DOCKET NUMBER: 94-11604
ADV. NUMBER: 94-1237
JUDGE: M. A. Mahoney
PARTIES: Terry Gene Counts, Terry G. Counts, Transworld Systems, Inc.
CHAPTER:
ATTORNEYS: R. R. Blair, L. C. Williams
DATE: 4/5/95
KEY WORDS:
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UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF ALABAMA

In Re

TERRY GENE COUNTS aka
TERRY G. COUNTS,

Case No. 94-11604-MAM

Debtor.

TRANSWORLD SYSTEMS, INC.,

Plaintiff,

v.

Adv. No. 94-1237

TERRY GENE COUNTS aka
TERRY G. COUNTS,

Defendant.

ORDER AND JUDGMENT SUSTAINING COMPLAINT TO DETERMINE DISCHARGEABILITY

Robert R. Blair, Selma, AL for Debtor/Defendant
Lionel C. Williams, Mobile, AL for Plaintiff

This matter came before the Court on the complaint of Plaintiff, Transworld Systems, Inc. ("TSI"), to determine the dischargeability of a debt owed by Debtor/Defendant ("Counts") to TSI pursuant to 11 U.S.C. §§ 523(a)(2)(A), (4) and (6). This Court has jurisdiction to hear this matter pursuant to 11 U.S.C. §§ 157 and 1334 and the Order of Reference of the District Court. This matter is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(I). Proper notice of the trial was given and appearances were as noted in the record. For the reasons indicated below, the Court grants relief to TSI pursuant to 11 U.S.C. § 523(a) and concludes that TSI's debt is nondischargeable.

On August 11, 1994, Counts filed a petition under Chapter 7 of the Bankruptcy Code and relief was duly ordered. Counts properly scheduled TSI as an unsecured creditor in his bankruptcy schedules.

TSI is engaged in the business of collection of accounts receivable. TSI has developed a system of collection services which it markets to business clients through sales agents who are independent contractors for TSI. Prior to the filing of his bankruptcy petition, Counts was employed as a "sales agent" for TSI pursuant to a written agreement dated March 26, 1985 (Plaintiff's Exhibit 1).

In paragraph 4 of this Sales Agent Agreement, Counts specifically agreed to be an "independent contractor" of TSI. Part of Counts' job description was "to receive checks made payable to the company." (See paragraph 4 of Plaintiffs Exhibit 1.) Paragraph 9 of the sales agreement states in part:

> (9) PAYMENT FOR THE SERVICES
> The agent shall forward to [TSI] each sales order together with the client's check made payable to [TSI] . . . The agent further agrees that each such check shall be made payable to the order of [TSI]. The agent shall have no rights of any kind whatsoever to personally receive payment or to endorse or deposit any check for any services sold by [Counts] hereunder.

(paragraph 9 of Plaintiff's Exhibit 1) (emphasis added).

The evidence clearly revealed that on more than one occasion Counts violated the Sales Agent Agreement, specifically the provisions in paragraphs 4 and 9. Counts initiated a scheme by which checks that should have been made to the order of TSI exclusively and forwarded to TSI were instead made payable to Counts or one of his entities and deposited in a bank account in Clanton, Alabama.

For example, Plaintiff's Exhibit 6 is a copy of checks from Network USA made payable to "Counts & Associates." These checks were endorsed by Counts and deposited in the Clanton

bank account. Plaintiff's Exhibit 10 is a copy of a check from Jones Intercable, Inc., made payable to TSI but endorsed and deposited into Counts' bank account. Plaintiff's Exhibit 12 is copies of two checks from the Jackson County Hospital made payable to "C&A Inc. dba TSI, Inc." Both of these checks were endorsed and deposited into the Clanton bank account. Plaintiff's Exhibit 13 is a copy of a check from Charles R. Bradford, M.D., P.C. made payable to TSI but endorsed and deposited by Counts into his bank account.

Kent A. Wigton, an officer of TSI, testified that these are examples of Counts' fraudulent behavior and under no circumstances has TSI ever allowed their sales agents to collect checks made to multiple payees or deposit them into their own accounts. Counts, just like all of the other sales agents, was to forward checks to TSI, not deposit them into his own account. Wigton testified that there was no exception to this requirement for Counts or any other sales agent. See item No. 9 of Plaintiff's Exhibit 1. According to uncontroverted trial testimony by Wigton, the Sales Agent Agreement is the standard contract on which TSI relies when entering into such an arrangement with their agents in the field. Because of Counts' fraudulent activities, the Sales Agent Agreement with Counts was terminated by TSI in August 1994.

TSI has the burden of proving each and every element of the § 523 action by a preponderance of the evidence. *Grogan v. Garner*, 498 U.S. 279, 111 S. Ct. 654, 112 L. Ed. 2d 755 (1991). This Court is obligated to construe exceptions to discharge liberally in favor of Counts, recognizing that the reasons for denying discharge must be substantial and not merely conjectural. *Gleason v. Thaw*, 236 U.S. 558, 35 S. Ct. 287, 59 L. Ed. 2d 717 (1915); *Equitable Bank v. Miller (In re Miller*, 39 F.3d 301 (11th Cir. 1994).

I. § 523(a)(2)(a)

11 U.S.C. § 523(a)(2)(a) states in relevant part that discharge of a debt is not allowed:

> for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by . . . false pretenses, a false representation, or actual fraud, other than a statement reporting the debtor's or an insider's financial condition.

According to *Schweig v. Hunter (In re Hunter)*, 780 F.2d 1577 (11th Cir. 1986), TSI must prove the following elements in a § 523 nondischargeability action:

> (1) debtor made a false representation with the purpose and intention of deceiving the creditor;
>
> (2) the creditor relied on such representations;
>
> (3) his reliance was reasonably founded; and
>
> (4) the creditor sustained a loss as a result of the representation.

Id. at 1579 (citations omitted).

Applying the test required by *Hunter*, TSI meets the necessary burden of proof. Counts used the Sales Agent Agreement as a tool to deceive TSI and the clients of TSI. TSI reasonably relied on the sales agreement, the reliance was well founded, and TSI lost at least the amount of money misdirected by Counts into his own bank accounts. In other words, TSI has satisfied the requisite elements of § 523(a)(2)(a).

II. § 523(a)(4)

11 U.S.C. § 523(a)(4) provides that there should not be a discharge of a debt "for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny."

Although the question of a fiduciary relationship between Counts and TSI remains unresolved due to the incomplete nature of the Sales Agent Agreement, Counts is still guilty of embezzlement pursuant to 11 U.S.C. § 523(a)(4).[1]

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[1]In the immediate case, the evidence is clear that Counts misdirected and converted funds entrusted to him by TSI. Nevertheless, there is a question as to whether a bankruptcy court must look to state law to determine if a debtor and a claimant had a fiduciary relationship. In the immediate case, the Sales Agent Agreement (Plaintiff's Exhibit 1) has a provision entitled,

The establishment of a fiduciary relationship is not required to prevail on an embezzlement claim. *In re Rigsby*, 152 B.R. 776, 778 (Bankr. M.D. Fla. 1993); *citing In re Kelley*, 84 B.R. 225 (Bankr. M.D. Fla. 1988). Based on *Rigsby*, in order for TSI to prove its embezzlement claim, they "must demonstrate that [Counts] appropriated funds or property for his own benefit and that he did so with fraudulent intent or deceit." *Rigsby* at 778 (citations omitted).

In the immediate case, the evidence is sufficient to establish Counts' fraudulent intent. Wigton's uncontroverted testimony is that Counts knew through oral discussions and the written

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"Choice of Law." However, the parties to this contract left blank the provision directing exactly which state's laws would be controlling. Simply put, it is unclear which, if any, state's laws apply.

According to the Eleventh Circuit, although "defalcation" for purposes of § 523(a)(4) has never been clearly defined, it does refer to the failure to produce funds entrusted by a fiduciary. *Quaif v. Johnson*, 4 F.3d 950, 955 (11th Cir. 1993) (citations omitted). By inference, the *Quaif* court applies (Georgia) state law to a § 523(a)(4) question, although choice of law was not a question before the court. Counts is an Alabama resident and deposited the misdirected checks in an Alabama bank. TSI is a California corporation, with its principal place of business in California.

In Alabama, "the principal-agency relationship is fiduciary in nature and imposes upon [Counts] a duty of loyalty, good faith, and fair dealing." *Sevigny v. New South Federal Savings and Loan*, 586 So. 2d 884 (Ala. 1991) (citations omitted). In fact, in *Meyers v. Ellison*, 31 So. 2d 353 (1947), the Alabama Supreme Court concluded that an agent acting without good faith violates his fiduciary duty and is to be considered fraud upon the confidences entrusted. *Id*. at 355.

The Ninth Circuit, on the other hand, has a very different view of this matter. In *In re Short*, 818 F.2d 693 (9th Cir. 1987), the court concluded that the meaning of the term "fiduciary" in § 523(a)(4) context is an issue exclusively for federal law. *Id*. at 695. California state law is irrelevant on this particular point and for a fiduciary relationship to exist, there must be an express or statutory trust. *In re Martin*, 161 B.R. 672, 676 (9th Cir. BAP (Cal.) 1993) (citations omitted).

Although TSI's complaint is sustained pursuant to § 523(a)(4) for other reasons, this Court is not deciding Counts was acting in a fiduciary capacity pursuant to the Sales Agent Agreement.

Sales Agent Agreement that he was simply to forward collected monies to TSI. Also, Wigton testified that under no circumstances was an agent to deposit or cash any of the checks collected. Further, Plaintiff's Exhibit 2 is a copy of a letter from the President of TSI, Gordon S. Dunn, to Counts informing him that his previous fraudulent behavior is a clear violation of their contractual arrangement. This letter restated Counts' limited role of forwarding checks to TSI in a prompt fashion. Finally, the Sales Agent Agreement itself gives complete and explicit instructions on the handling of such checks. In relevant part, the contract between TSI and Counts states:

> The agent [Counts] shall have no right of any kind whatsoever to personally receive payment or to endorse or deposit any check for any services sold by him [Counts] hereunder.

Plaintiff's Exhibit 1, paragraph 9.

Based on the evidence, Counts is guilty of embezzlement pursuant to 11 U.S.C. § 523(a)(4).

III. § 523(a)(6)

11 U.S.C. § 523(a)(6) states that a discharge is not available for any debt based upon "willful and malicious injury by the debtor to another entity or to the property of another entity." In order to preclude dischargeability of indebtedness pursuant to § 523(a)(6), TSI must establish intentional and deliberate behavior by Counts, and not merely recklessness. *Chrysler Credit Corp. v. Rebhan*, 842 F.2d 1257, 1262-63 (11th Cir. 1988). The case law in the Eleventh Circuit states that willful as defined in § 523(a)(6) means intentional. *In re Ikner*, 883 F.2d 986 (11th Cir. 1989).

For purposes of § 523 (a)(6), malicious behavior "can be established by a finding of either implied or constructive malice." *Id*. at 1263. Indeed, citing *Rebhan*, the court in *Ikner*,

supra, found that "constructive or implied malice can be found if the nature of the act itself implies a sufficient degree of malice." *Ikner* at 991.

It is clear from the evidence and testimony discussed above that Counts acted in a willful and malicious manner. He knowingly converted money that did not belong to him. Counts got caught. He was warned and given a second chance, but he chose to steal again. Consequently, Counts' debt is not dischargeable pursuant to 11 U.S.C. § 523(a)(6).

Therefore, it is ORDERED that the complaint denying Counts dischargeability is SUSTAINED in the amount of $23,834.55 plus interest and attorneys fees.

Dated: April 5, 1995

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MARGARET A. MAHONEY
U.S. BANKRUPTCY JUDGE