

IN THE UNITED STATES BANKRUPTCY COURT

FOR THE DISTRICT OF SOUTH CAROLINA

FILED

IN RE:

Avie James Rainwater,

Debtor(s)

James Mallas Invidiually and d/b/a
Joel Enterprises and/or
The Investment Group of America,

Plaintiff(s)

v.

Avie James Rainwater,

Defendant(s)

CASE NO: 94-73566

ADVERSARY/COMPLAINT NO: 94-8234

95 JAN 11 AM 9:50

U.S. DISTRICT COURT

JUDGMENT ON ORDER OF THE COURT ISSUED January 9, 1995

The judgment debt owed to plaintiff by defendant is excepted from discharge pursuant to 11 U.S.C. Section 523 (a)(2)(4) and (6).

JOHN E. WAITES
United States Bankruptcy Judge

Columbia, South Carolina
January 10, 1995

ENTERED

JAN 11 1995

J.G.S.

UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF SOUTH CAROLINA

FILED

95 JAN -9 AM 11:42

U.S. DISTRICT COURT

IN RE:

Avie James Rainwater,

Debtor.

James Mallas, individually and d/b/a JOEL
ENTERPRISES and/or THE
INVESTMENT GROUP OF AMERICA,

Plaintiff,

v.

Avie James Rainwater,

Defendant.

Case No. 94-73566

Adversary No. 94-8234

ORDER

Chapter 7

ENTERED

JAN 11 1995

J.G.S.

This matter comes before the Court on the Motion of the Plaintiff, James Mallas, individually and d/b/a Joel Enterprises and/or The Investment Group of America (hereinafter referred to as Mallas) for Summary Judgment filed December 9, 1994. All parties to this action were given notice of a Pre-Trial conference to be held on December 19, 1994. The Notice provides specifically that the matter may be called for trial at the conclusion of the Pre-Trial conference. At the conclusion of the Pre-Trial conference, the matter was called for trial. The Plaintiff's Motion for Summary Judgment was heard prior to beginning the trial.

The Debtor filed a voluntary petition for relief under Chapter 7 of the Bankruptcy Code on July 27, 1994. Mallas is a creditor of the Debtor, having obtained a jury verdict in the United States District Court for the District of South Carolina against the Debtor in the amount of \$340,000 actual and \$75,000 punitive damages. The jury verdict arises from the Debtor's breach of contract accompanied by a fraudulent act and breach of fiduciary duty.

The Debtor did not appeal the jury verdict. However, Leila Drake Rainwater, a co-defendant and the Debtor's wife, appealed the verdict to the Court of Appeals for the

Fourth Circuit. The Court of Appeals affirmed the verdict.

In his Answer to the Complaint, the Debtor admitted that the following allegations are true:

5. The Plaintiff entrusted large sums of money to the debtor.
6. The Debtor and the Plaintiff agreed that the Debtor would manage and invest the funds so that the Plaintiff would receive a 20% annual return.
7. As compensation, the Debtor was to be paid 25% of the earnings.
* * *
9. The investments failed and the funds were lost.
10. The Debtor agreed to a three year "consulting" contract at an annual rate of \$30,000.00 as a result of the investments.
11. The Debtor's wife, Leila D. Rainwater, received a "finders fee" of \$10,000.00 and medical and dental benefits as a result of the investments.
12. The Plaintiff brought an action in the United States District Court for the District of South Carolina, Florence Division, Case No. 4:87-2758-2 for the Debtor's breach of contract accompanied by a fraudulent act and for breach of fiduciary duty.

In his Answer, the Debtor did not respond to the allegations of paragraph 13 of the Plaintiff's complaint. Consequently the allegations are deemed to be admitted pursuant to Rule 8(d) of the Federal Rules of Civil Procedure which is applicable to this matter pursuant to Rule 7008 of the Federal Rules of Bankruptcy Procedure. Paragraph 13 provides in part as follows:

13. The matter was tried by a jury and a verdict entered in the amount of \$340,800.00 actual, and \$75,000.00 punitive damages for the Debtor's breach of contract accompanied with a fraudulent act and breach of fiduciary duty.

Mallas has requested that the Debtor's obligations to Mallas be excepted from discharge pursuant to 11 USC Section 523(a)(2), (4), and (6) which provide as follows:

- (a) A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt-

* * *

(2) for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by-

(A) false pretenses, a false representation, or actual fraud . . . ;

* * *

(4) for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny;

* * *

(6) for willful and malicious injury by the debtor to another entity or to the property of another entity;

In the action which Mallas filed against the Debtor and which was tried in the District Court, the jury found that the Debtor had damaged Mallas by his breach of contract accompanied by a fraudulent act and breach of fiduciary duty. The Debtor may not relitigate the issues which have been determined by the jury in this discharge action. In Combs v. Richardson, 838 F.2d 112, 18 C.B.C.2d 487, 17 B.C.D. 151 (4th Cir. 1988), the Fourth Circuit Court of Appeals was confronted with a situation which is the same as the current case in all relevant respects. In Combs, a jury found against a debtor and awarded a creditor actual and punitive damages for malicious beating and striking. The debtor sought to discharge the judgment by filing bankruptcy. The Bankruptcy Court excepted the debt from discharge. The decision was affirmed by the District Court and the Court of Appeals on the principles of collateral estoppel. The Court of Appeals held:

We do hold that a jury's finding that a defendant's actions were willful and malicious will collaterally estop the judgment debtor from relitigating that issue in a discharge proceeding only if an examination of the record of the earlier proceeding satisfies the bankruptcy court that the issue was raised and litigated and that the resolution of the issue was necessary to the verdict in the prior case.

Combs, at 114.

The verdict against the Debtor is for Breach of Fiduciary Duty and for Breach of Contract Accompanied by a Fraudulent Act. A Breach of fiduciary duty constitutes a "defalcation while acting in a fiduciary capacity" and consequently is excepted from discharge under Section 523(a) (4). The term defalcation as it is used in Section 523 is very broad and

includes a breach. This Court, in In re Owens, 54 B.R. 162 (Bankr. D.S.C. 1984) gave a detailed explanation of the meaning of defalcation.

The case law interpreting the term "defalcation" has given it a broad definition. "Generally, defalcation is a failure to account for money or property that has been entrusted to one." American Metals Corp. v. Cowley (In re Cowley), 35 B.R. 526, 529 (Bankr.D.Kan.1983). Treacher v. Duttenhofer (In re Duttenhofer), 12 B.R. 926, 7 B.C.D. 1187 (Bankr.C.D.Cal. 1981); See Kansas State Bank and Trust Co. v. Vickers (In re Vickers), 577 F.2d 683 (10th Cir.1978). A mere deficit resulting from the debtor's misconduct, even if the debtor's conduct does not benefit him, may be "defalcation." In re Cowley, 35 B.R. at 529; Aetna Insurance Co. v. Byrd (In re Byrd), 15 B.R. 154, 8 B.C.D. 436 (Bankr.E.D.Ba.1981). "Defalcation" is the slightest misconduct, and it need not be intentional misconduct; negligence or ignorance may be "defalcation". In re Cowley, 35 B.R. at 529. See, In re Duttenhofer, supra; Baugh v. Matheson (In re Matheson), 10 B.R. 652, 7 B.C.D. 643 (Bankr.S.D.Ala.1981)

Since the breach of a fiduciary duty is more than the "slightest misconduct", the jury verdict constitutes a finding that the Debtor committed a defalcation while acting in a fiduciary capacity. Since the breach of fiduciary duty was raised and litigated in the trial which lasted several days, the Debtor may not now relitigate the issue. The debt is not dischargeable under Section 523(a)(4).

In the District Court action, the jury also found that the Debtor was liable to Mallas for Breach of Contract Accompanied by a Fraudulent Act. The jury's finding that the Debtor defrauded Mallas precludes his right to a discharge under Section 523(a)(2) and (6). Section 523(a)(2) provides that a debt for "actual fraud" is not discharged. Since the jury has determined that the Debtor committed fraud, the debt is not discharged under Section 523(a)(2).

The judgment which Mallas holds is also nondischargeable under Section 523(a)(6) which provides that debts "for willful and malicious injury by the debtor" are not dischargeable. A finding of fraud necessarily includes a finding of willful and malicious injury. In order to be awarded a judgment for fraud, Mallas had to convince the jury, by clear and convincing evidence, that the elements of fraud were present. The elements of

fraud in South Carolina are as follows:

To constitute actionable fraud there must appear: (1) a representation; (2) its falsity; (3) its materiality; (4) the author's knowledge of its falsity or ignorance of its truth; (5) his intent that it should be acted upon by the person and in the manner reasonably contemplated; (6) the other party's ignorance of its falsity; (7) his reliance on its truth; (8) his right to rely thereon; and (9) his consequent and proximate injury thereby.

McKay v. Anheuser - Busch, Inc., 199 S.C. 335, 341, 19 S.E.2d 457,459 (1942)

In order for a debt to be excepted from discharge pursuant to Section 523(a)(6) the injury must be "willful and malicious" as those terms are defined in In re Meyer, 100 B.R. 297 (Bankr. D.S.C. 1988).

"Willful", for the purposes of §523(a)(6), means deliberate or intentional. H.R. Rep. No. 95-595, 96th Cong., 1st Sess. 365 (1977), U.S. Code Cong. & Admin. News 1978, pp. 5787, 6320; *United Bank of Southgate v. Nelson (In re Nelson)*, 11 B.C.D. 159, 161, 35 B.R. 766, 769, 9 C.B.C.2d 745, 747 (N.D.Ill. 1983); *Firstmark Financial Corp. v. Aldrich (In re Aldrich)*, 37 B.R. 860, 862 (N.D. Ohio 1984).

An act is "malicious" within the meaning of §523(a)(6) if wrongful and without just cause or excuse. *St. Paul Fire & Marine Insurance Co. v. Vaughn*, 779 F.2d 1003, 1008 (4th Cir. 1985). In *St. Paul Fire & Marine Insurance Co.*, *supra*, the court stated: "We reaffirm our holding in *Bennett [Bennett v. W.T. Grant]*, 481 F.2d 664 (4th Cir. 1973)] and apply the principle that specific malice on the part of the debtor is not required under §523(a)(6)." The court, in so holding, found a showing of constructive or implied malice to be sufficient to establish the malice required for exception to discharge. *Id.* at 1009. In other words, "[m]alice need not be specific evil intent to harm anyone but rather the deliberate intentional doing of an act which is inherently wrong in the absence of any just or mitigating cause." *Edge v. Simmons (In the Matter of Simmons)*, 17 B.R. 259, 261 (Bankr. N.D.Ga. 1982).

In order to find fraud, the jury had to find that the Debtor had "knowledge of its falsity or ignorance of its truth" that is, that the act was intentional or willful, and that the results of the fraud were "reasonably contemplated" that is, malicious. The judgment debt

owed to Mallas should be excepted from discharge pursuant to Section 523(a)(6)

The Debtor is collaterally estopped to deny the findings of the jury. Consequently, there is no question that the Debtor fraudulently persuaded Mallas to entrust substantial funds with the Debtor. The Debtor then breached his fiduciary duty by way of a scheme involving kickbacks to his wife. The judgment debt owed to Mallas should be excepted from discharge pursuant to 11 USC Section 523(a)(2), (4), and (6).

IT IS THEREFORE ORDERED, ADJUDGED, AND DECREED that the Judgment debt owed to Mallas is excepted from discharge pursuant to 11 USC Section 523(a)(2)(4) and (6),

AND IT IS SO ORDERED


UNITED STATES BANKRUPTCY JUDGE

Columbia, South Carolina
January 9, 1995