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Utah Supreme Court

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IN THE

SUPREME COURT

OF THE

STATE OF UTAH

FILED
MAR 23 1964
Clerk, Supreme Court, Utah

CHARD JENSEN and
ON CHRISTENSEN, d/b/a
ERNINA SEWING MACHINE CO.,
Plaintiffs and Appellants,

vs.

AROLD L. BARRICK and
RED M. POULSON (PAULSON),
b/a
ODERN SEWING MACHINE CO.,
Defendants and Respondents.

No. 10027

RESPONDENTS' BRIEF

Appeal from Order of Perpetual Stay of Execution
Third Judicial District Court, Salt Lake County
Hon. Marcellus K. Snow, Judge

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ICHARD JENSEN and
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Plaintiffs and Appellants,

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Defendants and Respondents.

RESPONDENTS' BRIEF

STATEMENT OF THE KIND OF CASE

This is an appeal from an order of the District Court ranting a perpetual stay of execution on a default judgment. The stay of execution was granted on the ground hat the indebtedness sued upon had been discharged in ankruptcy.

DISPOSITION IN LOWER COURT

Appellants obtained a judgment by default against espondents in the District Court. The court subsequently ssued its order granting a perpetual stay of execution on he judgment.

RELIEF SOUGHT ON APPEAL

Appellants seek an order vacating the District Cour order of perpetual stay of execution or, alternatively, ; order remanding the matter for trial on the issue of di chargeability of indebtedness.

STATEMENTS OF FACTS

The indebtedness owed by respondents to appellan arose out of business dealings between the parties. Appe lants were principals and respondents were factors or cor mission merchants. The relationship of the parties w established by past conduct but particularly by a "Co signment Agreement" (R. 4). By the terms of the agre ment appellants were to deviler to respondents merchandis particularly sewing machines, which respondents wou undertake to sell. The agreement contained the usu standard provisions of a consignment agreement. Title the merchandise was to remain in appellants. A portion the proceeds of the sales of the merchandise, based up sales price from appellants to respondents, was to vest and remain the property of appellants and was to be r mitted to appellants.

In addition to the Consignment Agreement, the parti entered into what appellants describe as a "Condition Agreement," which was for the purpose of providing app lants additional security for the merchandise turned ov to respondents. By the terms of this second agreeme respondents pledged and assigned to appellants certa dealers' reserve accounts in finance companies and two mot vehicles. The agreements contained a general stateme that monies and proceeds were to be held in trust.

Respondents suffered financial reverses and failed to remit funds to appellants for the sale of merchandise. Out of these business dealings respondents became indebted to appellants in the sum of about $6,000. In March 1961, appellants instituted suit against respondents for the indebtedness. On February 8, 1962, respondents filed a bankruptcy petition and properly scheduled the indebtedness owing to appellants in the sum of $6,668.83. On July 31, 1962, default judgment was rendered against respondent. Respondent was discharged in bankruptcy on November 20, 1962. Subsequently, upon respondent's motion, the District Court issued its order granting the perpetual stay of execution on the said default judgment.

Although appellants' brief contains assertions charging respondent with "obtaining money by false pretenses," "wilful and malicious injury to property," "fraud," "embezzlement," "misappropriation," or "defalcation," no such allegations were made in appellants' Complaint.

ARGUMENT

POINT I

APPELLANTS HAVE FAILED TO MEET THEIR BURDEN AND HAVE NOT ESTABLISHED THAT RESPONDENTS' DEBT SHOULD NOT BE DISCHARGED IN BANKRUPTCY.

The Utah Supreme Court has held in the case of *National Finance Company of Provo vs. Daley,* 14 Utah 2d 263, that in determining dischargeability of a judgment, the court will look only to the judgment and the record of the case upon which it was based. Quoting from the opinion of the Utah Supreme Court at page 266 of the Utah 2d Report, the considerations supporting this rule are set forth as follows:

> "In our judgment it better comports with the orderly process of justice to require the plaintiff to bear the responsibility of pleading, proving and claiming the full benefit of whatever character of cause of action he possesses in the original action and of being bound thereby, than to allow another trial upon the same cause of action raising issues which could have been dealt with in the original action. This rule also serves the purpose of the bankruptcy act and at the same time leaves the way open to guard against the discharge of debts of the character excepted from discharge if the facts so justify."

The judgment which appellants claim falls within the exception of Section 17 of the Bankruptcy Act relative to obtaining property by false pretenses and wilful and malicious injury to property right, was obtained by default and default judgment (R. 15, 16). No findings of fact or conclusions of law were entered.

An analysis of the plaintiffs' complaint against the respondents dicloses that paragraphs 1 through 5 allege matters of agreement, title retention and trust rights between appellants and respondents.

Paragraphs 6 and 7 allege that respondents did not keep their agreements, and wrongfully appropriated plaintiffs' property to their personal use, and failed to account for certain funds and the disposition of two automobiles on which respondents had given a second mortgage to appellants. There is no allegation in the complaint that respondents obtained money or property by false pretenses from appellants, or that any of their actions were alleged to have been wilful and malicious injuries to appellants' property.

Granting that the failure of respondents to answer the complaint of appellants', and the entry of the respondents' default does constitute an admission of the allegations of plaintiffs' complaint, a reading of the complaint clearly shows that the obligation in question does not come within the exception to Section 17 of the Bankruptcy Act because there is no allegation in the complaint that respondents obtained property by means of false pretenses practiced upon the appellants, nor that any act done by them constitutes a wilful and malicious injury to the property of appellants. There is no allegation or showing in the record that respondents intentionally failed to keep their agreement with appellants or intentionally diverted any trust funds in which appellants had rights. The claims made by appellants with reference to the chattel mortgages given on the automobiles are without merit because such mortgages were second to those in favor of a third party, and there is no claim in the complaint as to what respondents did with the vehicles other than to fail to account to appellants for them.

The cases cited by appellants in support of their argument in Point I as to the wilful and malicious injury to their property are not in point because in each case either the complaint's alleged wilful and malicious injury to specific property rights, or the court made specific findings in the case that the actions of the defendants were in fact wilful and malicious.

The rule announced by the Supreme Court of the State of Utah in the *Daley* case, supra, confine the inquiry in this proceeding to the record of the case as same is presently before this court, and does not permit new findings or conclusions on the question of malice or wilfulness at the appellate court level. For this court to permit otherwise would enable creditors whose claims have been listed in bankruptcy proceedings to relitigate matters of fraud, wilful and malicious injury, and other matters within Section 17 of the Bankruptcy Act the second time when they had once elected to bring suit for the claim without setting up such circumstances which may have exempted the claim from a discharge in bankruptcy.

The cases cited by appellants which show that judgments for wilful and malicious injury to property may not be dischargable under the Bankruptcy Act are not disputed by respondents. The law in this area is clear. However, to take advantage of this exception to the Bankruptcy Act, it is encumbent upon the party claiming his judgment to be within the exception to make a clear showing in this respect. All of the cases cited by appellants on this point contain specific findings in the record of the case that the injury to property did result from wilful and malicious action by the other party. The record in the case before this court does not disclose that respondents were guilty of such action. Having failed to sustain its burden in this respect, this Court should affirm the decision of the lower court in this matter.

POINT II

THE RESPONDENTS IN THEIR RELATIONSHIP WITH APPELLANTS WERE NOT ACTING IN A FIDUCIARY CAPACITY WITHIN THE MEANING OF THE BANKRUPTCY STATUTE.

A bankrupt is entitled to have the Bankruptcy Act liberally construed in his favor. *Jones v. Gerts* (C.A. 10th, 1941), 121 F. 2d 782, and *In Re Newman* (C.A. 6th, 1942), 126 F. 2d 336.

Appellants' argument under Point II of their brief is that respondents in their relationship to appellants were acting in a fiduciary capacity, and consequently, by virtue of the exceptions set forth in Section 17 of the Bankruptcy Act (11 U.S.C.A. 35), the indebtedness was not discharged. The pertinent portions of that section are as follows:

> "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 any fiduciary capacity; * * *."

It is a well established rule that brokers, factors and commission merchants are not acting in a "fiduciary capacity" as that term is used in the Bankruptcy Act. *Crawford v. Burke*, 195 U. S. 176; *Davis v. Aetna Acceptance Co.*, 293 U. S. 328; *Swift & Co. v, Bullard & Son*, 3 F. 2d 814; *Royal Indemnity Co. v. Sherman*, 269 P. 2d 123; 9 Am. Jur. 2d 604, Bankruptcy, Section 802; see also the cases annotated in 42 A.L.R. 2d 896.

As set forth in the Statement of Facts, and as acknowledged by appellants, respondents were factors, or commission merchants. The indebtedness arose out of the business relationship between the parties. The courts in a long history interpreting the above provision of the Bankruptcy Act, have construed the term "fiduciary capacity" to be one created or established by an express or technical trust and not one arising from implications from contract. *Chapman v. Forsyth,* 2 How. 202. The reason for this construction of the rule is sound. If the term was construed to embrace every fiduciary capacity, it would be difficult to limit its application – it would include all debts arising from agencies in all cases where the law implies an obligation from the trust reposed in the debtor. The Supreme Court in the *Chapman* case said:

> "Such a construction would have left but few debts on which the law could operate. In almost all the commercial transactions of the country, confidence is reposed in the punctuality and integrity of the debtor, and a violation of these is, in a commercial sense, a disregard of a trust. * * *.
>
> " * * *. The act speaks of technical trusts, and not those which the law implies from the contract. A factor is not, therefore, within the act."

See also *Emery & Kaufman, Ltd. v. Heyl* (La. 1954), 80 So. 2d 95 and *Shapiro v. Marzigliano* (N. J. 1956), 120 A. 2d 490.

In establishing the relationship existing between the parties, their business dealings plus all the written agreements must be viewed and considered as a whole. *Davis v. Aetna Acceptance Co.*, supra. Although the agreements between the parties contained a statement that certain monies or proceeds were to be held in trust, the agreements could by no means be considered to constitute express or technical trusts. The one was a consignment agreement, the other a conditional or security agreement.

The courts have concluded that a statement in a contract that funds are to be held in trust does not create the fiduciary capacity of which the statute speaks. In *Upshur v. Briscoe*, 138 U. S. 365, the United States Supreme Court used the following language:

> "The statement in the paper signed by Andrews, that Briscoe accepts the 'trust,' the statement in the paper signed by Briscoe, that he accepts the 'mandate,' and the statement in the paper signed by Annie M. Andrews, that she accepts the appointment of Briscoe 'as her trustee,' does not create a 'trust' in its technical sense, or make the debt of Briscoe one created by him while acting in a 'fiduciary character.' The relation created was merely the usual one of contract between debtor and creditor. Within the meaning of the exception in the bankruptcy act, a debt is not created by a person while acting in a 'fiduciary character,' merely because it is created under circumstances in which trust or confidence is reposed in the debtor, in the popular sense of those terms."

In *American Agricultural Chemical Co. v. Berry* (Me. 1913), 87 Atl. 218, the defendant bankrupt was indebted to plaintiff for proceeds of fertilizers shipped to defendant for sale as plaintiff's agent. The contract between the parties contained the following language:

> " 'All proceeds of sales and goods remaining unsold to be our property and you are to have no title or lien upon said fertilizers, or their proceeds. It is specially agreed that you will hold the same in trust and separate for the settlement of our account with you. All sales shall be guaranteed by you, and the specific proceeds of the same are to be sent to us as received by you; and, until the proceeds of such sales are received by us, the same shall be held by you in trust for us.' "
> The court said:
>
> "But this in no wise changes or strengthens the plaintiff's case. The use of the word 'trust' does not alter the relations between the parties so as to create such a fiduciary capacity as would escape the bankrupt act. That relation was fixed by the nature of the transaction itself and grew out of the transaction as between principal and agent, or owner and factor. * * * ".

In *Michelin Tire Co. v. Hearn* (Tex. 1916), 188 S.W. 943, defendant bankrupt was sued upon an account based on a contract covering a consignment of automobile tires. The contract provided that the defendant was to hold the proceeds of sale "separate and apart and in trust" for the plaintiff. The court held that this did not create the fiduciary capacity so as to exempt the indebtedness from discharge.

Appellants cite three cases under Point II in their brief. *Culp v. Robey*, 229 S.W. 846, involved a suit by Culp, a trustee of a trust company organized as an unincorporated association, against Robey, to recover funds misappropriated by Robey while he was acting as trustee of the trust company. It particularly concerns the status of partners and stockholders; the case does not involve factors or commission merchants. In *Bracken v. Milner,* 104 Fed. 522, defendant was plaintiff's agent, who was given plaintiff's money for purposes of making loans to others and secured by mortgages and deeds of trust. The Court held that in respect of the collections made by the defendant independently of his trusteeship in the deeds of trust, his liability was released by his discharge in bankruptcy. The court did hold that since defendant had made himself the trustee in certain of the deeds of trust, he was as to those instruments a trustee of an express trust and that as to monies collected on foreclosure of the deeds of trust he was acting in a "fiduciary capacity." The court's opinion includes the following significant statement:

> "Judge Brown, in Re Basch (D. C.) 97 Fed. 761, has applied the same construction to the term 'fiduciary capacity' under the present bankrupt act, and held that a debt due by the bankrupt in the character of a commission merchant, arising out of his failure to account for the value of goods consigned to him for sale on commission, on a contract to return the goods or their specific proceeds, is not a debt created by the bankrupt's 'fraud, embezzlement, misappropriation, or defalcation while acting in a fiduciary capacity,' and was therefore released by his discharge in bankruptcy."

In *Mathieu v. Goldberg,* 156 Fed. 541, the relationship of the parties was that of principal and factor, as here. However, the court's holding was based on a specific finding that the defendant's conduct amounted to fraud and embezzlement. No such allegation is contained in appellants' Complaint. (See Point I of this brief.)

Appellants contend on page 11 of their brief that with reference to the vehicles respondent was a mortgagor, and the failure to account for proceeds received from sale of the mortgaged vehicles constituted breach of a fiduciary relationship. This argument is expressly denied by the United States Supreme Court in the *Davis* case, supra, which considered the status of a mortgagor of an automobile who had executed a note, chattel mortgage, trust reecipt and bill of sale as security for a loan. The Court held that the liability for conversion of the automobile did not constitute liability arising from fraud or misappropriation of the bankrupt while acting in a fiduciary capacity. The Court, speaking through Justice Cardozo said:

> "The substance of the transaction is this, and nothing more, that the mortgagor, a debtor, has bound himself by covenant not to sell the mortgaged chattel without the mortgagee's approval. The resulting obligation is not turned into one arising from a trust because the parties to one of the documents have chosen to speak of it as a trust."

In the same general area the cases hold that a bailee is not acting in a "fiduciary capacity," *Lewis v. Shaw,* 106 N.Y.S. 1012; *Sumner v. Richie,* 6 N.W. 752; and *Herman v. Lynch,* 26 Kan. 435, nor is a pledgee, *Hennequin v. Clews,* 111 U. S. 176; *Crawford,* supra; *In re Toklas,* 201 Fed. 377 and *In re Ennis,* 171 Fed. 755.

As appellants have argued, there is a minority view to the contrary and cases so holding are cited in 42 A.L.R. 2d 896, supra, beginning at page 902. However, it is significant that a number of these cases have been overruled. The United States Supreme Court has consistently adhered to the general rule stated above.

CONCLUSION

Respondents' indebtedness to appellants was scheduled in the bankruptcy proceeding, and respondents were properly discharged. There are no allegations in appellants' complaint to the effect that respondents were guilty of obtaining property by false pretenses or that they caused wilful and malicious injury to appellants' property; nor is there any allegation in the complaint that respondents were guilty of fraud or embezzlement. The respondent's relation to appellants was that of a factor; a fiduciary capacity did not exist.

The District Court's order of a perpetual stay of execution should not be disturbed. Appellants' appeal should be dismissed.

Respectfully submitted,

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