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

Embezzlement is defined as "the fraudulent appropriation of property by a person to whom such property has been entrusted, or into whose hands it has lawfully come." 3 Collier on Bankruptcy, ¶523.14[3] at 523-116. 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. In re Taylor, 58 B.R. 849, 855; In re Graziano, 35 B.R. 589, 593. The fraudulent intent and misappropriation elements of embezzlement may be proven by circumstantial evidence. In re Graziano, 35 B.R. at 596.

As discussed, supra, Kagin purchased silver at a quoted market price for RCPM pursuant to the oral agreement between Kagin and RCPM. All of the silver bullion was eventually sold and all of the sales proceeds for the 7,000 ounces of silver bullion were paid to RCPM. RCPM has not proven by clear and convincing evidence that Kagin appropriated funds of RCPM for Kagin's benefit, let alone that any appropriation was done

with a fraudulent intent or by deceit. The Court denies Count IV of RCPM's complaint.

CONCLUSION AND ORDER

WHEREFORE, based on the foregoing analysis, the Court concludes: (1) Stern has not proven by clear and convincing evidence Stern's complaint against Kagin pursuant to 11 U.S.C. §523(a)(2)(A); (2) RCPM has not proven by clear and convincing evidence Count I of RCPM's complaint against Kagin pursuant to 11 U.S.C. §523(a)(2)(A); (3) RCPM has not proven by clear and convincing evidence Count II of RCPM's complaint against Kagin pursuant to 11 U.S.C. §523(a)(2)(A); (4) RCPM has not proven Count III of RCPM's complaint against Kagin pursuant to 11 U.S.C. §523(a)(6); and (5) RCPM has not proven by clear and convincing evidence Count IV of RCPM's complaint against Kagin pursuant to 11 U.S.C. §523(a)(4).

IT IS ACCORDINGLY ORDERED that the debt of Kagin to Stern is dischargeable, and the complaint must be dismissed.

IT IS FURTHER ORDERED that the debt of Kagin to RCPM is dischargeable, and the complaint must be dismissed.

LET JUDGMENT ENTER ACCORDINGLY.

Dated this 5th day of November, 1990.

RUSSELL J. HILL
U.S. BANKRUPTCY JUDGE