UNITED STATES BANKRUPTCY COURT
DISTRICT OF NEW HAMPSHIRE

In re: Bk. No. 99-10779-JMD
Chapter 7

Richard Rivela and
Mary Jo Rivela,
Debtors

Andrew M. Osborne,
Plaintiff

v. Adv. No. 99-1111-JMD

Richard Rivela,
Defendant

Michael S. Askenaizer, Esq.
Attorney for Plaintiff

Richard D. Gaudreau, Esq.
Attorney for Defendant

MEMORANDUM OPINION

I. BACKGROUND

Before the Court is a complaint filed by Andrew M. Osborne (the "Plaintiff") against Richard Rivela (the "Debtor"), which seeks to have a certain judgment debt declared nondischargeable pursuant to 11 U.S.C. §§ 523(a)(2)(A), (a)(4), or (a)(6).[1] A trial was held on December 13, 1999. Because this proceeding involves a protracted business relationship between the parties and numerous factual disputes, a detailed factual discussion is necessary.

The Plaintiff's spouse owned On Common Ground Inc., a natural food store, from 1990 until 1993, at which time business operations ceased. When the business closed, the Plaintiff, a licensed attorney, and his spouse became the owners of all of the tangible assets of the spouse's corporation

[1] Unless otherwise noted, all section references hereinafter are to Title 11 of the United States Code.

through foreclosure of a security interest. Those assets included freezers, a checkout conveyor, a cash register, and other trade equipment. Ultimately the Plaintiff became the sole owner of the equipment. The Plaintiff had the equipment removed from the food store and stored by American Food Service ("AFS"), a third party not involved in the instant proceeding. When AFS could no longer store the equipment, a friend of the Plaintiff recommended that he contact the Debtor concerning further storage of the equipment. At the time, the Debtor was one of two owners operating Superior Refrigeration ("Superior"), a partnership which, among other things, bought and sold certain trade equipment.[2] In February 1994, the Debtor picked up the equipment and transported it to a warehouse for storage. The Debtor invoiced the Plaintiff for moving the equipment from AFS's premises to the Debtor's premises. The amount of that invoice was deducted from the proceeds paid to the Plaintiff from the sale of equipment.

Either at the time the Debtor took possession of the equipment or shortly thereafter, the parties entered into an oral consignment relationship concerning the property. Both parties agree that the Debtor did not take ownership of the property, but instead was to merely store the equipment and try to obtain buyers, with the understanding that the proceeds of any resulting sales would be split 80/20 between the Plaintiff and the Debtor, respectively. Testimony at trial revealed that the Debtor did obtain buyers for some of the Plaintiff's equipment and did in fact consummate the consequent sales. It appears that the Debtor sold at least three pieces of the equipment and remitted the proceeds, net of the invoiced transportation charges, to the Plaintiff, although on at least one occasion the proceeds were not paid in a lump sum.

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[2] The Debtor and his partner had operated the business under the trade name Superior Refrigeration since 1991. See Ex. 111, Application for Registration of Trade Name. On March 2, 1994, the Debtor and his partner filed Articles of Incorporation with the New Hampshire Secretary of State's office under the name Superior Refrigeration, Inc. See Ex. 121, Articles of Incorporation. On June 27, 1994, the Plaintiff sent a letter to the new corporation. See Ex. 2, Letter from Plaintiff to Superior Refrigeration Inc., dated June 27, 1994. However, subsequent correspondence from the Plaintiff was either addressed to the trade name or the Debtor, individually, and suit was ultimately brought in state court against the Debtor and his partner both individually and under the trade name. See Exs. 3, 4, 6, 8, 9, and 11 through 22. Neither party has raised any issue with respect to the incorporation of the Debtor's business and the fact that the underlying state court judgment is against the Debtor individually. Accordingly, this Court will deal with the relevant obligations as the individual debts or obligations of the Debtor to the Plaintiff.

The business relationship between the parties appears to have begun unraveling during the later part of 1994. See Exs. 2 & 3, Letters from Plaintiff to Debtor dated June 27, 1994 and November 11, 1994, respectively. On May 22, 1995, the Debtor wrote the Plaintiff a letter explaining that Superior had been unable to locate a buyer for the remaining equipment and requesting that the Plaintiff make arrangements to remove the equipment from Superior's warehouse no later than July 1, 1995 since Superior intended to vacate the premises. See Ex. 5, Letter from Debtor to Plaintiff dated May 22, 1995. At trial, the Plaintiff testified that the Debtor subsequently informed him that Superior's plan to vacate its warehouse was postponed and that, consequently, the Plaintiff did not need to remove his equipment and that the consignment arrangement would continue. The Debtor disputed this assertion at trial; he testified that he never told the Plaintiff that Superior's plan to leave the warehouse would be delayed and that it was his desire that the Plaintiff remove his equipment from Superior's warehouse. In any event, in late 1995, the Debtor moved all of his tools and equipment, including the Plaintiff's equipment, to a friend's machine shop in Lawrence, Massachusetts.

In April and May 1996, the Plaintiff wrote the Debtor requesting that the Debtor deliver the remaining unsold equipment to the Plaintiff at no charge. See Exs. 14 & 15, Letters from Plaintiff to Debtor dated April 9, 1996 and May 9, 1996, respectively. The Plaintiff testified that in June 1996, he spoke with the Debtor and asked where the equipment was being stored and made it clear that he wanted the equipment returned to him. The Plaintiff testified that the Debtor stated that the equipment was in Lawrence, Massachusetts, but refused to give an exact address. The Debtor disputes this assertion and testified at trial that the Plaintiff never asked for a specific address. The Debtor then moved his tools and equipment, including the Plaintiff's equipment, to a self-storage facility in New Hampshire. On December 20, 1996, the Plaintiff obtained a preliminary injunction from a Massachusetts state court ordering the Debtor to deliver all of the remaining equipment to the Plaintiff. The Debtor testified that he did not comply with the court order due to a back injury that prevented him from moving the equipment. The Plaintiff then obtained a default judgment against the Debtor from a Massachusetts state court in the amount of $38,462.08. See Ex. 25, Massachusetts Default Judgment. Sometime during 1997, all of the property in

storage, including the Plaintiff's remaining equipment, was sold via auction by the New Hampshire self-storage facility due to the Debtor's failure to pay storage costs. On November 12, 1998, the Plaintiff commenced an action on the Massachusetts judgment in New Hampshire state court. The Debtor entered an appearance and the Plaintiff moved for summary judgment in the amount of $43,020.66, which was granted on February 25, 1999. It is the New Hampshire judgment that forms the basis of the Plaintiff's complaint.[3]

The Plaintiff's complaint is premised upon four alternative grounds. First, the Plaintiff argues that the Debtor obtained the relevant property by false pretenses, a false representation, or actual fraud and that, therefore, the debt at issue is nondischargeable pursuant to § 523(a)(2)(A). Second, the Plaintiff argues that the Debtor committed defalcation while acting in a fiduciary capacity and therefore the debt is nondischargeble pursuant to § 523(a)(4). Third, the Plaintiff argues that the Debtor committed embezzlement, therefore making the debt nondischargeable pursuant to § 523(a)(4). The Plaintiff's final argument is that the Debtor's actions constituted a willful and malicious injury to the Plaintiff's property and therefore the debt is nondischargeable pursuant to § 523(a)(6). The Debtor, of course, argues that there are no grounds supporting a finding of nondischargeability. Each of the Plaintiff's four arguments shall be addressed in turn.

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[3] On December 1, 1999, this Court held a hearing on a motion for summary judgment filed by the Plaintiff. The Court denied the Plaintiff's motion. At the hearing, however, the Court addressed the question of whether the Debtor would be collaterally estopped from litigating certain issues in this forum given the New Hampshire judgment. In a federal bankruptcy court, it is the law of the state rendering the operative judgment that determines the applicability of collateral estoppel. See Worster v. Howcroft (In re Howcroft), 223 B.R. 845, 848 (Bankr. D.N.H. 1998); Phalon v. Varrasso (In re Varrasso), 194 B.R. 537, 538-39 (Bankr. D. Mass. 1996). In New Hampshire, the doctrine of collateral estoppel is triggered when three elements are present: (1) the issue must be identical in both actions; (2) the first action must have resolved the issue finally on the merits; and (3) the party to be estopped must have appeared in the first action. See Howcroft, 223 B.R. at 848. The substantive issues relating to the Plaintiff's claims under §§ 523(a)(2)(A), (a)(4), and (a)(6) (e.g., whether the transaction at issue was tainted by fraud, whether embezzlement occurred, etc.) were not resolved by the New Hampshire action. Accordingly, those issues are left open with respect to the instant proceeding. However, as the Court stated at the summary judgment hearing, the Debtor is collaterally estopped from challenging the amount of the debt at issue, as fixed by the New Hampshire judgment. See Sparks v. Adams (In re Adams), 147 B.R. 407, n.27 (Bankr. W.D. Mich. 1992); Comer v. Comer (In re Comer), 723 F.2d 737, 740 (9th Cir. 1984). Accordingly, because the parties did not contest this conclusion at trial, the debt at issue is $43,020.66.

The Court has jurisdiction of the subject matter and the parties pursuant to 28 U.S.C. §§ 1334 and 157(a) and the "Standing Order of Referral of Title 11 Proceedings to the United States Bankruptcy Court for the District of New Hampshire," dated January 18, 1994 (DiClerico, C.J.). This is a core proceeding in accordance with 28 U.S.C. § 157(b).

II. DISCUSSION

A. Generally

As a threshold matter, the Court notes that when passing on the question of whether a debt should be excepted from discharge, the relevant facts and circumstances are to be viewed through a lens characterized by liberality towards the debtor. As the Court of Appeals for the First Circuit has stated, "'[e]xceptions to discharge are narrowly construed in furtherance of the Bankruptcy Code's 'fresh start' policy,' and, for that reason, the claimant must show that his 'claim comes squarely within an exception enumerated in Bankruptcy Code § 523(a).'" Palmacci v. Umpierrez, 121 F.3d 781, 786 (1st Cir. 1997) (quoting Century 21 Balfour Real Estate v. Menna (In re Menna), 16 F.3d 7, 9 (1st Cir. 1994)). Moreover, "[t]he statutory requirements for a discharge are 'construed liberally in favor of the debtor' and '[t]he reasons for denying a discharge to a bankruptcy must be real and substantial, not merely technical and conjectural.'" Id. (quoting Boroff v. Tully (In re Tully), 818 F.2d 106, 110 (1st Cir. 1987)). The Court shall analyze the Plaintiff's various arguments with these directives in mind. Because the Plaintiff's complaint is based solely upon § 523(a), he bears the burden of proving the necessary elements by a preponderance of the evidence. See id. at 787.

B. Section 523(a)(2)(A)

Section 523(a)(2)(A) provides that a debt for money or property is nondischargeable if it is obtained by "false pretenses, a false representation, or actual fraud . . . ." 11 U.S.C. § 523(a)(2)(A). To satisfy his burden under § 523(a)(2)(A), the Plaintiff must prove the following:

1. The Debtor made a false representation;
2. He did so with fraudulent intent – i.e., with scienter;
3. He intended to induce the Plaintiff to rely on the misrepresentation;
4. The misrepresentation actually induces reliance that is justifiable; and
5. The Plaintiff suffered damages.

See Reilly v. Beeman (In re Beeman), 225 B.R. 522, 528 (Bankr. D.N.H. 1998); Palmacci, 121 F.3d at 786. At trial, the Plaintiff argued that there were two pertinent false representations made by the Debtor that establish a § 523(a)(2)(A) claim. First, the Plaintiff argues that at the time of the initial agreement between the parties, the Debtor represented that he would store the equipment, find possible buyers, and return any unsold equipment. The Plaintiff alleges that the Debtor did not actually intend to do such things at the time of agreement and therefore these statements constitute false representations. Second, the Plaintiff argues that the Debtor continually stated that he would return the unsold equipment to the Plaintiff throughout the course of the parties' business relationship when in fact he did not so intend, thus making further false representations.

The Court finds that the Plaintiff has not carried his burden with respect to proving all of the elements of his § 523(a)(2)(A) claim. To prove the first element (i.e., that the Debtor made a false representation) the Plaintiff must show that, at the time of making the pertinent representation, the Debtor did not intend to perform the stated promise. See Palmacci, 121 F.3d at 787. Moreover, to establish the second element (i.e., scienter) the Plaintiff must prove that the Debtor acted with fraudulent intent. In other words, it must be shown that the Debtor acted with an actual intent to mislead or was reckless in disregarding the truth of a representation. See id. at 788-89. Because direct evidence of an intent to mislead or defraud is seldom available, these elements may be proven by the totality of circumstantial evidence. See id. at 789; Williamson v. Busconi, 87 F.3d 602, 603 (1st Cir. 1996). Based upon the totality

of the evidence presented by the Plaintiff, the Court finds that he has not shown, by the relevant evidentiary margin, that the Debtor made a false representation with fraudulent intent.[4]

It does not appear that, when the Debtor made the relevant representations, he did not intend to carry them through. The parties agree that the equipment remained property of the Plaintiff until sold by the Debtor on terms approved by the Plaintiff. The evidence establishes that this agreement was followed and three pieces of equipment were sold in this manner. The evidence also establishes that the Plaintiff authorized the Debtor to dispose of several pieces of equipment because they had no value in the market for used equipment. However, the Plaintiff contends that the Debtor's conduct in refusing to redeliver the remaining equipment to the Plaintiff or to disclose its location is evidence that the Debtor had already sold the equipment and never had any intention to remit the proceeds or return the equipment to the Plaintiff. After reviewing the evidence, the Court does not find support for the Plaintiff's contention, but instead finds uncontroverted evidence that the Debtor followed the consignment agreement until the dispute between the parties over the return of the remaining equipment. Accordingly, the Plaintiff has not established that the Debtor did not intend to carry out the terms of the consignment agreement in early 1994.

The Plaintiff next argues that the Debtor's later statements that he would return the equipment were false and that the Debtor never intended to return the equipment. However, the evidence tends to show that the primary issue of contention over the later part of the parties' business relationship involved the question of who would bear the cost of transporting the remaining unsold equipment back to the Plaintiff. The letters written by the Plaintiff to the Debtor show that the Plaintiff unequivocally thought that the Debtor should bear such a burden. The Debtor's testimony at trial indicates that it was his view that the Plaintiff should have borne the relevant expense. This disagreement appears to offer a reasonable explanation as to why the parties could not come to an agreement regarding the return of the Plaintiff's unsold equipment. This explanation appears more reasonable as compared to the Plaintiff's unsupported

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[4] This is not meant to imply that the Plaintiff has carried his burden with respect to the remaining elements under § 523(a)(2)(A). Because the Court finds that the Plaintiff has not met his burden with respect to the first two elements under § 523(a)(2)(A), the remaining elements become irrelevant.

assertion that the Debtor never intended to return the remaining unsold equipment to the Plaintiff. The evidence does not show that the Debtor acted with fraudulent intent. The evidence at trial shows that the Debtor did remit the proceeds of various equipment sales to the Plaintiff. Moreover, it does not appear that the Debtor experienced any significant benefit from retaining the relevant property. Such evidence is at odds with the allegation that the Debtor acted with an intent to defraud the Plaintiff.

C. Section 523(a)(4) – Defalcation While Acting in a Fiduciary Capacity

Section 523(a)(4) provides that a debt is nondischargeable when it is "for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny . . . ." 11 U.S.C. § 523(a)(4). The Plaintiff's second claim is that the relevant debt is nondischargeable because it results from the Debtor committing defalcation while acting in a fiduciary capacity. In essence, the Plaintiff's second claim will prevail if he can show that (1) the Debtor committed defalcation; and (2) the Debtor committed such defalcation while in a fiduciary relationship vis-a-vis the Plaintiff.

The Court finds that the business relationship between the parties never placed the Debtor in a fiduciary capacity with respect to the Plaintiff for purposes of § 523(a)(4). The term "fiduciary" is given a relatively stringent federal interpretation in the context of § 523(a)(4), an interpretation that is narrower than its state law counterpart. See Bamco 18 v. Reeves (In re Reeves), 124 B.R. 5, 7-8 (Bankr. D.N.H. 1990) ("[T]he term 'fiduciary' in the Bankruptcy Code is narrower than the word as used under state law."). As explained by Judge Yacos, a fiduciary relationship will arise, for purposes of § 523(a)(4), only in:

> the express trust situation in which the debtor either expressly signified his intention at the outset of the transaction, or was clearly put on notice by some document in existence at the outset, that he was undertaking the special responsibilities of a trustee to account for his actions over and above the normal obligations that contracting parties have to each other in a commercial transaction.

Reeves, 124 B.R. at 8. See also Peerless Ins. v. Swanson (In re Swanson), 231 B.R. 145, 148 (Bankr. D.N.H. 1999) (citing Reeves with approval); Office of Public Guardian v. Messineo (In re Messineo), 192 B.R. 597, 600 (Bankr. D.N.H. 1996) (same). The Plaintiff concedes that the Debtor did not qualify as a fiduciary at the outset of the parties' business relationship. Instead, the parties agree that their initial relationship could best be described as one of consignment. The Plaintiff argues, however, that subsequent

events acted to cloak the Debtor with fiduciary duties. More specifically, the Plaintiff argues that the Debtor became a fiduciary vis-a-vis the Plaintiff when the Plaintiff demanded by letter the return of the equipment and he obtained a Massachusetts state court order requiring the Debtor to return the same.

The Court finds the Plaintiff's argument unpersuasive. There is no evidence indicating that the Debtor affirmatively consented to undertake fiduciary duties at the outset of the transaction or was put on notice that he would be held to such a standard from the beginning. The pertinent time for purposes of determining whether a fiduciary relationship exists under § 523(a)(4) is the outset of the parties' relationship. See Reeves, 124 B.R. at 8. In the instant matter, there was no fiduciary relationship at such time. Since the Debtor was not a fiduciary with respect to the Plaintiff for purposes of § 523(a)(4), the Court need not consider whether defalcation occurred.

D. Section 523(a)(4) – Embezzlement

Like the Plaintiff's second claim, his third claim relies on § 523(a)(4). However, in his third claim, the Plaintiff relies on § 523(a)(4)'s directive that debts resulting from embezzlement be excepted from discharge. To prove embezzlement under § 523(a)(4), the following three elements must be shown:

1. The relevant property was rightfully in the possession of a nonowner;
2. The nonowner appropriated the property for a use other than which it was entrusted; and
3. The circumstances indicate fraud.

See TransAmerica Comm. Fin. Corp. v. Littleton (In re Littleton), 942 F.2d 551, 555 (9th Cir. 1991). See also Brady v. McAllister (In re Brady), 101 F.3d 1165, 1173 (6th Cir. 1996). The Plaintiff has clearly proven the first element: the Plaintiff's equipment was rightfully in the possession of the Debtor, who was a nonowner at the time. The Court also finds that the Plaintiff has proven the second element of embezzlement. For purposes of embezzlement under § 523(a)(4), "appropriation" does not require a showing that the nonowner individually profited from his or her actions. See Brady, 101 F.3d at 1173. The evidence shows that the Debtor retained the relevant property despite clear directions in 1996 from the Plaintiff and a Massachusetts state court that he return the property to the Plaintiff. These circumstances amount to appropriation for a use other than which the property was entrusted. Accordingly, the second element of embezzlement is satisfied. The third element – that the circumstances indicate fraud – requires

the Plaintiff to prove fraudulent intent on the part of the Debtor. See Nat'l Tour Assoc., Inc. v. Rodriguez, 221 B.R. 1012, 1017 (Bankr. M.D. Fla. 1998). As discussed above in the context of the Plaintiff's § 523(a)(2)(A) claim, the Court finds that the Plaintiff has not proven, by a preponderance of the evidence, that the Debtor acted with fraudulent intent during the course of the parties' business relationship. While the Plaintiff suspects that the Debtor sold some of his equipment without remitting the proceeds to the Debtor, he was unable to offer any evidence supporting his suspicions. Accordingly, the Plaintiff has not proven embezzlement for purposes of § 523(a)(4).

E. Section 523(a)(6)

Section 523(a)(6) provides that a debt shall be excepted from discharge when it results from a "willful and malicious injury by the debtor to another entity or to the property of another entity . . . ." 11 U.S.C. § 523(a)(6). The Plaintiff argues that the Debtor's actions constituted a willful and malicious injury to the property of the Plaintiff and therefore the relevant debt is nondischargeable. The Supreme Court has recently spoken on the issue of the proper construction of § 523(a)(6). In a unanimous decision, Justice Ginsburg stated:

> The word "willful" in (a)(6) modifies the word "injury," indicating that nondischargeability takes a deliberate or intentional injury, not merely a deliberate or intentional act that leads to injury . . . . Moreover, as the Eighth Circuit observed, the (a)(6) formulation triggers in the lawyer's mind the category "intentional torts," as distinguished from negligent or reckless torts. Intentional torts generally require that the actor intend "the consequences of an act," not simply "the act itself."

Kawaauhau v. Geiger, 523 U.S. 57, 61-62 (1998). To make out a § 523(a)(6) claim, therefore, the Plaintiff must show, by a preponderance of the evidence, that the Debtor acted with an actual intent to injure the Plaintiff's property. See id. See also Roumeliotis v. Popa (In re Popa), 140 F.3d 317, 318 (1st Cir. 1998). The Court finds that the Plaintiff has not carried his burden of proving that the Debtor acted with such an intent. The discussion above relating to the Court's conclusion that the Plaintiff has not proven that the Debtor acted with fraudulent intent in wrongly retaining the equipment is relevant to the instant analysis. A reasonable explanation for the Debtor's refusal to return the Plaintiff's equipment is the apparent disagreement between the parties regarding who would bear the resulting moving costs. The Debtor

testified that his failure to advise the Plaintiff of the impending sale for nonpayment of storage charges was due to his lack of awareness of the notice of sale. The evidence supports a conclusion that the Debtor's lack of attention to business matters was due to his financial difficulties caused by medical problems that made it impossible for him to work. While such inattention to business affairs may be negligent or reckless, the evidence does not support a conclusion that the Debtor concealed such information with the intent to injure the Plaintiff's property. Accordingly, the Plaintiff's § 523(a)(6) claim must fail.

III. CONCLUSION

For the reasons stated above, the Court finds that the Plaintiff has not carried his burden of proof with respect to his claims under §§ 523(a)(2)(A), (a)(4), and (a)(6). Consequently, the Debtor's obligation arising under the New Hampshire state court judgment is dischargeable. This opinion constitutes the Court's findings of fact and conclusions of law in accordance with Federal Rule of Bankruptcy Procedure 7052. A separate judgment in accordance with this opinion shall be entered.

DONE and ORDERED this 4th day of January, 2000, at Manchester, New Hampshire.

J. Michael Deasy
Bankruptcy Judge