

UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF NEBRASKA

IN THE MATTER OF)	
)	
KENNETH E. HARSCH and)	
SYLVIA K. HARSCH,)	CASE NO. BK93-81751
)	
DEBTOR)	A94-8007
)	
BARTLEY EQUITY COOPERATIVE,)	
A Nebraska Corporation,)	
)	CH. 7
Plaintiff)	
vs.)	
)	
KENNETH E. HARSCH and)	
SYLVIA K. HARSCH,)	
)	
Defendant)	

MEMORANDUM

This matter is before the Court on a complaint requesting an order of nondischargeability of a particular debt. It was submitted on a stipulation of facts and briefs. Appearing on behalf of debtor was Richard A. Birch of North Platte, Nebraska. Appearing on behalf of Bartley Equity Cooperative was Bert E. Blackwell of McCook, 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 and Findings of Fact

The debtors filed for Chapter 7 bankruptcy relief on October 25, 1993. The plaintiff Bartley Equity Cooperative (Bartley), filed this adversary complaint against the debtors to determine whether their unsecured claim is dischargeable pursuant to 11 U.S.C. §527(a)(4) and (a)(6).

Before this Chapter 7 case was filed, the debtors were operating under a Chapter 12 bankruptcy plan. The debtors filed for Chapter 12 bankruptcy relief on March 18, 1987. A Chapter 12 plan was confirmed by this Court on February 12, 1988.

The parties have stipulated that the plaintiff Bartley had an administrative priority claim in the amount of \$5,683.79 in the Chapter 12 bankruptcy case. Because it is not decisive of any issue, for the purpose of ruling on this particular complaint, such stipulation shall be accepted, although the Court doubts that post-confirmation debts obtain any administrative priority. The Chapter 12 plan provided that the debtor would be solely responsible for paying all administrative claims under the Chapter 12 plan. The debtors became indebted to Bartley after the debtors failed to repay Bartley for hog feed that Bartley provided to the debtors post confirmation. The Chapter 12 case was dismissed on April 2, 1993 because the debtors were not able to generate sufficient income to fund the confirmed Chapter 12 plan.

Bartley alleges that the debtors failed to report all of their property in their Chapter 12 schedules and in addition, the debtors sold the unreported property without notice and hearing to interested parties and improperly applied the funds from the sale of the property. Bartley alleges that the debtors actions denied Bartley the opportunity to claim the proceeds in satisfaction of their claim, and therefore, pursuant to the Bankruptcy Code, the debtors should not be permitted to receive a discharge for Bartley's claim.

The allegation arose due to a parcel of property that the debtor Sylvia Harsch inherited from her mother during the pendency of the Chapter 12 case. The mother purchased the property as a residence in 1976, and at the time of the purchase, the mother listed herself, the debtor Sylvia Harsch, and Sylvia Harsch's brother on the deed as owners in joint tenancy. The deed was recorded on November 19, 1976 in the Register of Deeds Office for Furnas County, Nebraska. Sylvia Harsch provided no consideration for the property, and she never lived in the residence or received a benefit therefrom while her mother was living. In addition, Sylvia Harsch had no knowledge that she was even listed on the deed as a co-tenant until January 6, 1990, which is shortly after her mother died and after the Chapter 12 plan was confirmed.

In March of 1990, Sylvia Harsch and her brother rented the residence to a tenant and received rental income from the residence until May 4, 1992. On this date, Sylvia Harsch sold her interest in the residence to her brother and his wife for \$20,000.00. The debtors used this money to pay the Red Willow County Treasurer for the (Chapter 12) prepetition real estate taxes that were due on the debtors' other real estate. The parties have stipulated that Raymond Durner, a member of the Board of Directors of Bartley, became aware that the debtors were renting the residence to a tenant shortly after the rental agreement was entered into, which

was a few months before the debtors defaulted on their post-confirmation debt to Bartley.

At no time during the bankruptcy case did the debtors ever show in their reports to the Chapter 12 trustee that they were entitled to receive rental income. This income, however, totaled less than \$100.00 over the duration of Sylvia Harsch's ownership after expenses for the house were deducted from the joint account that Sylvia Harsch and her brother maintained to hold the joint tenancy income.

At no time during the pendency of the bankruptcy case did the debtors amend their schedules to reflect that Sylvia possessed an interest as a joint tenant in the residence.

The debtors did not give notice, request a hearing or otherwise inform creditors that they were selling Sylvia's interest in the residence to Sylvia's brother. They also did not inform any interested parties in the Chapter 12 bankruptcy case about the \$20,000 that they received from the sale or request any input regarding the distribution of those funds.

The debtors' confirmed Chapter 12 plan provided for the payment of real estate taxes to Red Willow County, and therefore, the \$20,000 payment did not violate the Chapter 12 plan.

Decision

Bartley's motion to have its claim excepted from discharge under Section 523(a)(4) and (a)(6) of the Bankruptcy Code is denied.

Discussion

A. Property of the Estate

On the date the Chapter 12 case was filed, Sylvia Harsch's interest in the residence was property of the estate. 11 U.S.C. § 541(a)(1) (stating that all legal and equitable interests of a debtor constitute property of the estate); Lewis v. Poduska, 240 Neb. 312, 319-20, 481 N.W.2d 898 (1992) (holding that donor was not required to actually deliver deed to donee for gift to be valid, mere act of recording the deed constitutes a valid gift).

B. Section 523(a)(4)

Bartley takes the position that its claim should be excepted from discharge pursuant to Section 523(a)(4) of the Bankruptcy Code, which provides:

(a) A discharge under section 727, ... does not discharge an individual debtor from any debt -- (4) for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny;

11 U.S.C. § 523(a)(4). Bartley has the burden of proving that its claim falls within Section 523(a)(4): "Exceptions to discharge are construed narrowly. The burden of proving that a debt falls within a statutory exception is on the party opposing discharge." Belfry v. Cardozo (In re Belfry), 862 F.2d 661, 662 (8th Cir. 1988) (citations omitted).

Bartley takes the position the debtor was a fiduciary of the bankruptcy estate and that pursuant to its fiduciary duty, the debtor was obligated not to commit fraud or defalcation with regard to property of the estate under Section 523(a)(4).

Debtors in possession owe a fiduciary duty to the bankruptcy estate and to the creditors of that estate. Wolf v. Weinstein, 372 U.S. 633, 649-53, 83 S. Ct. 969, 979-82, 10 L. Ed. 2d 33, reh'g denied, 373 U.S. 928, 835 S. Ct. 1572, 10 L. Ed. 2d 427 (1963). However, in post-petition transactions, this fiduciary duty does not extend to entities who enter into post-petition contracts with the debtor. Laurelton Elec. and Mechanical Corp. v. Battinelli (In re Battinelli), 169 B.R. 522, 524-25 (Bankr. E.D.N.Y. 1994). Bartley would have had to have been a creditor of the debtors' estate at the time the Chapter 12 petition was filed in order for the debtors to be held to a higher fiduciary standard. Id. Under the definition of "creditor" in the Bankruptcy Code, creditors are only those claimholders whose claims arose before or at the time of the petition for relief. Id. (citing 11 U.S.C. § 101(10)). Since Bartley's right to payment accrued in the Chapter 12 case post confirmation, the debtors did not owe a fiduciary duty to Bartley in the Chapter 12 case as a debtor in possession.

The nature of the relationship between the debtors and Bartley, at the time the debt arose, was a debtor-creditor relationship, not a fiduciary relationship. For a fiduciary relationship to exist under Section 523(a)(4), the debtors and Bartley would have had to enter into an express trust. Barclays American/Business Credit, Inc. v. Long (In re Long), 774 F.2d 875, 878 (1985). However, the contract for the hog feed was a typical debtor-creditor transaction, not an express trust and therefore, did not create a fiduciary duty on behalf of the debtor. See Long, 774 F.2d at 878 (stating that even if debtor was a trustee by virtue of his status as officer of corporate fiduciary, debtor was not a fiduciary in the "strict and narrow" sense that Section 523(a)(4) implies because the substance of the transaction, not the

labels of the parties involved, determines whether there is a fiduciary relationship).

In addition to the lack of a fiduciary responsibility, there is also no evidence that Bartley's underlying claim in the Chapter 12 case arose as a result of fraud, defalcation, embezzlement or larceny. Bartley alleges that the fraudulent transaction was the concealment from the bankruptcy estate of the residence, the subsequent rental income from the residence and the proceeds from the sale of the residence.

The conduct of the debtor with regard to the residence does not fall under Section 523(a)(4). The plain language of Section 523(a)(4) states that the debtors are not entitled to a discharge "from any debt for fraud or defalcation ..., embezzlement or larceny." 11 U.S.C. § 523(a)(4)(emphasis added). Under Section 523(a)(4), the allegations of misconduct must apply to the debt that is sought to be declared nondischargeable. See Werner v. Hofmann, 5 F.3d 1170, 1172 (8th Cir. 1993) ("The [creditor]s first invoke § 523(a)(4), which excepts from discharge a debt arising from the debtor's "fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny.")

There is no evidence nor are there any allegations that the debt incurred for the hog feed post petition arose from fraud, defalcation, embezzlement or larceny on the part of the debtor. Bartley has centered its allegations of misconduct on the conduct of the debtors with regard to the residence, but this conduct is outside of the scope of Section 523(a)(4).

The debt is not excepted from discharge under Section 523(a)(4). No fiduciary duty was owed by the debtors to Bartley because the hog feed transaction is a regular contractual arrangement, and did not create an express trust. In addition, Bartley has not shown that the debt which it seeks to have discharged, that is, the debt for the hog feed, arose from fraudulent or other proscribed misconduct on the part of the debtor under Section 523(a)(4).

Section 523(a)(6)

Bartley alleges that the debt for the hog feed should be excepted from discharge under Section 523(a)(6), which states:

- (a) A discharge under section 727, ... of this title does not discharge an individual debtor from any debt -- (6) for willful and malicious injury by the debtor to another entity or to the property of another entity;

11 U.S.C. § 523(a)(6).

Bartley must show in this section that the debt was incurred as a result of willful and malicious injury by the debtor to the property of another. Harmon v. Keller (In re Keller), Neb. Bkr. 94:266 (Bankr. D. Neb. 1994). The Eighth Circuit Court of Appeals has ruled that in cases addressing a breach of a security agreement that the question of nondischargeability under this section turns on whether the conduct is:

- (1) headstrong and knowing ("willful") and,
 - (2) targeted at the creditor ("malicious"),
- 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. A showing of the conversion of property or of the reckless disregard for a creditor's economic interest is not enough to support a Chapter 7 exception to discharge under Section 523(a)(6). Id. at 879 (citing Davis v. Aetna Acceptance Co., 293 U.S. 328, 55 S. Ct. 151, 79 L. Ed. 393 (1934)), 881 (stating that a heightened level of culpability must be found beyond recklessness).

Bartley has not submitted any evidence that the debt incurred for the hog feed resulted from a malicious and willful injury upon Bartley. Every indication is that the debtors incurred the debt for the hog feed to obtain feed for their hogs post confirmation and that the feed was used for this purpose.

Bartley alleges that the failure to provide notice to interested parties about the residence, the income therefrom, and the subsequent sale of the residence was the willful and malicious injury. For the reasons stated in the analysis under Section 523(a)(4), the debt that Bartley wants to have excepted from discharge must be the result of the malicious and willful injury, other acts by the debtor are not included under Section 523(a)(6).

Even if the debtors' conduct with regard to the residence could be construed as a debt for Section 523(a)(6) purposes, Bartley has not shown that the debtors' conduct was malicious or willful towards Bartley. The evidence shows that the total rental income received amounted to less than \$100, which is too insignificant of an amount in this case to constitute a willful injury towards Bartley, especially in the absence of any nexus between the debtors failing to report this income to the Chapter 12 trustee and Bartley's debt. The evidence also shows that an officer of Bartley had knowledge that the debtor had entered into a rental agreement for the property.

The Bartley claim did not arise until after the plan was confirmed. Although it is definitely improper for the debtors to fail to report to the trustee assets that debtors obtained after confirmation and it is improper to sell such assets during the pendency of the case without notice, it was not improper for debtors to use the proceeds of the sale of property to pay real estate taxes. By paying the Red Willow County Treasury, the debtors used the \$20,000 proceeds in a manner that was compatible with the Chapter 12 plan. The Court finds that the debtors' actions were neither "willful" nor "malicious" towards Bartley. After the debtors received the proceeds, they used the money to pay off a creditor in their Chapter 12 bankruptcy case. There was no requirement in the plan, and there is no requirement in the Code, that debtors use the proceeds of asset sales to pay any particular prepetition or post-confirmation creditor. Even though the conduct did not technically follow proper bankruptcy procedure, it has not been shown that the debtors actions were in bad faith.

Bartley is not entitled to have its claim excepted from discharge pursuant to Section 523(a)(6) of the bankruptcy code. There is no evidence that the underlying claim of Bartley for the payment for hog feed arose from a willful or malicious injury. Even if an argument could be made linking the debtors' conduct with regard to the residence to Bartley's underlying claim, there is still no evidence that by paying the Red Willow County Treasury for real estate taxes the debtor intended to willfully or maliciously injure Bartley.

Separate journal entry to be entered.

DATED: January 24, 1995

BY THE COURT:

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

Copies faxed by the Court to:

BIRCH, RICHARD

8-308-532-3153

Copies mailed by the Court to:

Bert Blackwell, P.O. Box 426, McCook, NE 69001
United States Trustee

Movant (*) is responsible for giving notice of this journal entry to all other parties (that are not listed above) if required by rule or statute.

UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF NEBRASKA

IN THE MATTER OF)	
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KENNETH E. HARSCH and)	
SYLVIA K. HARSCH,)	CASE NO. BK93-817151
)	A94-8007
<u>DEBTOR(S)</u>)	
)	CH. 7
BARTLEY EQUITY COOPERATIVE,)	
A Nebraska Corporation,)	Filing No.
Plaintiff(s))	
vs.)	<u>JOURNAL ENTRY</u>
KENNETH E. HARSCH and)	
SYLVIA K. HARSCH,)	
)	DATE: January 24, 1995
<u>Defendant(s)</u>)	

Before a United States Bankruptcy Judge for the District of Nebraska regarding COMPLAINT REQUESTING AN ORDER OF NONDISCHARGEABILITY OF A PARTICULAR DEBT.

APPEARANCES

Richard A. Birch, Attorney for debtors
Bert E. Blackwell, Attorney for Bartley

IT IS ORDERED:

Judgment is entered in favor of the debtors/defendants. The debt to Bartley Equity Cooperative is dischargeable in this case. See memorandum this date.

BY THE COURT:

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

Copies faxed by the Court to:
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