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Richard Jensen and Don Christensen dba Bernina Sewing Machin Co. v. Harold L. Barrick and Fred M. Poulson dba Modern Sewing Machine Co. : Brief of Appellants

Utah Supreme Court

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IN THE SUPREME COURT OF THE STATE OF UTAH

RICHARD JENSEN and DON CHRISTENSEN, d/b/a BERNINA SEWING MACHINE CO.,
Plaintiffs and Appellants,

vs.

HAROLD L. BARRICK and FRED M. POULSON, d/b/a MODERN SEWING MACHINE CO.,
Defendants and Respondents.

No. 10027

APPELLANTS' BRIEF

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Defendants and Respondents.

No. 10027

APPELLANTS' BRIEF

STATEMENT OF THE KIND OF CASE

Appeal from order of perpetual stay of execution on question of whether debt for misappropriation of trust funds, conversion of property delivered on consignment, and conversion of mortgaged property and collection of assigned fund and appropriation of proceeds is dischargeable in bankruptcy.

RELIEF SOUGHT ON APPEAL

Order vacating District Court's order of perpetual stay of execution, or failing that, remanding the matter for trial on issue of dischargeability of debts in question.

STATEMENT OF FACTS

Appellants delivered merchandise (sewing machines, etc.) to Respondents under terms of agreement (R. 4-7) under which Appellants retained title until merchandise was sold to customers for cash (R. 4, Par. 2; R. 5, Par. 4; R. 6, Par. 12), whereupon title to proceeds of sale vested in Appellants (R. 4, Par. 2) to be held in trust for the benefit of Appellants and to be forthwith remitted to Appellants (R. 6, Par. 12). At the time of the execution of said agreement, Respondents acknowledged that they were holding the sum of $2,831.37 cash in trust for the benefit of Appellants (R. 4). Respondents failed to remit or to account for said trust funds or the proceeds received from sale of consigned merchandise to Appellants or to return or to account for unsold merchandise when demand for its return was made upon them (R. 2, Par. 2 & 3), a grand total of $5,617.83 (R. 1, Par. 3; R. 3, Par. 7; R. 16).

Respondents further secured their debt to Appellants by a written agreement (R. 8-9) wherein they assigned $2,710.32 of reserve funds held by finance companies (R. 8, Par. 1-3) to Appellants and expressly agreed that all amounts received by them from said assigned funds, or from the sale of merchandise pledged by third parties in connection therewith, would be held in trust for the benefit of and forthwith remitted to Appellants (R. 8-9, Par. 5). Respondents collected said trust funds but failed to remit any part thereof to Appellants (R. 1, Par. 5; R. 2, Par. 4).

Respondents also further secured their debt to Appellants by executing a chattel mortgage on two motor ve-

hicles subject to existing mortgage thereon in favor of a third party (R. 8, Par. 4). The Appellants' chattel mortgage was not recorded at the request of Respondents and because of the prior mortgage thereon. The vehicles were wrongfully sold by Respondents in utter disregard of the mortgage in favor of Appellants and the proceeds appropriated by the Respondents (R. 2, Par. 5). Appellants filed an affidavit for attachment by reason of "misappropriation of trust funds" (R. 10) and a complaint alleging misappropriation and conversion of trust funds, of merchandise delivered on consignment, of proceeds from sale thereof, of funds received from finance companies which had been assigned to Appellants, and of vehicles mortgaged to Appellants and of the proceeds received therefrom (R. 1-9), and obtained a judgment by default against the Respondents (R. 16), after the Respondents had filed bankruptcy (R. 19).

Respondent Poulson's motion for permanent stay of execution (R. 17-18) was granted, and the order entered recited that Appellants' claim was a dischargeable obligation which had been discharged by Respondent's bankruptcy (R. 34). Appellants prosecute this appeal from that order for the reason that the Respondents' debt to Appellants is not a dischargeable debt under Section 17 of the bankruptcy law (11 U.S. Code Annotated 35). The Respondent's discharge in bankruptcy expressly recites that it does not discharge debts which are excepted from the operation of a discharge in bankruptcy (R. 19).

ARGUMENT

POINT I

APPELLANTS' JUDGMENT WAS NOT DISCHARGED IN BANKRUPTCY BECAUSE OF RESPONDENTS' OBTAINING PROPERTY BY FALSE PRETENSES AND THEIR WILLFUL AND MALICIOUS INJURY TO THE APPELLANTS' PROPERTY RIGHTS.

Section 17 of the Bankruptcy Act (11 U.S. Code Annotated 35) reads in part as follows:

> "Sec. 17 Debts Not Affected by a Discharge. — a. A discharge in bankruptcy shall release a bankrupt from all of his provable debts, except such as . . . (2) are liabilities for obtaining property by *false pretenses* or false representations, or for *willful and malicious injuries to the person or property of another,* . . ." (emphasis added)

Entry of the default certificate (R. 15) and the judgment by default (R. 16) was an admission by Respondents of every traversable allegation of Appellants' cause of action (*Utah Ass'n of Credit Men v. Bowman, Judge,* 38 Utah 326, 113 P. 63), and is tantamount to an admission that the Appellants were entitled to a judgment as prayed. (30A Am. Jur 296, Sec. 223 and cases there cited; 98 ALR 1020; 11 LRA NS 803; *Fitzgerald v. Herzer,* 177 P. 2d 364, 78 C.A. 2d 127). In determining the nature of the cause of action and whether it is dischargeable, the Court will look behind a judgment to ascertain from the record whether the obligation which was merged in the judgment is dischargeable in bankruptcy. *Lyon v. Lyon,* 115 U. 466; 206 P. 2d 148; *National Finance Company of*

Provo v. Daley, 14 U. 2d 263, 382 P. 2d 405; *Jaco v. Baker*, 48 P.2d 938, 174 Or. 191.

Entry of the default judgment constituted admission by Respondents that they were guilty of willful and malicious injury to the property rights of Appellants within the meaning of the Bankruptcy Act in many particulars, including but not limited to the following:

(a) Their conversion of Appellants' trust funds held by them in the sum of $2,831.37 (R. 4).

(b) Their conversion of merchandise of Appellants (R. 2, Par. 2; R. 4; R. 1-3).

(c) Their conversion of unsold merchandise of Appellants which they failed to return when Appellants demanded the return of said merchandise (R. 2, Par. 7).

(d) Their conversion and/or misappropriation of trust funds of Appellants received from sale of Appellants' merchandise.

(e) Their conversion and/or misappropriation of trust funds of Appellants collected from finance companies (R. 1, Par. 5; R. 2, Par. 4; R. 8 & 9, Par. 1, 2, 3 & 5).

(f) Their conversion of a truck and station wagon mortgaged to Appellants but sold by Respondents and the proceeds misappropriated by Respondents in utter disregard of the unrecorded chattel mortgage of Appellants (R. 2, Par. 5; R. 3, Par. 5 and 6; R. 8, Par. 4) which was not recorded at the request of Respondents and by reason of the existing mortgage on said vehicles in favor of a finance company (R. 8, Par. 4).

The debt due to Appellants, which was merged into

their default judgment, is for willful and malicious injuries to the property rights of Appellants and accordingly said debt was not discharged by Respondents' bankruptcy, it not being the purpose of the bankruptcy act to release a bankrupt from a judgment against him as a result of his fraud or his willful and malicious wrongdoing. *Koch v. Segler* (Mo App), 331 SW 2d 126, 78 ALR 2d 1220.

Obtaining property by means of false pretenses

The sale by Respondents of the vehicles upon which Appellants had a chattel mortgage and their appropriation of the proceeds constitutes obtaining of property under false pretenses (9-1-13, UCA, 1953) and makes the liability to Appellants non-dischargeable under the bankruptcy law [Sec. 17(2) supra]. In a like manner the Respondents made their obligation to Appellants non-dischargeable in bankruptcy by their misconduct described in paragraph (a) through (e) above.

Wilful and Malicious Injuries to the property of another

The acts done by Respondents described in paragraphs (a) through (f) above all constitute wilful and malicious injuries to Appellants' property which render their obligation to Appellants non-dischargeable in bankruptcy (Sec. 17[2] supra).

Ill will or special malice is not required, it being sufficient that a wrongful act was done intentionally, without just cause or lawful support. *Bank of Williamsville v. Amherst Motor Sales,* 234 App. Div. 261, 254 NYS 825, 20 Am. Bankr. Rep. (NS) 623. The default judgment entered in our case conclusively establishes that the acts

omplained of were done intentionally and without just ause or lawful support, which is sufficient without more o prevent the discharge by bankruptcy of the debt owed y Respondents to Appellants.

The property injured need not be tangible or physical. *Probst v. Jones,* 262 Mich 678, 274 NW 779; 63 ALR 2d 50. The disposal of another's property without his knowledge or consent, done intentionally in disregard of what one knows to be his duty, is a wilful and malicious injury o property which will prevent a discharge in bankruptcy. *McIntyre v. Kavanaugh,* 242 U.S. 138, 61 L. ed. 205, 37 S. Ct. 38; *Mason v. Sault,* 93 Vt. 412, 108 A. 267, 18 ALR 1426, 44 Am. Bankr. Rep. 504.

Sale of pledged or mortgaged property by the mortgagor as in our case [see paragraphs (b), (c) and (f) page 5] is clearly a wilful and malicious injury to the property rights of another which prevents discharge of the debt by bankruptcy as illustrated by the following cases:

(1) Wrongful sale of land subject to unrecorded deed given as mortgage. *Probst v. Jones,* 247 NW 779, 262 Mich. 578.

(2) Sale of mortgaged mare by mortgagor who appropriated proceeds. *Mason v. Sault,* 108 A. 267, 93 Vt. 412.

(3) Unlawful conversion of another's shares of stock and disposal thereof, the owner obtaining a judgment by default. *Van Epps v. Aufdemkamp,* 138 Cal. App. 622, 32 P. 2d 1116.

(4) Refusal of consignee of eggs to return or pay for them. *Re Nordlight,* 3 F. Supp. 486, 22 Am. Bankr. Rep.

(NS) 481.

(5) Taking another's cattle and appropriating them tc own use. *Bever v. Swecker,* 138 Iowa 721, 116 N.W. 704

(6) Failure to pay over to bank the proceeds received from sale of engine which was mortgaged as security for loan. *Sabinal Nat. Bank v. Bryant,* 221 S.W. 940, 45 Am. Bankr. Rep. 549.

The wrongful appropriation of funds of another as was done in our case [see par. (a), (d) and (f), page 5] is also a wilful and malicious injury to property which prevents the discharge of a debt in bankruptcy, as illustrated by the following cases:

(7) Conversion to own use by merchant of money collected for creditor on assigned accounts. *Baker v. Bryant Fertilizer Co.,* 271 F. 473, 46 Am. Bankr. Rep. 579.

(8) Collecting and retaining money from interest in corporation after assigning said interest in corporation as security for loan. *Re Binsky,* 6 F. Supp 789, 24 Am. Bankr. Rep. (NS) 170.

(9) Collection by employee of wages after he had assigned them to creditor. *Covington v. Rosenbusch,* 148 Ga. 459, 97 SE 78, 42 Am. Bankr. Rep. 400.

(10) Conversion of unsold consigned goods after demand for their return. *Mathieu v. Goldbert,* 156 F. 541; 42 ALR 2d 906.

(11) Conversion of money. *Young v. City Natl. Bank* (Tex. Civ. App.).

(12) Failure of an agent to pay over money collected

ır his principal is a wilful and malicious injury to the ıtter's property. *In re Stenger*, DC 1922, 283 F. 419.

POINT II

APPELLANTS' JUDGMENT WAS NOT DISCHARGED IN BANKRUPTCY BECAUSE DEBT WAS REATED BY RESPONDENTS' FRAUD, EMBEZZLEIENT, MISAPPROPRIATION OR DEFALCATION /HILE ACTING IN A FIDUCIARY CAPACITY.

Section 17 of the Bankruptcy Act (11 U.S. Code Annoıted 35) reads in part as follows:

> "Sec. 17 Debts Not Affected by a Discharge. — a. A discharge in bankruptcy shall release a bankrupt from all of his provable debts, except such as . . . (4) were *created by his fraud, embezzlement, misappropriation, or defalcation while acting* as an officer or *in a fiduciary capacity;* . . ." (emphasis added)

The entry of the default judgment in this matter is an dmission by Respondents of every Traversable allegation f Appellants' cause of action (see discussion supra at age 6), including but not limited to the failure of ıe Respondents to account to Appellants for their money nd property held by Respondents in a fiduciary capacity.

Generally brokers, factors and commission merchants ave not been held to be "fiduciaries" within the meaning f the foregoing statute excepting certain debts from disharge by bankruptcy (42 ALR 2d 896, 9 Am. Jur. 2d ankruptcy 604), however, there are a substantial numer of decisions to the contrary. 42 ALR 2d 902; 9 Am. ur. 2d Bankruptcy 604. The decisions seem to turn on the uestion of the nature of the trust, the "fiduciary" capa-

city mentioned in the bankruptcy statute relating to technical or express trusts and not to those trusts which the law implies from a contract or from the position of parties to a transaction. 16 ALR 2d 1152, 9 Am. Jur. Bankruptcy 602 and cases there cited. Ordinary commercial transactions where confidence is reposed in a person does not create a "fiduciary" relationship within the meaning of that act, however, without question, a trustee of an express trust is in a "fiduciary capacity" within the meaning of that statute. *Culp v. Robey,* 299 SW 846, 156 ALR 217, *Bracken v. Milner* (CC MU) 104 F. 522.

As to a part of the transactions between Appellants and Respondents the usual relationship of broker or factor does exist, however, our situation is different in that the parties expressly agreed that a trust relationship would exist.

In addition to the "fiduciary relationship" existing with respect to goods delivered to Respondents on consignment, the parties expressly agreed that a trust relationship would exist in several instances, each of which trusts were breached by Respondents misappropriating the trust assets, including the following:

(a) Respondents acknowledged that they were holding $2,831.37 of Appellants' funds in trust for Appellants (R. 4, Par. 1), which funds were never remitted to Appellants (R. 1-3; R. 10).

(b) Respondents agreed to hold all funds received from finance company reserves in trust for the benefit of Appellants and to forthwith remit said funds to Appellants (R. 1, Par. 5; R. 2, Par. 4; R. 8, 9, Par. 1, 2, 3 and 5). Funds were collected from finance company reserves by Re-

)ondents and misappropriated by Respondents (R. 2, ar. 5).

(c) Failure of Respondents to return the unsold mer- ıandise upon demand constitutes a breach of a "fidu- ıary" capacity which bars discharge of the debt in bank- ıptcy. *Mathieu v. Goldberg*, CC NY 156 F. 541.

(d) Failure of Respondents to account to Appellants)r proceeds received from wrongful sale by them of ehicles mortgaged to Appellants constitutes a breach of fiduciary relationship" within the meaning of foregoing tatute excepting such debts for discharge in bankruptcy.

In each of the instances indicated in paragraphs (a) hrough (d) above, an express trust existed between the arties, and in each instance the Respondents violated the rovisions of Sec. 17(4) of the bankruptcy act which revents discharge of debts ". . . *created by fraud, em- ezzlement, misappropriation, or defalcation while acting . . in any fiduciary capacity; . . .*" and accordingly Re- pondent's debt to Appellants was not discharged by his ischarge in bankruptcy.

SUMMARY AND CONCLUSION

The issue before the Court is clear. Shall a man be permitted to mis-appropriate funds held in trust by him, merchandise held on consignment, proceeds held in trust for another received from sale of that person's merchandise, to collect and appropriate to his own use funds which have been assigned to another, and to sell property which has been mortgaged to another and appropriate the proceeds to his own use, and then to discharge the entire indebtedness in bankruptcy? The legislature has imposed rather severe penalties and sanctions for conduct of this type. The bankruptcy statute is designed to relieve a man of his just debts, not from debts incurred by fraud, embezzlement, misappropriation, defalcation, etc. by a fiduciary or from debts incurred as a result of false pretenses or wilful and malicious injuries to the property of another. What the Respondents did with the Appellants' property and funds which they were holding in trust and/or wrongfully appropriated to their own use is immaterial. It is clear that the acts done by Respondents were done intentionally and with full knowledge of the injury that would necessarily be sustained by Appellants therefrom. No man should be permitted to take advantage of his own deliberate wrongdoing.

The District Court's order of perpetual stay of execution should be vacated, and Appellants should be permitted to execute on their judgment.

Respectfully submitted,

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