

UNITED STATES BANKRUPTCY COURT
For the Southern District of Iowa

IN THE MATTER OF: : Appeal No. 4-91-CV-70120
ARTHUR M. KAGIN, : Case No. 88-796-C-H
Debtor. : Chapter 7

RCPM INVESTMENT ASSOCIATES : Adversary No. 88-0191
LIMITED PARTNERSHIP, an :
Illinois Limited Partnership, :
Plaintiff, :
vs. :
ARTHUR M. KAGIN, :
Defendant. :

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**ORDER - REMAND FOR FINDINGS AND CONCLUSIONS
ON PREPONDERANCE OF THE EVIDENCE STANDARD**

On March 5, 1990, a trial was commenced on the Complaint in the above-captioned adversary proceeding to determine a dischargeability of debt. This adversary proceeding was consolidated for trial with the adversary proceeding captioned Steven B. Stern, Plaintiff, vs. Arthur M. Kagin, Defendant, Adversary Proceeding No. 88-0190. At the conclusion of the trial, the Court took the matters under advisement under a briefing schedule. Proposed findings and conclusions of law were timely filed.

This Court filed its findings and conclusions on November 5, 1990. This Court concluded that the Plaintiff, Steven B. Stern, in Adversary Proceeding No. 88-190, had failed to prove

by clear and convincing evidence his allegation that Kagin obtained property from Stern by false pretenses, false representations, and actual fraud pursuant to 11 U.S.C. § 523(a)(2)(A). Accordingly, judgement was entered on November 5, 1990, dismissing the Complaint and determining that Kagin's obligation to Stern was dischargeable. This judgment was not appealed.

This Court in its findings and conclusions of November 5, 1990, also concluded that the Plaintiff, RCPM, in Adversary Proceeding No. 88-191, had also failed to prove by clear and convincing evidence the following allegations:

- 1) as alleged in Count I and pursuant to 11 U.S.C. § 523 (a)(2)(A), that Kagin obtained monies from RCPM by false pretenses, false representation, and fraud;
- 2) as alleged in Count II and pursuant to 11 U.S.C. § 523(a)(2)(A), that Kagin had obtained money under false pretenses by virtue of fraud;
- 3) as alleged in Count III and pursuant to 11 U.S.C. § 523(a)(6), that Kagin willfully and maliciously converted property of RCPM;
- 4) as alleged in count IV and pursuant to 11 U.S.C. 523(a)(4), that Kagin embezzled property of RCPM.

Accordingly, judgment was entered in Adversary Proceeding No. 88-191 on November 5, 1990 for Kagin and against RCPM dismissing the Complaint in four counts and determining that the debt of Kagin to RCPM was dischargeable.

On December 5, 1990, RCPM filed the notice of appeal in Adversary Proceeding No. 88-0191.

On January 15, 1991, the United States Supreme Court in Grogan v. Garner, ____ U.S. ____, 111 S. Ct. 654, 112 L. Ed 2d 755 (1991) ruled that the preponderance-of-the-evidence standard was applicable to all discharge exceptions in § 523(a) of the Bankruptcy Code.

The parties stipulated that an order should enter reversing the November 5, 1990 order and judgment of this Court. The District Court entered its order on March 8, 1991 vacating and reversing the judgement and findings entered on November 5, 1990 and remanded the case to this Court for further proceedings on the merits of the case under a preponderance-of-the-evidence standard of proof.

DISCUSSION

"The term [burden of proof] encompasses two separate burdens of proof. One burden is that of producing evidence, satisfactory to the judge, of a particular fact in issue. The second is the burden of persuading the trier of fact that the alleged fact is true." Edward W. Cleary, McCormick on Evidence, § 336, p. 947 (Lawyer's ed.) (3rd ed. 1984). Federal Rule of Evidence 301 speaks in terms of "the burden of going forward with evidence" and "burden of proof in the sense of the risk of nonpersuasion." As used herein, the "burden of producing evidence" will be used to denote the burden of going forward with evidence and "burden of proof" will be used for the burden of persuasion. "Preponderance of the evidence"

means the greater weight of evidence. It is the evidence which, when weighed with that opposed to it, has more convincing force and is more probably true and accurate. If, upon any issue in the case, the evidence appears to be equally balanced, or if it cannot be said upon which side it weighs heavier, then plaintiff has not met his or her burden of proof." Smith v. United States, 557 F. Supp. 42, 51 (W.D. Ark. 1982), aff'd, 726 F.2d 428 (8th Cir. 1984).

RCPM has the burden of proof in this proceeding. RCPM met its burden of producing evidence by establishing a prima facie case on all counts in its case in chief. The defendant responded by producing evidence in his defense, which produced a question of fact on all material issues. The question now before this court is whether RCPM has proven its allegations by a preponderance of the evidence. Upon a review of the entire record the court concludes that it has not. The following findings and conclusions supplement those contained in the order of November 5, 1990.

I. Count I: The Coin Transactions

RCPM alleges and claims that Kagin obtained silver bullion by false pretenses, false representations and actual fraud as alleged in Counts I and II. In order to be nondischargeable under 11 U.S.C. § 523(a)(2)(A) the coins and silver bullion must actually have been obtained by Kagin as a

result of fraud. Whether there was fraud must be determined from all the facts and circumstances of the transaction by and between Stern and Kagin. See, In re Crea, 31 B.R. 239 (Bankr. D. Minn. 1983); In re Hunt, 30 B.R. 425 (D. Ct. M.D. Tenn. 1983). Actual fraud requires proof of moral turpitude or intentional wrongdoing. In re Simpson, 29 B.R. 202 (Bankr. N.D. Iowa 1983). The fraud must exist at the inception of the debt. In re Vissers, 21 B.R. 638, 640 (Bankr. E.D. Wis. 1982); In re Tabers, 28 B.R. 679, 681 (Bankr. W.D. Ky. 1983). Kagin's subsequent conduct may, however, reflect upon his state of mind at the time he made the promises and may be considered in determining if he possessed a fraudulent intent at the time the debt was created. In re Kelsy, 9 B.R. 154, 157 (Bankr. W.D. Ky. 1981).

Stern was looking for a rare coin investment opportunity which would diminish the risk in a speculative venture. Kagin, a coin dealer, was interested in trading in coins and regarded the RCPM coins as a source of coins for future trading. Kagin selected, graded and valued coins which were invoiced directly to RCPM's numismatist who independently graded the coins and made his recommendation to Stern as to which coins should be accepted or rejected. Stern then purchased or rejected the coins upon his expert's advise and his own independent examination and judgment.

Kagin accepted the return of the rejected coins. He also

purchased coins from RCPM when RCPM offered them for sale to Kagin. In 1986 Stern was advised that the grading standards had been refined and tightened. Stern did not return the coins to Kagin for regrading. Rather, he asked Kagin to inflate the "liquidation" value of the coins, sight unseen. Kagin complied with this request with the mutual understanding that Kagin would now have the ability to repurchase the coins in a manner which would take optimum advantage of market conditions. Stern had never returned the coins to Kagin for regrading. The only time coins were returned to Kagin was when coins were rejected or when they were repurchased by Kagin. In 1988 Stern commenced a lawsuit against Kagin for breach of contract because Kagin had not repurchased coins offered by RCPM/ Stern. Fraud was not alleged at that time.

It was at this time that Stern employed another numismatist to examine the coins. This expert attempted to grade the coins as they were several years ago and at a point in time when the grading standards were different. This expert was critical of Kagin's grading and valuations. However, this expert did concede that the grades might have been correct at the time of the purchase of the coins but were not properly graded at the time of his examination.

There is independent expert opinion that Kagin's original grading of the coins was reasonable. None of the experts, however, could agree as to the grading and value of all the

coins, which supports the conclusion that the grading of coins is an inexact science and subjective factors influence the grading and valuation process. It is unknown if the condition of the coins had changed since they came into the possession of RCPM/Stern, and if there was a change, the degree of the change. It is uncontroverted that slight physical changes, which can be caused by moisture, handling, and chemicals from packaging, can change the grade and consequent value of the coins.

To summarize, the following facts and circumstances support Kagin's denial of any fraud in his dealings with RCPM and Stern: RCPM/Stern had their own expert grade and value the coins prior to purchase; Kagin accepted the rejected coins; Kagin repurchased coins from RCPM; over-grading of coins by Kagin was against his own best interest in light of the repurchase agreement; numismatists do not agree upon the grade and value of coins; the condition of coins does not improve with the passage of time, but their condition deteriorates.

Given these facts and circumstances, RCPM has failed to prove by a preponderance of the evidence that Kagin made false representations as to the grade and value of coins at the time they were purchased by RCPM and Stern; that Kagin had an intention and purpose of deceiving RCPM/Stern; and, that RCPM/Stern relied upon Kagin's grading and value of the coins.

Accordingly, Count I of RCPM's Complaint must be dismissed.

II. Count II: The Silver Bullion Transactions.

RCPM contends that Kagin used, for his own benefit, monies that were intended to be used on behalf of RCPM for the purchase of silver bullion. The evidence does not support RCPM's allegation.

RCPM/Stern and Kagin entered into an oral agreement in 1981 whereby RCPM purchased silver bullion through Kagin at a quoted market price. As Kagin received funds from RCPM for the purchase of silver bullion, he accounted for the funds by giving the date of receipt, the amount of bullion involved, the price per ounce, the total price, and the fact that the bullion was purchased subject to the order of RCPM. Kagin purchased the bullion through his account with Silvertown. The price at which RCPM purchased the silver was established at that time. RCPM did not want the silver delivered and there was no agreement as to how the funds for the purchase for the silver were to be managed.

Originally, RCPM did not have the ability to access the Silvertown account directly but had to proceed through Kagin. For example, evidence was presented of a silver bullion transaction ordered by RCPM in 1985. Kagin relayed the order to Silvertown; Silvertown entered the sale on Kagin's account and paid Kagin for the bullion, plus interest; then Kagin

forwarded the sales proceeds to RCPM in the form of rare coins pursuant to the order of RCPM.

Upon RCPM's inability to engage in a rapid silver sale, the agreement by and between RCPM and Kagin was changed. The price of silver bullion had increased suddenly in 1987 and RCPM was not able to sell because of its inability to contact Kagin, through no fault of Kagin. The parties changed their agreement so that RCPM had the ability to authorize sales of silver by direct communication with Silvertown. Thereafter, on two occasions, RCPM directed Silvertown to sell bullion from the Kagin account. Silvertown entered the sale on Kagin's account and the net proceeds were credited to RCPM by Kagin.

RCPM has proven that it failed to realize upon a temporary high price for silver bullion and that it suffered losses as a result of its speculation in the silver market. As a result the parties changed their agreement so RCPM could order the sale and purchase of silver on Kagin's account and Kagin credited the net proceeds to RCPM. RCPM has, however, failed to prove by a preponderance of the evidence that Kagin obtained money or property belonging to RCPM by false pretenses, false representation, or actual fraud. Accordingly, Count II of the Complaint must be dismissed.

III. Count III: Willful and Malicious Injury.

The contract between Kagin and RCPM did not define how Kagin was to manage the money he received from RCPM for silver transactions. Thus, Kagin was at liberty to manage this money in a commercially reasonable manner. The failure of RCPM to sell its silver bullion at its high price was due to Stern's inability to contact Kagin on short notice on a weekend. There was no agreement that Kagin would be immediately available upon call by Stern and Kagin's unavailability does not show willfulness or malice on Kagin's part.

RCPM has failed to show by a preponderance of the evidence that Kagin converted RCPM funds or that Kagin acted willfully or maliciously. RCPM has failed to prove that Kagin exercised dominion over property belonging to RCPM to the exclusion of RCPM's right to possession of the property or in repudiation of RCPM's rights in the silver bullion. Even assuming a conversion, RCPM has failed to show by a preponderance of the evidence that there was any intentional or deliberate conduct on Kagin's part, which violated RCPM's rights. There was no showing of malice and no showing that Kagin had any intention of harming RCPM. Accordingly, Count III must be dismissed.

IV. Count IV: Embezzlement.

RCPM also asserts that Kagin embezzled the RCPM funds, which were paid to Kagin for the purchase of the silver

bullion, and therefore this debt should be declared nondischargeable pursuant to 11 U.S.C. § 523(a)(4). In a dischargeability proceeding, under the theory of embezzlement, RCPM must prove by the appropriate federal standard that Kagin appropriated funds for his own benefit and that he did so with fraudulent intent or deceit. In re Weber, 892 F.2d 534, 538-39 (7th Cir. 1989).

There has been no showing that Kagin fraudulently appropriated any money or property entrusted to him by RCPM. The evidence shows that RCPM/Stern sent the money to Kagin for the purchase of silver bullion. There was no agreement restricting Kagin as to how the purchases were to be accomplished. In fact, Stern knew that the silver bullion was purchased through Kagin's account with Silvertown and on two occasions dealt directly with Silvertown when he desired that a sale take place. Kagin accounted to RCPM for all silver transactions as RCPM and the contract provided. As Kagin received money, he accounted for it and he advised RCPM that silver bullion had been purchased on RCPM's behalf and was subject to further order of RCPM. Upon an order to sell, Kagin paid the full purchase price, plus interest, and remitted the proceeds to RCPM. Accordingly, RCPM fails in its allegations that Kagin embezzled funds belonging to RCPM and Count IV must be dismissed.

CONCLUSION AND ORDER

WHEREFORE, based on the foregoing analysis, the Court concludes that RCPM has failed to show by a preponderance of evidence, as follows:

(1) that Kagin defrauded RCPM as alleged in Counts I and II of the Complaint;

(2) that Kagin willfully and maliciously converted property of RCPM as alleged in Count III; and

(3) that Kagin embezzled property of RCPM as alleged in Count IV.

IT IS ACCORDINGLY ORDERED that the Complaint in four counts must be dismissed and the debt of Kagin to RCPM is dischargeable.

LET JUDGMENT ENTER ACCORDINGLY.

Dated this 24th day of January, 1992.

RUSSELL J. HILL
U.S. Bankruptcy Judge