

IN THE UNITED STATES BANKRUPTCY COURT  
FOR THE DISTRICT OF NEBRASKA

IN THE MATTER OF: )  
)  
KATHERINE E. SULLIVAN, )  
)  
Debtor(s). ) CASE NO. BK07-80422-TJM  
A07-8052-TJM  
RADIO ENGINEERING INDUSTRIES, INC. )  
and EMPLOYERS MUTUAL INSURANCE )  
COMPANIES, )  
)  
Plaintiffs, ) CH. 13  
)  
vs. )  
)  
KATHERINE E. SULLIVAN, )  
)  
Defendant. )

MEMORANDUM

This matter is before the court on the plaintiffs' motion for summary judgment (Fil. #11) and objection by the debtor (Fil. #14). The debtor is not represented by counsel. Michael J. Whaley represents the plaintiffs. The motion was taken under advisement as submitted without oral arguments. This memorandum contains findings of fact and conclusions of law required by Federal Rule of Bankruptcy Procedure 7052 and Federal Rule of Civil Procedure 52. This is a core proceeding as defined by 28 U.S.C. § 157(b)(2)(I).

The debtor, Ms. Sullivan, was formerly employed by plaintiff Radio Engineering Industries, Inc. ("REI") in the company's accounts payable department. In that position, she converted certain REI funds to her own use. She was convicted of theft by deception (a Class III felony), sentenced to two to four years' imprisonment, and ordered to pay \$12,000 in restitution. The jury found the loss to REI to be \$110,531.23. REI submitted an insurance claim to its insurer, plaintiff Employers Mutual Insurance Companies, and as part of its payment of the claim, Employers Mutual obtained certain subrogation rights.

Ms. Sullivan filed a Chapter 13 bankruptcy petition in March 2007, after her sentencing hearing. No plan of reorganization has yet been confirmed. The plaintiffs filed this adversary proceeding to except the debt owed to REI and Employers Mutual from discharge under 11 U.S.C. §§ 523(a)(2), (a)(4), (a)(6), and 1328.

As part of Ms. Sullivan's duties at REI during the more than four years she was employed there, she paid vendor's invoices from the REI checking account. She reviewed the invoices, confirmed delivery of the materials or services, and prepared checks on the corporate account at U.S.

Bank for those vendors, which the company president would sign. In the weeks following Ms. Sullivan's departure from the company, it became clear that some checks written to pay vendors had never been delivered to the vendors. REI's investigation revealed that the checks in question, although purportedly endorsed by the vendors, had all been deposited into U.S. Bank account number 150870475194, owned by Ms. Sullivan. The company discovered that 35 checks, totaling \$113,876.23, had been diverted to that account.

Summary judgment is appropriate only if the record, when viewed in the light most favorable to the non-moving party, shows there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law. Fed. R. Civ. P. 56(c) (made applicable to adversary proceedings in bankruptcy by Fed. R. Bankr. P. 7056); *see, e.g., Celotex Corp. v. Catrett*, 477 U.S. 317, 322-23 (1986); *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 249-50 (1986); *Aviation Charter, Inc. v. Aviation Research Group/US*, 416 F.3d 864, 868 (8th Cir. 2005); *Ferris, Baker Watts, Inc. v. Stephenson (In re MJK Clearing, Inc.)*, 371 F.3d 397, 401 (8th Cir. 2004).

In ruling on a motion for summary judgment, the court must view the facts in the light most favorable to the party opposing the motion and give that party the benefit of all reasonable inferences to be drawn from the record. *Widoe v. District No. 111 Otoe County Sch.*, 147 F.3d 726, 728 (8th Cir. 1998); *Ghane v. West*, 148 F.3d 979, 981 (8th Cir. 1998). A summary judgment motion should be interpreted by the court to dispose of factually unsupported claims and defenses. *Tiffey v. Speck Enter., Ltd.*, 418 F. Supp. 2d 1120, 1123 (S.D. Iowa 2006).

To withstand a motion for summary judgment, the nonmoving party must submit "sufficient evidence supporting a material factual dispute that would require resolution by a trier of fact." *Austin v. Minnesota Mining & Mfg. Co.*, 193 F.3d 992, 994 (8th Cir. 1999) (quoting *Hase v. Missouri Div. of Employment Sec.*, 972 F.2d 893, 895 (8th Cir. 1992), *cert. denied*, 508 U.S. 906 (1993)). In this respect, the nonmoving party "must do more than simply show that there is some metaphysical doubt as to the material facts; [it] must show there is sufficient evidence to support a jury verdict in [its] favor." *Chism v. W.R. Grace & Co.*, 158 F.3d 988, 990 (8th Cir. 1998). "Rule 56(c) mandates the entry of summary judgment, after adequate time for discovery and upon motion, against a party who fails to make a showing sufficient to establish the existence of an element essential to that party's case, and on which that party will bear the burden of proof at trial." *Celotex*, 477 U.S. at 322. "We look to the substantive law to determine whether an element is essential to a case, and only disputes over facts that might affect the outcome of the suit under the governing law will properly preclude the entry of summary judgment." *Williams v. Marlar (In re Marlar)*, 252 B.R. 743, 751 (B.A.P. 8th Cir. 2000) (quoting *Ries v. Wintz Properties, Inc. (In re Wintz Cos.)*, 230 B.R. 848, 858 (B.A.P. 8th Cir. 1999)) (internal quotations omitted).

The plaintiffs are asking this court to find that Ms. Sullivan's criminal conviction and restitution order are sufficient to except the debt from discharge. A state court verdict may be used to collaterally estop the relitigation of factual or legal issues that were determined in the prior proceeding. *Grogan v. Garner*, 498 U.S. 279, 284 n.11 (1991). The plaintiffs must establish four elements before the doctrine of collateral estoppel can be applied to preclude relitigation of an issue in a subsequent proceeding: (1) the issue sought to be precluded must be the same as that involved

in the prior action; (2) the issue must have been litigated in the prior action; (3) the issue must have been determined by a valid and final judgment; and (4) the determination must have been essential to the prior judgment. Johnson v. Miera, 926 F.2d 741, 743 (8th Cir. 1991).

The Nebraska statute defining theft by deception is as follows:

§ 28-512. Theft by deception.

A person commits theft if he obtains property of another by deception. A person deceives if he intentionally:

- (1) Creates or reinforces a false impression, including false impressions as to law, value, intention, or other state of mind; but deception as to a person's intention to perform a promise shall not be inferred from the fact alone that he did not subsequently perform the promise; or
- (2) Prevents another from acquiring information which would affect his judgment of a transaction; or
- (3) Fails to correct a false impression which the deceiver previously created or reinforced, or which the deceiver knows to be influencing another to whom he stands in a fiduciary or confidential relationship; or
- (4) Uses a credit card, charge plate, or any other instrument which purports to evidence an undertaking to pay for property or services delivered or rendered to or upon the order of a designated person or bearer (a) where such instrument has been stolen, forged, revoked, or canceled, or where for any other reason its use by the actor is unauthorized, or (b) where the actor does not have the intention and ability to meet all obligations to the issuer arising out of his use of the instrument.

The word deceive does not include falsity as to matters having no pecuniary significance, or statements unlikely to deceive ordinary persons in the group addressed.

Neb. Rev. Stat. Ann. § 28-512.

A conviction under that statute requires the element of criminal intent, where a person knowingly creates a false impression in order to obtain another's property. State v. Ladehoff, 424 N.W.2d 361, 363 (Neb. 1988).

The plaintiffs allege that Ms. Sullivan's act of converting REI's funds constitutes (a.) obtaining money by actual fraud pursuant to § 523(a)(2)(A); (b.) embezzlement or larceny pursuant to § 523(a)(4); and (c.) willful and malicious injury pursuant to § 523(a)(6).

To establish fraud within the context of § 523(a)(2)(A), the plaintiffs must show, by a preponderance of the evidence, that: (1) the debtor made a representation; (2) the representation was made at a time when the debtor knew the representation was false; (3) the debtor made the representation deliberately and intentionally with the intention and purpose of deceiving the plaintiffs; (4) the plaintiffs justifiably relied on such representation; and (5) the plaintiffs sustained a loss as the proximate result of the representation having been made. Universal Bank, N.A. v. Grause (In re Grause), 245 B.R. 95, 99 (B.A.P. 8th Cir. 2000) (citing Thul v. Ophaug (In re Ophaug), 827 F.2d 340, 342 n.1 (8th Cir. 1987), as supplemented by Field v. Mans, 516 U.S. 59 (1995)).

“The intent element of § 523(a)(2)(A) does not require a finding of malevolence or personal ill-will; all it requires is a showing of an intent to induce the creditor to rely and act on the misrepresentations in question.” Merchants Nat’l Bank v. Moen (In re Moen), 238 B.R. 785, 791 (B.A.P. 8th Cir. 1999) (quoting Moodie-Yannotti v. Swan (In re Swan), 156 B.R. 618, 623 n.6 (Bankr. D. Minn. 1993)). “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.” Id. (quoting Caspers v. Van Horne (In re Van Horne), 823 F.2d 1285, 1287 (8th Cir. 1987)). The intent to deceive will be inferred when the debtor makes a false representation and knows or should know that the statement will induce another to act. Id. (quoting Federal Trade Comm’n v. Duggan (In re Duggan), 169 B.R. 318, 324 (Bankr. E.D.N.Y. 1994)).

A debt incurred through embezzlement is non-dischargeable under § 523(a)(4). “Embezzlement” is the fraudulent appropriation of property of another by a person to whom such property has been entrusted or into whose hands it has lawfully come. Belfry v. Cardozo (In re Belfry), 862 F.2d 661, 662 (8th Cir. 1988). The plaintiffs must establish that the debtor was not lawfully entitled to use the funds for the purposes for which they were in fact used. Id. To show embezzlement, the creditor has to prove that it entrusted its property to the debtor, the debtor appropriated the property for a use other than that for which it was entrusted, and the circumstances indicate fraud. Bankers Trust Co. v. Hoover (In re Hoover), 301 B.R. 38, 52 (Bankr. S.D. Iowa 2003). Implicit in a claim of embezzlement is a degree of fraudulent intent. Chapman v. Fuget (In re Fuget), 339 B.R. 702, 707 (Bankr. S.D. Iowa 2006).

A debt may be excepted from discharge if it is “for willful and malicious injury by the debtor to another entity or to the property of another entity.” § 523(a)(6). To except a debt from discharge under this section, a plaintiff must establish, by a preponderance of the evidence, that the debt arises from an injury that is both willful and malicious. In this context, the term “willful” means that the injury, not merely the act leading to the injury, must be deliberate or intentional, and a “malicious” injury is one that is targeted at the creditor, in the sense that the conduct is certain or almost certain to cause financial harm. Jamrose v. D’Amato (In re D’Amato), 341 B.R. 1, 4-5 (B.A.P. 8th Cir. 2006). The injury must have arisen from an intentional tort. Osborne v. Stage (In re Stage), 321 B.R. 486, 492 (B.A.P. 8th Cir. 2005) (citing Kawaauhau v. Geiger, 523 U.S. 57, 62 (1998)). In a practical sense,

if the debtor was aware of the plaintiff-creditor’s right under law to be free of the

invasive conduct of others (conduct of the sort redressed by the law on the underlying tort) and nonetheless proceeded to act to effect the invasion with particular reference to the plaintiff, willfulness is established. If in so doing the debtor intended to bring about a loss in fact that would be detrimental to the plaintiff, whether specific sort of loss the plaintiff actually suffered or not, malice is established.

KYMN, Inc. v. Langeslag (In re Langeslag), 366 B.R. 51, 59 (Bankr. D. Minn. 2007).

A debtor's "reckless appropriation" of another's money for the debtor's personal use can be willful and malicious when it was or should have been clear to the debtor that such conversion would almost certainly cause financial harm. Cain v. Burghoff (In re Burghoff), 374 B.R. 672, 679 (Bankr. N.D. Iowa 2007).

Ms. Sullivan objects to the motion for summary judgment on the grounds that portions of REI's evidence are inconsistent with the evidence at her criminal trial, and that not all of the 35 allegedly fraudulent checks were proven up at trial. She also expects her appeal of the conviction to be successful.

For purposes of this motion, the plaintiffs focus only on non-dischargeability under § 523(a)(4). As noted above, REI must prove that it entrusted its property to the debtor, the debtor misappropriated the property, and the circumstances indicate fraud. Neither the charging document nor the jury instructions were made part of the record of this case, so the specific subsection of Neb. Rev. Stat. § 28-512, if any, under which she was found guilty is unclear. However, the criminal statute necessitates a finding that Ms. Sullivan obtained the property of another by deception, which are two of the three elements required under § 523(a)(4). The remaining element, that REI entrusted its property to the debtor, is established by the fact that Ms. Sullivan concedes she worked in REI's accounts payable department and her duties included preparing checks on REI's checking account for vendors. Much of her argument in opposition to the motion for summary judgment goes to the weight of the evidence at her trial, but that is not before this court and is not relevant on this motion. There are no material facts at issue. Her conviction and restitution order are final judgments. The elements of the embezzlement exception were established at a trial on the merits of the criminal charges against the debtor. Therefore, she is collaterally estopped from attempting to relitigate her theft conviction in the context of non-dischargeability under § 523(a)(4).

The "super discharge" of Chapter 13 discharges certain debts that would not be dischargeable in a Chapter 7 case, but embezzlement is not one of those debts. It is excepted from discharge in a Chapter 13. § 1328(a)(2).

The issue remaining before the court is the amount of the debt. As noted above, the verdict was for \$110,531.23. The court ordered Ms. Sullivan to pay restitution toward REI's loss of \$110,581.23. Approximately \$3,000 of REI's total loss was attributable to checks written outside of the three-year criminal statute of limitations and therefore was not included in the verdict. REI asserts that the four-year Nebraska civil statute of limitations for fraud and conversion is applicable

here and would cover all 35 checks. REI filed a civil action against Ms. Sullivan in state court to recover the converted funds, but that lawsuit was stayed by the bankruptcy filing. REI and Employers Mutual have filed proofs of claim in the bankruptcy case totaling \$162,314.22, which represents the actual loss of approximately \$113,000 plus interest accrued from 30 days after the bank transaction date of each check. That is the amount they seek to have excepted from discharge.

Because the amount of the debt will be ascertained in the state court lawsuit, which was at the summary judgment stage when the bankruptcy case was filed, I will abstain from making a factual determination of the amount here. I simply find that the debt created by the debtor's embezzlement of REI's funds is non-dischargeable. A separate judgment will be entered.

DATED: November 15, 2007

BY THE COURT:

Timothy J. Mahoney

Chief Judge

Notice given by the Court to:  
Katherine E. Sullivan  
\*Michael J. Whaley  
Kathleen A. Laughlin  
U.S. Trustee

Movant (\*) is responsible for giving notice to other parties if required by rule or statute.

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Defendant. )

JUDGMENT

This matter is before the court on the plaintiffs' motion for summary judgment (Fil. #11) and objection by the debtor (Fil. #14). The debtor is not represented by counsel. Michael J. Whaley represents the plaintiffs.

IT IS ORDERED: For the reasons stated in the Memorandum filed contemporaneously herewith, the plaintiffs' motion for summary judgment (Fil. #11) is granted. The debt incurred as a result of the debtor's embezzlement of funds from Radio Engineering Industries, Inc., is not dischargeable, and the amount of the debt shall be determined in a separate state court action which is currently pending.

DATED: November 15, 2007

BY THE COURT:

Timothy J. Mahoney  
Chief Judge

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