

11 USC § 523(a)(6)  
Fed R Bankr P 4004(a)  
Fed R Bankr P 7015  
Fed R Ev 408  
42 USC § 1396(a)(32)  
ORS 414.095

Capital Resource Finance Corp. v. Foster, Civ. No. 93-1116-RE  
Adv. No. 91-3257-P

In re Foster

10/28/93 J. Redden aff'g DDS oral ruling

The district court affirmed a judgment against the debtor for \$47,000. The judgment was non dischargeable as a willful and malicious injury because the debtor converted the proceeds of the creditor's collateral. The collateral was a check for government medical assistance payments.

The district court found:

1) The allegations in the original complaint were adequate to describe a cause of action under 523(a)(6). The facts were the same as those alleged for the original 523(a)(2) claim, so the amendment related back to the original complaint.

2) The debtor was not unduly prejudiced by the addition of the 523(a)(6) claim at trial because the facts were the same, and the court offered to extend the trial if requested.

3) The evidence regarding settlement discussions was either admissible for the purpose of refuting the existence of a guaranty limiting liability, or was harmless error if inadmissible.

4) The debtor suffered no surprise or prejudice when the court allowed testimony of a witness who was not included on the witness lists, but was discussed by both parties.

5) The creditor had an interest in the check which the debtor converted. Federal law prohibits a direct payment of government medical assistance payments to a factor. However, a security interest in medical assistance accounts is not per se illegal under federal law. Under Oregon law, the assignment of a medical assistance account to the creditor would be unlawful. The debtor did not establish that a security interest in the accounts was an illegal assignment, and even if he had, his own actions in converting the check were enough to prohibit him from asserting the defense due to "unclean hands".



FILED

OCT 28 1993

U.S. BANKRUPTCY COURT

DISTRICT OF OREGON

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U.S. BANKRUPTCY COURT  
DISTRICT OF OREGON  
FILED

OCT 28 1993

IN THE UNITED STATES DISTRICT COURT  
FOR THE DISTRICT OF OREGON  
TERENCE H. DUNN, CLERK  
BY WA DEPUTY

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In re:

CARL AND PATRICE FOSTER,

Debtors,

CAPITAL RESOURCE FINANCE  
CORPORATION, an Oregon  
corporation,

Plaintiff/Appellee,

vs.

CARL FOSTER,

Defendant/Appellant,

PATRICE FOSTER,

Defendant.

Stephen Werts  
Lucy E. Kivel  
Preston Thorgrimson Shidler  
Gates & Ellis  
3200 U.S. Bancorp Tower  
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Of Attorneys for Plaintiff/Appellee

Britt Nelson  
Attorney at Law  
1220 Benjamin Franklin Plaza

1 - OPINION

Civil No. 93-1116-RE

Adversary Proceeding No.  
91-3257

OPINION

Certified to be a true and correct  
copy of original filed in my office.  
Dated 10/29/93  
Donald M. Cinnamon, Clerk  
By A. Priestley Deputy

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1 Portland, Oregon 97258  
2 Attorney for Defendant/Appellant

3 REDDEN, Judge:

4 Defendant Carl Foster appeals the judgment of the  
5 bankruptcy court that a debt of \$47,998.53 is not dischargeable  
6 under 11 U.S.C. § 523(a)(6). For the reasons stated below, the  
7 judgment is AFFIRMED.

8 **PROCEDURAL BACKGROUND**

9 Carl and Patrice Foster (the Fosters) filed a petition  
10 for relief under Chapter 7 in March 1991. ER 6. Capital  
11 Resource Finance Corporation (Capital) filed a complaint on  
12 June 5, 1991, alleging that debts owed it should not be  
13 discharged in bankruptcy under 11 U.S.C. § 523 (a)(2)(A) and  
14 (B), which provide that a debt obtained by false pretenses,  
15 false representations, actual fraud, or certain written  
16 statements is not dischargeable. ER G. The complaint was  
17 amended on August 21, 1991 to allege new facts. ER H. The  
18 parties filed a pretrial order on December 10, 1991. ER I.

19 Trial before bankruptcy judge Donal D. Sullivan was held  
20 between January 5 and 12, 1993. On the second day of trial,  
21 January 6, Judge Sullivan stated his intention to make  
22 additional findings under 11 U.S.C. § 523 (a)(6). ER  
23 Transcript at 230. That section provides that a debt resulting  
24 from willful and malicious injury to the property of another is  
25 not dischargeable. The next day, Capital filed a motion to  
26 amend its complaint to conform to the evidence. ER 9.

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1 Carl Foster objected to the addition of the new legal  
2 theory. ER Transcript at 352. Judge Sullivan allowed the new  
3 theory, but granted a continuance in the trial from the  
4 afternoon of Friday, January 8 until Tuesday morning, January  
5 12, 1991. Id. at 632. The judge also stated that he would  
6 consider a request for a further continuance on Tuesday. Id.  
7 None was made. Evidence on the (a)(6) claim was heard on  
8 Tuesday, January 12, the last day of trial.

9 On January 15, 1991, Judge Sullivan issued findings of  
10 fact and conclusions of law in a telephone conference. ER D.  
11 Capital prevailed on one claim: the (a)(6) claim against Mr.  
12 Foster for \$47,998.53 plus interest. Id. All other debts of  
13 the Fosters were discharged. Id.

14 Mr. Foster filed a notice of appeal on January 25, 1993.  
15 ER B. Capital filed an objection to Bankruptcy Appellate Panel  
16 determination on February 12, 1993. Objection to Determination  
17 by BAP, Document No. 70. Accordingly, this court has  
18 jurisdiction under 28 U.S.C. § 158 (a).

#### 19 STATEMENT OF THE FACTS

20 Mr. Foster was the president of Quality Health Services,  
21 Inc. (Quality), a corporation that managed the operations of  
22 Parkrose Nursing Home (Parkrose). When Quality had financial  
23 difficulties in early 1990, Mr. Foster, on behalf of Quality,  
24 entered into a Security Agreement (Agreement) with Capital. ER  
25 1.

26 \ \ \

3 - OPINION

1           The Agreement provided that Capital would take assignment  
2 of accounts receivable selected by Quality for an amount less  
3 than face value. Id. The accounts represented payments from  
4 various sources, including the state Senior and Disabled  
5 Services Division. Quality continued to collect on the  
6 accounts. In addition, Capital took a security interest in all  
7 receivables. Id.

8           The Fosters signed a personal guaranty making them  
9 jointly and severally liable for Quality's debts under the  
10 Agreement. ER 3.

11           In September 1990, Mr. Foster signed an agreement with  
12 the Parkrose property lessor, West Coast Management (West  
13 Coast) through Parkrose Properties. ER Transcript at 576. The  
14 agreement provided that Mr. Foster would surrender Parkrose to  
15 West Coast if rent was not properly paid. Id. On January 1,  
16 1991, West Coast took over Parkrose pursuant to the Agreement.  
17 Id. at 581. On that same day, Mr. Foster began working for  
18 West Coast. Id. Capital was not informed of these events.  
19 Id. at 578, 154.

20           The debt at issue in this appeal stems from an invoice  
21 representing monies owed Quality/Parkrose by the state Senior  
22 and Disabled Services Division. The invoice was assigned under  
23 the Agreement to Capital. On January 7, 1991, Mr. Foster drove  
24 to the Senior and Disabled Services Division office in Salem  
25 with Mr. Holmberg (the manager of Parkrose) and picked up a  
26 check for \$47,998.53 made payable to Parkrose. Id. at 645-56.

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1 The check represented payment under the invoice. That day, Mr.  
2 Foster gave the check to Mr. Holmberg. Id. at 598.

3 Later when asked about the payment, Mr. Foster lied to  
4 Capital's principal, Mr. Maring, about receiving the check, and  
5 said that the state was still processing the payment. Id. at  
6 456. The check proceeds were not paid to Capital. Id. at 195.

### 7 TRIAL COURT'S DECISION

8 The bankruptcy judge issued his findings of fact and  
9 conclusions of law in a telephone conference on January 15,  
10 1993. ER D. Capital prevailed on only one claim, the (a)(6)  
11 claim against Mr. Foster for \$47,998.53 plus interest. Id.

12 Pertinent to this appeal, the judge found the following  
13 facts. On or about January 1, 1990 [sic 1991] Quality's  
14 landlord repossessed Parkrose and applied for Quality's  
15 operating license. Id. at 4. On January 7, 1991, Mr. Foster  
16 drove to Salem to collect a check for \$47,998.53. Id. at 8.  
17 Instead of paying the check over to Capital, who owned the  
18 account, he delivered it to his office manager and then lied to  
19 Mr. Maring. Id. Mr. Foster knew that the office manager would  
20 divert those funds to purposes other than paying Capital.

21 The judge also made the following conclusions of law.  
22 That, under In re Cecchini and In re Riso, Mr. Foster  
23 willfully and maliciously injured Capital's property. Id. The  
24 Agreement was not unlawful under federal law. Id. On the  
25 issue of whether the Agreement was lawful under state law, the  
26 judge said:

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1 I am very reluctant to disapprove or even  
2 to interpret the legality of state  
3 practice, which is sanctioned by state  
4 regulation, and which involved public  
5 obligations, without the state or federal  
6 agency being a party, or without the  
7 clear showing of legality or illegality,  
8 and such showing has not been made.

9 Id. The judge also concluded that Capital's original complaint  
10 contained enough facts as to the \$47,998.53 check to put Mr.  
11 Foster on notice and to support an additional legal theory at  
12 trial. Id. at 9-10.

#### 13 STANDARD OF REVIEW

14 The bankruptcy court's conclusions of law are reviewed de  
15 novo by this court. In re Mellor, 734 F.2d 1396, 1399 (9th  
16 Cir. 1984). The bankruptcy court's findings of fact are  
17 reviewed under the "clearly erroneous" standard. Fed. R.  
18 Bankr. P. 8013; Mellor, 734 F.2d at 1399.

19 Matters within the discretion of the trial court are  
20 reviewed under the abuse of discretion standard. The granting  
21 of leave to amend a complaint falls under this standard. Mende  
22 v. Dun and Bradstreet, 670 F.2d 129, 131 (9th Cir. 1982). A  
23 trial court's ruling on the admissibility of evidence is also  
24 reviewed for abuse of discretion. United States v. Catabran,  
25 836 F.2d 453, 456 (9th Cir. 1988). The trial judge's decision  
26 must not be disturbed unless the reviewing court is left with  
the "definite and firm conviction that the court below  
committed a clear error of judgment in the conclusion it  
reached upon a weighing of the relevant factors." Mission



1 Indians v. American Management and Amusement, Inc., 840 F.2d  
2 1394, 1408 (9th Cir. 1987).

3 **DISCUSSION**

4 Mr. Foster raises the following six assignments of error.

5 1. Amendment of Complaint During Trial

6 He contends that it was an abuse of discretion for the  
7 trial judge to allow Capital to amend its complaint to conform  
8 to the evidence on the third day of trial. The amendment added  
9 the successful (a)(6) claim. Mr. Foster argues that the (a)(6)  
10 claim was legally and factually unrelated to the (a)(2) claims  
11 that were previously alleged in the complaint. He claims that  
12 the amendment created undue prejudice because he did not have  
13 adequate time to prepare his defense at trial.

14 Capital counters that the amendment properly related back  
15 to the original complaint because it merely added a new legal  
16 theory, not new factual allegations. Further, Mr. Foster was  
17 not, in fact, prejudiced at trial.

18 After the expiration of the 60-day period imposed by Fed.  
19 R. Bankr. P. 4004(a), a complaint cannot be amended, except  
20 with leave from the court. A new claim alleged in an amended  
21 complaint relates back to the original complaint if it "arose  
22 out of the conduct, transaction, or occurrence set forth or  
23 attempted to be set forth in the original pleading." Fed. R.  
24 Bankr. P. 7015, Fed. R. Civ. P. 15(c).

25 The trial court determined that the original complaint  
26 contained sufficient facts to put Mr. Foster on notice and to

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1 support a change in legal theories. ER 11 at 10. This  
2 determination will not be upset unless it was an abuse of  
3 discretion. Mende, 670 F.2d at 131.

4 In re Gunn outlines two standards for determining whether  
5 new allegations are part of the same conduct, transaction or  
6 occurrence. In re Gunn, 111 B.R. 291 (Bankr. 9th Cir. 1990).  
7 The looser standard requires a "general nexus between the  
8 original and amended complaints" such as the same loan or  
9 relationship, while the more stringent standard requires a  
10 "closer identity between the facts that would be provable"  
11 under the causes of action alleged in the original and amended  
12 complaints. Id. at 293.

13 Among the allegations in the original complaint were:

14 In January 1991, Carl Foster represented  
15 that Senior Services had failed to pay an  
16 account receivable to Quality which had  
17 been factored to [Capital]. This  
18 representation was false. Carl Foster  
19 had personally picked up the check from  
20 Senior Services and turned the check over  
21 to employees of Quality for deposit into  
22 Quality's bank account or some other bank  
23 account.

24 ER 7. These facts were alleged to support Capital's (a)(2)  
25 claim. An (a)(6) claim requires proof that the debtor  
26 willfully and maliciously injured the property of another.

In this case, both Gunn standards were met. The  
allegations of the original complaint described the events  
supporting the new cause of action. That Mr. Foster picked up  
the \$47,998.53 check from the state, lied about the receipt and

1 failed to give Capital money that was its property, is all  
2 alleged with particularity in the original complaint. Only the  
3 legal theory was new. Not only was there a "general nexus"  
4 between the complaints, there was substantial factual  
5 similarity.

6 This case is analogous to In re Fondren. As in this  
7 case, the creditor in Fondren alleged an (a)(2) claim but  
8 amended its complaint to add an (a)(6) claim. The complaint in  
9 Fondren alleged that the debtor had converted property of the  
10 creditor by cashing a check belonging to the creditor. The  
11 court allowed the complaint to be amended because the original  
12 factual allegations supported the new claim. In re Fondren,  
13 119 B.R. 101, 105 (Bankr. S.D. Miss. 1990).

14 The Fondren complaint stated that the debtor had  
15 "converted" the check, lending itself easily to an (a)(6)  
16 conversion theory. Nonetheless, the facts alleged in this case  
17 and Fondren are very similar. Both alleged that the debtor  
18 wrongfully took a particular check that belonged to the secured  
19 party. In both cases the complaints were amended during trial.  
20 Id. at 102. Here, as in Fondren, the (a)(6) claim arose out of  
21 the same transaction alleged in the original complaint.

22 Mr. Foster's contention that he was unduly prejudiced at  
23 trial by the addition of the (a)(6) claim is without merit. On  
24 the second day of trial, January 6, the bankruptcy judge  
25 notified the parties that he would make findings under (a)(6)  
26 and might allow the complaint to be amended. ER Transcript at

1 230-31. On January 7, Capital filed a motion to amend the  
2 complaint to conform to the evidence. ER 9. On Friday,  
3 January 8, the bankruptcy judge continued the trial until  
4 Tuesday, January 12 and expressly stated that motions for a  
5 further continuance would be entertained on January 12. ER  
6 Transcript at 632. On January 12, no motion for a further  
7 continuance was made.

8 While the (a)(6) legal theory was first presented at  
9 trial, the facts were not. Mr. Foster had full notice of the  
10 facts surrounding the check conversion. In addition, the  
11 witnesses who appeared at trial were known to Mr. Foster. The  
12 judge was aware of Mr. Foster's objection to the new claim. A  
13 continuance was granted. If Mr. Foster had felt that he needed  
14 further time, he could have made that request. The judge  
15 specifically told the parties that he would entertain such a  
16 motion. Mr. Foster was not unduly prejudiced by the amendment.

17 2. Statements Regarding Settlement

18 Mr. Foster argues that introduction of evidence regarding  
19 settlement was an abuse of discretion. Capital contends that  
20 the evidence was offered for impeachment and, therefore, was  
21 admissible under FRE 408.

22 On the second day of trial and during a motion on the  
23 destruction of evidence, Capital's attorney made a reference to  
24 Mrs. Foster's previous willingness to settle the case for  
25 \$60,000. ER Transcript at 221. The motion dealt with a claim  
26 by Mrs. Foster's attorney that a guaranty limiting the

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1 liability of the Fosters to \$10,000 had been lost while in the  
2 possession of Capital. In referring to the offer to settle  
3 made by Mrs. Foster, Capital's attorney was casting doubt on  
4 her claim that a guaranty limiting liability existed. Id.  
5 That is, if the guaranty existed, why would she seek to settle  
6 for six times the liability limitation?

7 Under Fed. R. Evid. 408, settlement evidence can be  
8 offered for a purpose other than proving liability for, or the  
9 validity or amount of, a claim. Fed. R. Evid. 408. The  
10 settlement evidence was offered to refute the claim that a  
11 guaranty existed. For that purpose, the evidence was  
12 admissible.

13 Even if the evidence was inadmissible, the error would be  
14 harmless. The judge stated that he would ignore any settlement  
15 evidence. ER Transcript at 221. Under either harmless error  
16 standard, it can be said with "fair assurance," or that it is  
17 "more probable than not," that any error was harmless. United  
18 States v. Hitt, 981 F.2d 422, 425 (9th Cir. 1992).

19 3. Testimony of Witness

20 Mr. Foster claims that the calling of an unlisted witness  
21 on the last day of trial was error. Capital responds that  
22 there was good cause for the judge to allow the testimony  
23 because it was necessary to rebut the testimony of Mr. Foster,  
24 and that Mr. Foster suffered no surprise or prejudice.

25 On the last day of trial, Dexter Henderson, a Senior  
26 Services employee, testified regarding Mr. Foster's receipt of

1 the \$47,998.53 check. While Mr. Henderson did not appear on  
2 any of the parties' witness lists, he was known to the parties.  
3 In fact, on Thursday, January 7, Mr. Foster's counsel indicated  
4 that he wished to call Mr. Henderson to explain inconsistencies  
5 in Mr. Foster's testimony. ER Transcript at 559, 561. Counsel  
6 for Capital stated that arrangements had already been made for  
7 Mr. Henderson to be available as a witness. Id. Mr. Henderson  
8 was not called as a witness until January 12.

9 In light of Mr. Foster's own stated desire to call Mr.  
10 Henderson and the forewarning given to Mr. Foster that Capital  
11 was intending to call Mr. Henderson, Mr. Foster suffered no  
12 prejudice and the judge did not abuse his discretion.

13 4. Illegality of Security Agreement

14 Mr. Foster next contends that the Agreement between  
15 Quality and Capital that he personally guaranteed was illegal  
16 under federal and Oregon law.

17 The bankruptcy judge found that the Agreement was not  
18 illegal under federal law and appears to have found that Mr.  
19 Foster did not meet his burden of showing that the Agreement  
20 was illegal under state law. ER D at 8-9.

21 This court must review this legal conclusion de novo.  
22 Mellor, 734 F.2d at 1399.

23 While this is not a contract enforcement action, the  
24 (a)(6) claim requires proof that Capital had a property  
25 interest in the \$47,998.53 check. Because Capital's property  
26 interest is based on the Agreement, a successful illegality

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1 argument would leave Capital without an (a)(6) claim.

2 A. Legality Under Federal Law

3 The Agreement provided that Quality could designate  
4 accounts receivable that Capital would purchase at a discount.  
5 The \$47,998.53 check at issue in this case represented an  
6 account that had been assigned by Quality to Capital under the  
7 Agreement. Capital's property interest, upon which the (a)(6)  
8 claim was premised, was based on the assignment of the account  
9 and on a security interest that Capital took, under the  
10 Agreement, in all of Quality's receivables.

11 The check that Mr. Foster picked up from Mr. Henderson  
12 was for medical assistance payments. The check was made  
13 payable to Parkrose, not Capital.

14 Under federal law, medical assistance payments cannot be  
15 paid directly to a factor: "no payment under the plan for any  
16 care or service provided to an individual shall be made to  
17 anyone other than such individual or the person or institution  
18 providing such care or service[.]" 42 U.S.C. § 1396a (32)  
19 (1988).

20 This provision was designed to prevent a provider from  
21 assigning its rights "to other organizations or groups under  
22 conditions whereby the organization or group submits claims and  
23 receives payment in its own name." H.R. Rep. No. 231, 92d  
24 Cong., 2nd Sess., reprinted in 1972 U.S.C.C.A.N. 4989, 5090.

25 Under portions of the Agreement, Capital could collect  
26 accounts directly. And, if the \$47,998.53 check had been

1 payable to Capital, rather than Parkrose, payment to Capital  
2 would have violated federal law. But such was not the case.  
3 The transaction at issue in this case did not involve a payment  
4 of medical assistance funds directly to anyone other than a  
5 provider of services. Therefore, it did not violate 42 U.S.C.  
6 § 1396a.

7 While Capital did not receive a direct payment from the  
8 government, it did have a security interest in medical  
9 assistance accounts, including the \$47,998.53 check. A  
10 security interest in medical assistance is not per se illegal  
11 under federal law. United States v. Northwest Commerce Bank,  
12 727 F. Supp. 403, 406 (N.D. Ill. 1989), In re Missionary  
13 Baptist Foundation, 796 F.2d 752, 759 (5th Cir. 1986), In re  
14 American Care Corp., 69 B.R. 66, 67 (Bankr. N.D. Ill. 1986).  
15 There is no evidence that Capital's security interest in the  
16 payment would have frustrated Congressional intent. In fact,  
17 "a prohibition on security interests in accounts receivable  
18 might cripple a provider's ability to obtain financing."  
19 Northwest Commerce Bank, 727 F. Supp. at 406.

20 B. Legality Under State Law

21 While not completely clear from the record, the  
22 bankruptcy judge appears to have held that Mr. Foster did not  
23 meet his burden in establishing a defense of illegality under  
24 state law. See supra Trial Court's Decision discussion, at 5.

25 Oregon law is broader than federal law. Under Oregon  
26 law,



1 [n]either medical assistance nor amounts  
2 payable to vendors out of public  
3 assistance funds are transferable or  
4 assignable at law or in equity and none  
of the money paid or payable . . . is  
subject to execution, levy, attachment,  
garnishment or other legal process.

5 Or. Rev. Stat. 414.095 (1991). Under this provision, the  
6 assignment of the medical assistance account by Quality to  
7 Capital was unlawful.

8 However, Capital's property interest in the \$47,998.35  
9 medical assistance check was also based on a security interest  
10 independent of the account assignment. The issue thus becomes  
11 whether a security interest in medical assistance is an  
12 assignment under Oregon law. Mr. Foster has not made a  
13 sufficient demonstration that it is.

14 While there is no legislative history or case law  
15 interpreting the provision, the use of the words "assignable"  
16 and "transferable" suggests that the Oregon Legislature sought  
17 to prohibit complete transfers, rather than the granting of  
18 security interests. First,

19 [a]n assignment has traditionally been  
20 defined in the law of contracts as a  
21 transfer by the assignor of all rights in  
the property assigned to the assignee.  
22 It effects an absolute and irrevocable  
transfer of ownership.

23 In re Apex Oil Co., 975 F.2d 1365, 1369 (8th Cir. 1992).

24 Second, prohibition of security interests in medical  
25 assistance might frustrate federal medicare goals by  
26 undercutting a "vital means of financing medical assistance for

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1 the needy." Missionary Baptist Foundation, 796 F.2d at 758;  
2 see also Northwest Commerce Bank, 727 F. Supp. at 406 ("[A]  
3 prohibition on security interests in accounts receivable might  
4 cripple a provider's ability to obtain financing[.]"). The  
5 Fifth Circuit, interpreting a nearly identical statutory  
6 provision concluded that the statute would conflict with the  
7 federal goals if it were interpreted to prohibit a security  
8 interest in medical assistance. Missionary Baptist Foundation,  
9 796 F.2d at 756-59.

10 Even if the granting of a security interest in the  
11 medical assistance account was illegal under Oregon law, Mr.  
12 Foster does not come with clean hands to enforce the  
13 illegality.

14 Bankruptcy is a court of equity. Pepper v. Litton, 308  
15 U.S. 295 (1939). A person seeking to benefit from the unclean  
16 hands doctrine must have acted "fairly and without fraud or  
17 deceit as to the controversy in issue." Ellenburg v. Brockway,  
18 Inc., 763 F.2d 1091, 1097 (9th Cir. 1985). The judge found  
19 that Mr. Foster willfully and maliciously injured Capital's  
20 property. He is, therefore, not in a position to raise this  
21 shield.

22 In conclusion, Mr. Foster has failed to demonstrate that  
23 the Agreement was illegal under federal or state law and, even  
24 if it were, his hands are sufficiently dirty to prohibit him  
25 from successfully asserting the defense.

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16- OPINION

1           5.    Willful and Malicious Standard

2           Mr. Foster also argues that the bankruptcy judge erred in  
3 applying the willful and malicious standard of Cecchini rather  
4 than that of Davis. Capital counters that the use of the  
5 Cecchini standard was proper and that the Davis standard is  
6 subsumed in the Cecchini standard. I review the judge's legal  
7 conclusion de novo.

8           Under 11 U.S.C. § 523(a)(6), a debt is not dischargeable  
9 for "willful and malicious injury by the debtor to another  
10 entity or to the property of another entity[.]" 11 U.S.C.  
11 § 523(a)(6) (1988). The Ninth Circuit, in Cecchini,  
12 interpreted this section to mean that "[w]hen a wrongful act  
13 such as conversion, done intentionally, necessarily produces  
14 harm and is without just cause or excuse, it is 'willful and  
15 malicious' even absent proof of a specific intent to injure."  
16 In re Cecchini, 780 F.2d 1440, 1443 (9th Cir. 1986).

17           In Davis, the Supreme Court held that a willful and  
18 malicious injury does not necessarily follow from every act of  
19 conversion. Davis v. Aetna Acceptance Co., 293 U.S. 328, 332  
20 (1934). "There may be a conversion which is innocent or  
21 technical, an unauthorized assumption of dominion without  
22 wilfulness or malice." Id. An "honest, but mistaken belief"  
23 also is not willful or malicious. Id.

24           Cecchini follows from Davis. Under Cecchini, it must be  
25 shown that 1) the debtor committed a wrongful act, 2) which  
26 necessarily caused harm, and 3) which was without justification

1 or excuse. In re Littleton, 942 F.2d 551, 554(9th Cir. 1991).  
2 While this standard does not require specific intent to injure,  
3 it does preclude a "technical", "innocent" or "honest, but  
4 mistaken" conversion from being willful and malicious under  
5 (a)(6). Davis does not require more. The bankruptcy judge  
6 properly chose the Cecchini standard.

7 Mr. Foster discusses at length the judge's application of  
8 the standard to the evidence. While the issue on appeal is the  
9 propriety of the standard and not its application, the judge's  
10 conclusion that Mr. Foster's conversion of the \$47,998.35 check  
11 was willful and malicious under Cecchini was not clearly  
12 erroneous.

13 The judge found that

14 [Mr. Foster] did, on January 7, 1991,  
15 drive to Salem to collect a check in the  
16 amount of \$47,998.53. Instead of paying  
17 it over to Capital, who owned the  
18 account, he delivered it to his office  
19 manager and then lied to [Capital]. I am  
20 satisfied that in doing so he knew that  
21 the office manager would divert those  
22 funds to other purposes -- or purposes  
23 other than paying Capital. As a  
24 consequence, Mr. Foster willfully and  
25 maliciously injured Capital's property[.]

26 ER D at 8.

21 Cecchini requires that the debtor's act be wrongful,  
22 necessarily causing harm, and without justification or excuse.  
23 Cecchini. Cecchini, 780 F.2d at 1443.

24 First, the evidence supports a finding that Mr. Foster's  
25 conversion of the check was wrongful. Mr. Foster testified  
26

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1 that he had been threatened by Mr. Holmberg on January 7 and  
2 that West Coast management was "going to steal funds from me  
3 and [Capital]." ER Transcript at 492-93. That day, Mr. Foster  
4 picked up the check with Mr. Holmberg, gave the check to Mr.  
5 Holmberg who, in Mr. Foster's presence, turned it over to Mr.  
6 Hahn. Id. at 495-96, 646. While Mr. Foster testified that he  
7 objected to Mr. Holmberg giving the check to Mr. Hahn, he did  
8 not attempt to stop payment on the check or notify Capital.  
9 Id. at 495-97. He then lied to Mr. Maring of Capital about  
10 receiving the check. Id. at 453. The record also includes  
11 evidence that Mr. Foster pled guilty to a charge of aggravated  
12 theft of other state accounts. Id. at 23, ER 4.

13 Second, this evidence also supports a finding that Mr.  
14 Foster's act necessarily caused harm. Under Cecchini, an act  
15 necessarily causes harm if the act would almost certainly be  
16 harmful to the creditor. Littleton, 942 F.2d at 555. The  
17 judge found that Mr. Foster "knew" that the money would be  
18 diverted and not paid to Capital when he gave Mr. Holmberg the  
19 check. ER D at 8.

20 Finally, the evidence supports a conclusion that Mr.  
21 Foster's act was without just cause or excuse. Despite Mr.  
22 Foster's contention, the fact that he often picked up the  
23 medical assistance checks from the state office in Salem does  
24 not mean that Capital consented to Mr. Foster's conversion.

25 The bankruptcy judge's application of the legal standard  
26 to the facts in this case was not clearly erroneous and are,

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1 therefore, upheld.

2 6. Cause of Harm Standard

3 Mr. Foster's last assignment of error is that the  
4 bankruptcy judge should have applied the "substantial  
5 certainty" standard of Rainey rather than a "strong  
6 probability" standard. Capital argues that Cecchini provides  
7 the correct standard and that, in any event, the judge's  
8 finding meets all of the standards.

9 Under Rainey, there must be a "substantial certainty"  
10 that the debtor's act will cause injury. In re Rainey, 1 B.R.  
11 569, 573 (Bankr. D. Or. 1979). As discussed above, Cecchini  
12 similarly requires that the act "necessarily produce harm."  
13 The bankruptcy judge applied the Cecchini standard and found  
14 that Mr. Foster "knew" that Capital would not be paid when he  
15 gave Mr. Holmberg the check. ER D at 8. There is no evidence,  
16 despite Mr. Foster's protestations, that the judge applied a  
17 "strong probability" standard. The judge's finding surpasses  
18 the requirement of either the Rainey or Cecchini standards.  
19 Therefore, there was no error.

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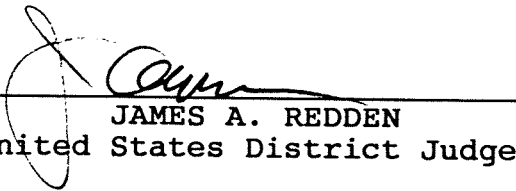
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**CONCLUSION**

Having found that Mr. Foster's assignments of error lack merit, I AFFIRM the judgment of the bankruptcy court. Mr. Foster's request for oral argument is DENIED.

Dated this 27 day of October, 1993.

  
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JAMES A. REDDEN  
United States District Judge