

UNITED STATES BANKRUPTCY COURT  
FOR THE DISTRICT OF NEBRASKA

IN THE MATTER OF	)	
	)	
RAY KELLER,	)	CASE NO. BK91-81553
	)	
DEBTOR	)	A91-8217
	)	
JEFFREY D. HARMON,	)	
JULIE HARMON,	)	
BARBARA HARMON, PERSONAL	)	
REPRESENTATIVE OF THE	)	
ESTATE OF KENNETH D. HARMON,	)	
MARGARET KAREL-SCEKELY, M. VICTOR	)	
MONSON, CATHY PETERSON-McGRATH,	)	
CHRIS AND KATHY WEIGEL,	)	
JACK D. VETTER, OCI, INC.,	)	
a Nebraska Corporation,	)	
and BOCI, INC., a Nebraska	)	
Corporation,	)	
	)	CH. 7
Plaintiff	)	
vs.	)	
	)	
RAY KELLER,	)	
	)	
Defendant	)	

MEMORANDUM

Hearing was held on the Adversary Complaint to Determine Dischargeability of Debt on February 16, 1994. Appearing on behalf of the debtor was Todd Elsbernd of Omaha, Nebraska. Appearing on behalf of the plaintiffs was Patrick Flood of Omaha, Nebraska. This memorandum contains findings of fact and conclusions of law required by Fed. Bankr. R. 7052 and Fed. R. Civ. P. 52. This is a core proceeding as defined by 28 U.S.C. § 157(b)(2)(I).

Background

This is an adversary proceeding to determine whether certain obligations of the debtor to the plaintiffs should be deemed nondischargeable pursuant to 11 U.S.C. § 523(a)(2)(A), § 523(a)(4), or § 523(a)(6).

The debtor/defendant, Ray Keller (Mr. Keller), prior to this bankruptcy case being filed, had spent the majority of his life in

the cattle ranching business in Nebraska and is considered an experienced cattleman. Mr. Keller prepared a business venture known as the "Cattle Breeding Program," and each of the plaintiffs invested in the business. Mr. Keller and each of the plaintiffs entered into individual contracts whereby Mr. Keller, who owned several hundred head of a specialized breed of cattle, would sell a number of head of heifers to the investor. For example, one contract provided that 100 head of registered percentage Chianina heifers would be sold by Mr. Keller to an investor for the purchase price of \$1,000.00 per heifer. The total purchase price would then be \$100,000.00, one-half of which was paid by the purchaser upon the execution of the contract, with the balance payable pursuant to a promissory note over a number of years.

As a part of the contractual arrangements, Mr. Keller agreed to have the heifers bred, retain possession of the heifers, provide for their care and maintenance, and purchase the calf crop on an annual basis at "market price" plus a premium of \$150.00 per calf. As consideration for the management services rendered by Mr. Keller, he would receive a maintenance fee which initially was \$500.00 per head or a total of \$50,000.00 payable upon the execution of the contract. For each year after the first year, the maintenance fee was contractually determined to be \$20.00 per head per month, payable in two semi-annual installments. In addition, the purchaser was to pay Mr. Keller a breeding fee in the amount of \$30.00 per cow per year. For such fees, Mr. Keller was to provide all of the facilities, labor, management and other services reasonably required to maintain the livestock in good condition, including the provision of pasture, feed, health, maintenance, veterinarian and vaccination expenses, calving, supervision and other assistance.

The agreement was effective as of July 1, 1983 and terminated January 31, 1991. At the termination, the purchaser of the breeding herd had the option of keeping the animals or selling the animals to Mr. Keller for \$700.00 per head.

With regard to the annual calf crop, Mr. Keller guaranteed that all of the heifers would be bred in the spring of 1984 and would deliver a live calf in the spring of 1985. The contract provided that in the event that any of the heifers failed to deliver a live calf in the spring of 1985, Mr. Keller, at his option, could either refund the purchase price and maintenance fees attributable to such heifers with interest at 10% per year or substitute heifers with calves at side.

Concerning risk of loss, the contract provided that after the closing of the agreement, the purchaser, that is the plaintiffs, would bear the entire risk of loss, and Mr. Keller would incur no

liability except for gross or willful negligence. Mr. Keller made no warranties, representations or undertakings except as stated in the written agreement, and the purchaser specifically accepted the risks associated with the cattle breeding operation.

### Facts

The heifers were artificially inseminated in the spring of 1984. The results were a disaster. Only about one-half of the heifers became pregnant. The reproductive organs of the other heifers were damaged, and they were unable to give birth to any calves. Of those heifers that become pregnant, many had serious birthing problems with calves having to be pulled. The problems apparently affected the ability of those animals to calve thereafter. As a result of the problems, there was only a 25% to 30% calf crop for 1985.

Mr. Keller did not tell the plaintiffs about the problems that had occurred during the 1985 calf crop year. Neither did he refund the purchase price and maintenance fee attributable to the heifers that did not calf. Instead, he paid the plaintiffs as if there had been a 100% calf crop. The source of such payment is not exactly clear from his testimony, but it appears that such funds came from the sale of some of his own heifers which suffered the same problems as those of the plaintiffs and from the sale by Mr. Keller of the non-producing heifers owned by the plaintiffs.

At or about the same time that he paid for the 1985 calf crop, he received from the plaintiffs their annual installment of principal and interest and maintenance fees for future services. Those maintenance fees were calculated on a per head basis assuming the full herd was being maintained by Mr. Keller.

Partly as a result of the damage to the animals during the first calving season, the second calving season was just as bad or worse. There was only a 20% to 25% calf crop in 1986. Since Mr. Keller had sold the non-producing animals, the 1986 calf crop, even if all remaining cows had given birth, would have been reduced. However, all of the cows did not give birth, and there was a calf crop of only 20% to 25% from the remaining cows.

The contract had required Mr. Keller to guarantee that each of the initially purchased cows would give birth to a live calf during the first calving season. The contract guaranteed that Mr. Keller would purchase that 100% calf crop. The contract did not guarantee any particular percentage of live births after the first calf crop. Therefore, Mr. Keller was not required, at the end of the 1986 calving season, to guarantee the live birth of 100 calves and purchase 100 calves from the plaintiff. The contract provided that

he would purchase all of the calves which were born, but did not require any minimum. Nonetheless, Mr. Keller paid each of the plaintiffs as if there was a calf crop in 1986 equal to 100% live birth from the initial 100 heifers. Once again, the source of such funds appears to be from the sale of some of his own animals and from the sale of most of the rest of the initial group of heifers which was purchased from him by the plaintiffs.

Mr. Keller did not tell the plaintiffs at the end of the 1986 calving season that the disaster had occurred. Instead, when he paid the plaintiffs in 1986 for the phantom calves, he received from the plaintiffs their annual installment of principle, interest and maintenance fees. Once again, the maintenance fees were based upon the supposed existence of 100 breeding animals.

Since there were fewer breeding animals going into the 1987 calf crop year, the resulting calf crop could only have been minuscule compared to what it should have been had there been 100 breeding animals. In November of 1987, Mr. Keller finally informed all of the plaintiffs that there had been a disaster, that there were no calves and that there were no breeding animals. He did not explain to them what had occurred, only that the animals were all gone and that there was no money to repurchase the animals.

Within a few months after admitting that the cattle were gone, Mr. Keller and the plaintiffs entered into a written agreement in which he acknowledged that he had converted property entrusted to his care which belonged to the plaintiffs and that he had willfully and maliciously converted such property to his own use. He further agreed that he had fraudulently transferred property belonging to the creditors. The parties agreed that the value of the property which was converted was \$733,731.00. The written agreement further provided that the total amount agreed upon as being the value of the property had taken into account the fact that certain amounts may be due from the plaintiffs to Mr. Keller. Those amounts due from the plaintiffs to Mr. Keller were, by the written agreement, canceled, and the underlying promissory notes were to be canceled.

The written agreement provided a payment schedule and provided that Mr. Keller would agree to the confession of judgment in favor of the plaintiffs and against Mr. Keller in the sum agreed upon. Pursuant to the agreement, an offer to confess judgment was filed in the District Court of Dodge County, Nebraska, and a judgment was entered in the amount of \$733,731.00 plus interest.

Without paying the full amount of the judgment, Mr. Keller filed a Chapter 7 bankruptcy in 1991. This adversary proceeding followed shortly thereafter.

Conclusions of Law

The plaintiffs contend that the financial obligation of Mr. Keller to them represented by the judgment referred to above is nondischargeable under 11 U.S.C. § 523(a)(2)(A), § 523(a)(4), or § 523(a)(6). The amount of the obligation, if determined by this Court to be nondischargeable, is not an issue before the Court.

The Bankruptcy Code provides that a discharge under Section 727 does not discharge an individual debtor from any debt for money, property, services or an extension, renewal, or refinancing of credit, to the extent obtained by false pretenses, a false representation or actual fraud, other than a statement respecting the debtor's or an insider's financial condition; for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny; for willful and malicious injury by the debtor to another entity or to the property of another entity. 11 U.S.C. § 523(a)(2)(A), (a)(4) & (a)(6).

11 U.S.C. § 523(a)(4) Embezzlement

To support a conclusion of nondischargeability of a debt under Section 523(a)(4) for embezzlement, the Court must find that the property of another was entrusted to the debtor, the debtor appropriated the property for use other than for which it was entrusted and the circumstances indicate fraud. Rech v. Burgess (In re Burgess), 106 B.R. 612 (Bankr. D. Neb. 1989).

In this case, there is no evidence of embezzlement. Mr. Keller was certainly entrusted with heifers owned by the plaintiffs. The debtor sold the heifers without permission. The act of sale was an appropriation of the property for use other than that for which it was entrusted. However, there did not appear to be circumstances indicating fraud. The undisputed testimony of the debtor is that during the first year there was a problem with the breeding program, certain of the heifers were injured and unable to reproduce, and they were sold. The proceeds of their sale was paid to the plaintiffs. In the second year, all of the remaining animals were sold, with the proceeds paid to the purchasers. There is no evidence that Mr. Keller used the proceeds for his own benefit. Additionally, there is evidence that he sold some of his own cattle and used those proceeds to pay his obligations to the plaintiffs.

There is no question that the sale of the cattle is a conversion and is a breach of the contractual arrangement. However, under the circumstances of this case, an act of embezzlement cannot be found.

11 U.S.C. § 523(a)(6) Willful and Malicious Injury

The Bankruptcy Code prohibits the discharge of a debt which was incurred as a result of willful and malicious injury by the debtor to the property of another. Section 523(a)(6). The Eighth Circuit Court of Appeals in the case of In re Long determined that for a debt to be barred from discharge under this exception, the conduct must be:

1) willful, meaning "headstrong and knowing";  
and

2) malicious, meaning "targeted at the creditor, at least in the sense that the conduct is certain or almost certain, to cause financial harm."

774 F.2d at 881.

In this case, there is no question that the conduct of Mr. Keller was willful. He sold animals belonging to the plaintiffs. There is no evidence that such sale was the cause of the injury to the plaintiffs. The cause of the injury to the plaintiffs was the failure of the breeding program. The contract between Mr. Keller and the plaintiffs provided that if, in 1985, all of the heifers did not deliver a live calf, Mr. Keller could either refund the purchase price and maintenance fees attributable to those heifers plus interest, or substitute heifers with calves at side. He did not refund the purchase price, but there is some evidence, through his own testimony, that he substituted some of his animals for those which did not bear live calves. In addition, he paid a sum of money to the plaintiffs which arguably represents the proceeds of the sale of plaintiffs' heifers.

There was no contractual obligation in 1986 and thereafter to refund the purchase price and maintenance fees or to substitute heifers with calves at side. Instead, the contractual risk of loss, through death or otherwise, was upon the plaintiffs. Although he sold their property, they received the proceeds.

The second part of the Long analysis concerns malice. Under Long, malice means actions targeted at the creditor in the sense that the conduct is certain or almost certain to cause harm. In this case, the sale of the non-calf bearing animals was not certain

to cause harm to the plaintiffs. Without the ability to bear a live calf, the animals were worth only slaughter price. They were sold for slaughter price, and the funds were paid over to the plaintiffs. Mr. Keller had no intent to cause economic or financial harm to the plaintiffs and did not take the proceeds of the sale of their property for his own use.

This Court cannot find that the obligation is nondischargeable under either 11 U.S.C. § 523(a)(4) or § 523(a)(6).

11 U.S.C. § 523(a)(2)(A) False Pretense,  
False Representation, Actual Fraud

The plaintiffs have also requested the Court to find that the obligation of Mr. Keller to the plaintiffs is nondischargeable under 11 U.S.C. § 523(a)(2)(A). That section prohibits the discharge of an obligation for money to the extent obtained by false pretenses, a false representation, or actual fraud.

Mr. Keller, although being fully aware that he did not have and would not have in the future the full 100 head herd as identified under the representative contract submitted into evidence, nonetheless charged maintenance fees in both 1985 and 1986 as if the full herd was in existence. He gave no hint to the plaintiffs that some animals they had purchased from him had been sold. Instead, he collected the installment of principal and interest to which he had a right under the purchase and sale agreement and, in addition, collected a fee of \$20.00 per month per head based upon the original number of animals which were the subject of the contract. Such action by him was fraudulent. He received payment for non-existent services to be rendered to non-existent animals. The representations he made to the plaintiffs to induce the plaintiffs to make payment to him were false, and he received such payments under false pretenses.

The conclusion is that any financial obligation owed to the plaintiffs by Mr. Keller as a result of his activities concerning the cattle program is nondischargeable under 11 U.S.C. § 523(a)(2)(A).

Separate judgment shall be entered.

DATED: May 6, 1994.

BY THE COURT:

/s/ Timothy J. Mahoney  
Timothy J. Mahoney  
Chief Judge

CC: Movant, Debtor(s) Atty. and all parties appearing at hearing  
[ ] Chapter 13 Trustee [ ] Chapter 12 Trustee [ ] U.S. Trustee  
Movant is responsible for giving notice of this journal entry to any parties in interest not listed above.

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JUDGMENT

Any obligation owed to the plaintiffs by Mr. Keller resulting from the "Cattle Breeding Program" is nondischargeable pursuant to 11 U.S.C. § 523(a)(2)(A). See memorandum entered this date.

DATED: May 6, 1994.

BY THE COURT:

/s/ Timothy J. Mahoney  
Timothy J. Mahoney  
Chief Judge

CC: Movant, Debtor(s) Atty. and all parties appearing at hearing  
[ ] Chapter 13 Trustee [ ] Chapter 12 Trustee [ ] U.S.Trustee

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