

Nondischargeability  
11 USC § 523(a)(2)(A)

Still v. Patten  
In re Glenn Patten

97-6351-fra  
697-64178-fra7

9/25/98

FRA

Published

This is an action by a customer against a now defunct automobile dealer, seeking a judgment for money damages, and a declaration that the award is nondischargeable. The Plaintiff purchased a used car from the Debtor for \$25,040, trading in his old car for a credit of \$6,995. The balance was financed by a loan from Portland Teachers' Credit Union (PTCU). By state law, the Debtor was required to pay off the existing lien on the vehicle, in the amount of \$24,633 to Wells Fargo, within 15 days. Debtor testified that it was his practice to pay off liens within approximately 30 days from the proceeds of subsequent sales, as he didn't have sufficient cash on hand at the time of a sale to pay off liens from both previous sales and the current sale. At the time of the sale in question, the DMV was investigating the Debtor's financial practices and soon thereafter served an order requiring the immediate suspension of Debtor's dealers license for a period of three years. Debtor was therefore unable to make any addition vehicle sales and could not pay off the Wells Fargo lien. Wells Fargo repossessed the vehicle without prior notice to the Plaintiff.

The bankruptcy court determined the amount of Plaintiff's damages and held that the judgment is nondischargeable under § 523(a)(2)(A), which excepts debts from discharge to the extent they are obtained by false pretenses, false representation, or actual fraud. The court determined that all of the elements to find fraud were present, stating that a fraud is not diminished by an aspiration to make the victim whole by defrauding someone else in the future. Moreover, the fraud is not made any less by the fact that Plaintiff was the injured party because of bad timing and intervening events. Sooner or later, someone would have been injured by Debtor's financial practices.

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UNITED STATES BANKRUPTCY COURT  
FOR THE DISTRICT OF OREGON

IN RE	)	Bankruptcy Case No.
	)	697-64178-fra7
GLENN L. PATTEN,	)	
	)	
<u>Debtor.</u>	)	
	)	
RYAN C. STILL,	)	
	)	
Plaintiff,	)	
vs.	)	Adversary Proceeding No.
	)	97-6351-fra
GLENN L. PATTEN,	)	
	)	MEMORANDUM OPINION
<u>Defendant.</u>	)	

This is an action by a customer against a now defunct automobile dealer, seeking a judgment for money damages, and a declaration that the award is not dischargeable. I find for the Plaintiff.

I. BACKGROUND

Plaintiff purchased a used 1996 Chevrolet 2500 Series pickup from the Defendant/Debtor, a used car dealer. The sale price was \$25,040, which included a \$10 license and registration fee and a \$35 "administration fee" charged by the dealer. A \$6,995 credit

1 was given for the Plaintiff's trade-in (a 1988 Chevrolet Blazer).  
2 The balance of \$18,045 was to be financed by a loan from Portland  
3 Teachers' Credit Union (PTCU).

4 Plaintiff took delivery of the pickup, and surrendered the  
5 Blazer, on January 18, 1987. At that time the pickup was subject to  
6 a security interest in favor of Wells Fargo Bank, and a debt of  
7 \$24,633.

8 On January 22, 1997 Portland Teachers' Credit Union issued its  
9 check for \$18,045, payable to Ryan C. Still and Patten  
10 Motors. Mr. Still endorsed the check and delivered it to a salesman  
11 at Patten Motors. Mr. Still testified that, at that time, he was  
12 reassured that the funds would be used to obtain clear title to the  
13 pickup, which would be forthcoming in approximately six weeks.

14 The check was deposited in Debtor's checking account on January  
15 22.<sup>1</sup> On January 24, Debtor made a \$991.30 payment to Wells Fargo,  
16 constituting two monthly installments. The source of the payment is  
17 not clear, although it is evident from the bank records that it did  
18 not come from the Debtor's business checking account. Debtor  
19 testified that he made the payment in order to keep the obligation  
20 to Wells Fargo from going into default. No other payments were made  
21 to Wells Fargo.

22 At the time of the payment, Debtor's cash on hand, including  
23 the payment, was insufficient to pay the Wells Fargo lien plus  
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25 <sup>1</sup>Apparently this checking account was the Debtor's only  
26 business bank account.

1 the liens on previously sold vehicles. He was also running short of  
2 funds for his household, and had recently missed several house  
3 payments. The balance of the cash then available to Debtor was used  
4 to discharge encumbrances on cars which had been sold previously to  
5 other customers. Debtor testified that he intended to discharge the  
6 encumbrance to Wells Fargo securing the Plaintiff's new vehicle with  
7 the proceeds of subsequent sales. He acknowledged that it had been  
8 his regular business practice for some years to pay lienholders on  
9 vehicles sold to new owners roughly 30 days after the sale, using  
10 the proceeds of subsequent sales to do so. His practice was to write  
11 out a check for the amount required to payoff the encumbrance, place  
12 it in an envelope, and hold it for delivery to the lienholder until  
13 he had deposited enough money from subsequent sales to cover the  
14 check. Debtor acknowledges that his habitual failure to obtain  
15 clear title violated ORS 822.045.<sup>2</sup> In this case he wrote out a check

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17 <sup>2</sup>ORS 822.045 provides, in part:

18 (1) A vehicle dealer improperly conducts a vehicle dealer  
19 business and is subject to the penalties under this section if  
the vehicle dealer commits any of the following offenses:

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\* \* \*

21 (k) A vehicle dealer commits the offense of failure to  
provide clear title if, within 15 days of transfer of any  
interest in a vehicle or camper by the dealer the dealer fails  
22 to satisfy:

23 (A) The interest of any person from whom the dealer  
purchased or obtained the vehicle or camper;

24 (B) The interest of any person from whom the person  
described in paragraph (A) of this paragraph leased the  
25 vehicle or camper; and

26 (C) All security interests in the vehicle or camper  
entered into prior to the time of the transfer. (Continued)

1 to Wells Fargo on February 9, in the sum of \$24,633.24, but did not  
2 deliver it.

3 At roughly the same time the Oregon Department of Motor  
4 Vehicles (DMV) was investigating the Debtor's financial practices.  
5 As a result of that investigation, the DMV served an order on  
6 February 21, 1997 requiring the immediate surrender of the Debtor's  
7 dealers license, and suspending his right to do business as an  
8 automobile dealer in Oregon for three years.<sup>3</sup> This had the effect  
9 of interrupting the cash flow necessary for the acquisition of funds  
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12 The offense is a Class A misdemeanor. ORS 822.045(3)(k).  
13 Another provision makes it a misdemeanor to fail to provide a  
14 certificate of title within 90 days. ORS 822.045(3)(L). A  
15 dealer is deemed not to have violated ORS 822.045(3)(L) if he  
16 has made a good faith effort to comply, and his inability to  
17 comply was due to circumstances beyond his control. ORS  
18 822.045(2)

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<sup>3</sup>Oregon Administrative Rule 735-150-0100 provides:

(1) A person shall be subject to immediate suspension of  
their dealer's certificate for a period not to exceed three  
years if the person creates a serious danger to the public  
health and safety, including but not limited to lost or  
diminished economic interest, security interest or ownership  
interest in vehicles by the public through the transaction of  
business with the person.

(2) Any person whose dealer's certificate has been  
suspended under this rule shall be granted an opportunity for  
a contested case hearing as provided in the Oregon  
Administrative Procedures Act (ORS Chapter 183), except that  
the provisions of OAR 735-150-0120(7) shall apply.

Debtor did not seek a hearing regarding the decision to  
suspend his license.

1 to clear encumbrances on previously sold vehicles. This meant that  
2 there were insufficient funds to cover the previously written check  
3 to Wells Fargo, which was never paid. Fourteen months after the  
4 original sale Wells Fargo repossessed the vehicle without prior  
5 notice to Plaintiff.

6 Plaintiff argues that Debtor is indebted to him for the amount  
7 Plaintiff borrowed from PTCU, which amount is still owed, plus the  
8 value of improvements made to the truck before it was repossessed,  
9 and the value of the trade-in. He claims other consequential  
10 damages, including time lost from work on the day of the  
11 repossession, and \$2,600 paid for a replacement vehicle. He further  
12 alleges that the claim is exempt from discharge on the following  
13 theories:

14 1. That the debt is based on actual fraud, and exempt from  
15 discharge under Code §523(a)(2). The alleged misrepresentation was  
16 that the proceeds of the credit union loan and the value of the  
17 trade-in would be used to obtain clear title, which necessarily  
18 meant paying off the Wells Fargo lien. Instead, the funds were used  
19 to pay off other obligations of the Debtor.

20 2. That the dealer acted in a fiduciary capacity, and that the  
21 use of the loan proceeds to pay off encumbrances in unrelated  
22 transactions was a defalcation exempt from discharge under  
23 § 523(a)(4). Alternatively, it is argued that the misuse of the  
24 funds was an act of embezzlement or larceny.

25 3. Finally, that the conscious decision to pay other  
26 encumbrances prior to the one securing the vehicle purchased by

1 Plaintiff was a willful and malicious injury to Plaintiff's property  
2 interests, and exempt from discharge under § 523(a)(6).

3 Debtor argues that he was engaged in a regular trade practice  
4 which, if not strictly in compliance with the Oregon Motor Vehicle  
5 Code, was nevertheless commonplace, and not fraudulent. He further  
6 argues that any representation made by Plaintiff's salesman cannot  
7 be imputed to him in this context. Debtor asserts that he did not  
8 act in a fiduciary capacity, and that he had no intention of  
9 injuring the Plaintiff. In fact, Debtor maintains that he acted at  
10 all times in good faith and without intent to injure. The heart of  
11 his argument is that, but for the fact that the State closed his  
12 business, he would have paid the obligation secured by Plaintiff's  
13 pickup truck in what amounted to the ordinary course in his  
14 business.

## 15 II. ANALYSIS

### 16 1. False pretenses, false representation, or actual fraud

17 §523(a)(2)(A) exempts from discharge debts:

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

20 (A) false pretenses, a false representation, or  
21 actual fraud, other than a statement respecting the  
debtor's or an insider's financial condition....

22 "False pretenses" or "false representation" both involve  
23 intentional conduct intended to create and foster a false  
24 impression. See Collier on Bankruptcy ¶ 523.08[1][d] (15<sup>th</sup> Ed.  
25 1998). The distinction is that a false representation involves an  
26 express statement, while a claim of false pretenses may be premised

1 on misleading conduct without an explicit statement. In re Scarlata,  
2 127 B.R. 1004 (N.D. Ill. 1991); Matter of Haining, 119 B.R. 460  
3 (Bankr. D.Del 1990). There is no significant difference, however,  
4 between the terms "false pretenses," "false representation," and  
5 "actual fraud." Fraud includes false pretenses and false  
6 representation for dischargeability purposes. See 3 Norton Law and  
7 Practice 2d § 47:15 n.16. Elements of actual fraud are (1) a  
8 representation by the debtor; (2) known by the debtor to be false;  
9 (3) made with the intent to deceive the creditor; (4) reliance by  
10 the creditor; and (5) damage to the creditor as a result of the  
11 representation. In re Apte, 96 F.3d 1319, 1322 (9th Cir. 1996).  
12 Reliance by the creditor must be justifiable, rather than  
13 reasonable. Id. (citing Field v. Mans, 516 U.S. 59, 72-75 (1995)).  
14 Plaintiff must prove each of these elements by a preponderance of  
15 the evidence. In re Eashai, 87 F.3d 1082, 1086 (9<sup>th</sup> Cir. 1996)  
16 (citing Grogan v. Garner, 498 U.S. 279, 286-287 (1991)).

17 At the time he delivered the credit union check to the Debtor,  
18 Plaintiff was told by Debtor's agent that the money would be used to  
19 clear the title on the pickup Plaintiff had just purchased. This,  
20 by itself, satisfies the false representation element, since Debtor  
21 had no such intention. Moreover, the law required that the existing  
22 lien be satisfied within 15 days. It is implicit in this  
23 requirement that the seller use the funds received from the buyer,  
24 or have ready access to the funds necessary to clear title.

25 Debtor argued at trial that any actual representation was made  
26 by the salesman, and not the Debtor. However, the salesman was



1 acting within his authority as Debtor's agent. An agent's  
2 misrepresentations are imputed to his principal for discharge  
3 purposes if the misrepresentation was known to the principal.  
4 Matter of Walker, 726 F.2d 452 (8<sup>th</sup> Cir. 1984). Debtor's salesman  
5 was acting consistently with Debtor's business practices, and Debtor  
6 is bound to the consequences of those actions.

7 In determining whether there was an intent to defraud, the  
8 court must examine the totality of the circumstances. In re  
9 Eashai, 87 F.3d 1082 (9<sup>th</sup> Cir. 1996). The court may infer the  
10 existence of an intent not to perform, sufficient to satisfy the  
11 false pretenses or fraud exceptions, if the circumstances of a case  
12 present a "picture of deceptive conduct by the debtor." Id.; In re  
13 Hashemi, 104 F.3d 1122 (9<sup>th</sup> Cir. 1997). Here the Debtor accepted  
14 Plaintiff's trade-in at a time when he did not have the funds  
15 available to pay the encumbrance on the product sold, and  
16 simultaneously discharge the same duty he owed to prior customers.  
17 While he claims that he intended to satisfy his obligation under his  
18 contract with Plaintiff, Debtor knew that he could only do so by  
19 continuing a business practice that he knew, or should have known,  
20 was unlawful. Debtor's undertaking of a lawful obligation with the  
21 knowledge (unknown to the buyer) that Debtor could perform only by  
22 resorting to unlawful means was fraudulent, for two reasons. First,  
23 the Debtor cannot, as a matter of law, establish a claim of intent  
24 to repay by unlawful means. Second, Debtor was chargeable with the  
25 knowledge that the State could interrupt his cash flow by suspending  
26 his licence for the very business practices he was depending on.

1 This is, in fact, exactly what happened.

2 A fraud is not diminished by an aspiration to make the victim  
3 whole by defrauding someone else in the future. Nor is the fraud  
4 made any less by the fact that Plaintiff was the injured party  
5 because of bad timing and intervening events. Sooner or later  
6 someone was going to be burned by Debtor's methods, since sooner or  
7 later either the law or nature would put an end to Debtor's cash  
8 flow. The only way out was the accumulation or infusion of enough  
9 capital to cover Debtor's obligations to customers as they arose.  
10 There is no evidence to suggest that Debtor had the means or the  
11 will to take that course.

12 Debtor presented testimony to the effect that the State's  
13 enforcement action was unprecedented, and the result either of  
14 selective prosecution because his wife worked for the DMV, or  
15 because of a new policy of strict enforcement resulting from recent  
16 adverse publicity regarding practices such as the ones described  
17 above. I do not believe these circumstances to be material. Debtor  
18 is chargeable with knowledge of Oregon law regulating the conduct of  
19 automobile dealerships, and specifically the requirement that  
20 encumbrances against sold vehicles be cleared within 15 days of the  
21 date of sale. Conduct of an unlawful business practice is not  
22 mitigated by an expectation, even if realistic, that the law will  
23 not be effectively enforced. Likewise, reliance on the unlawful  
24 practice does not allow Debtor to avoid Plaintiff's fraud claim.

25 As to the remaining elements, I find that Plaintiff justifiably  
26 relied on Debtor's representations, and that Debtor's fraudulent

1 actions were the proximate cause of Plaintiff's injuries, as  
2 discussed below. The debt is excepted from discharge.

3 2. Defalcation by fiduciary, embezzlement, or larceny

4 §523(a)(4) excepts from discharge debts incurred by "fraud or  
5 defalcation while acting in a fiduciary capacity, embezzlement, or  
6 larceny." Plaintiff makes two claims under this section: first,  
7 that Debtor embezzled the funds, and, second, that he was acting in  
8 a fiduciary capacity, and that his misuse of the funds was a  
9 "defalcation."

10 Debtor was not acting in a fiduciary capacity. As noted, the  
11 Oregon Motor Vehicle Code requires payment of encumbrances on sold  
12 vehicles with a fixed period of time. However, nothing in the Motor  
13 Vehicle Code requires that the particular funds paid by a buyer be  
14 earmarked for his particular purchase.<sup>4</sup> The source of funds used to  
15 clear the title is immaterial, so long as it gets done. Whether a  
16 person acts in a fiduciary capacity under §523(a)(4) is a question  
17 of federal law. In re Lewis, 97 F.3d 1182, 1185 (9<sup>th</sup> Cir. 1996).

18 The relationship must have existed prior to the alleged wrongdoing,  
19 and exist independently of the misconduct. Id. at 1185. The Motor  
20 Vehicle Code does not create a trust with respect to funds tendered  
21 to a dealer, and does not provide the basis of a fiduciary  
22 relationship. See American Ins. Co. v. Lucas, 41 B.R. 923 (Bankr.  
23 W.D. Pa. 1984) (Debtor authorized to sell hunting licenses who

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25 <sup>4</sup>Which is not the same as saying that a dealer should not  
26 accept payment when he lacks the means of discharging the lien  
as required by ORS 822.045(1)(k).

1 // // //

2 failed to remit fees to state did not hold such fees as a fiduciary,  
3 even though state law required earmarking of funds.)

4 Embezzlement in the context of §523(a)(4) is "the fraudulent  
5 appropriation of property by a person to whom such property has been  
6 entrusted or into whose hands it has lawfully come." In re  
7 Littleton, 942 F.2d 551 (9<sup>th</sup> Cir. 1991). Embezzlement requires that  
8 property rightfully be in the possession of a nonowner. Id. In this  
9 case Debtor, once paid by Plaintiff, was the owner of the funds,  
10 even though his receipt of them imposed the duties described above.  
11 The embezzlement claim is not satisfied under these facts.

12 3. Intentional injury to property interest

13 §523(a)(6) exempts from discharge debts "for willful and  
14 malicious injury by the debtor to another entity or to the property  
15 of another entity." In a recent decision the United States Supreme  
16 Court held that "[t]he word 'willful' in (a)(6) modifies the word  
17 'injury,' indicating that nondischargeability takes a deliberate or  
18 intentional injury, not merely a deliberate or intentional act that  
19 leads to injury." Kawaauhau v. Geiger, \_\_\_ U.S. \_\_\_, 118 S. Ct.  
20 974 (1998). In short, Plaintiff must demonstrate that Debtor  
21 intended to injure the Plaintiff. In fact, Debtor's intention was  
22 to continue his business, with all its faults, and pay off the Wells  
23 Fargo lien when he could. The circumstances of this case reveal  
24 fraudulent conduct, but do not demonstrate the sort of specific  
25 intent to injure required by Geiger.

26 4. Measure of damages

1 The pickup truck was repossessed because Debtor failed in his  
2 duty to pay the obligation to Wells Fargo secured by the truck.  
3 However, Plaintiff remains liable on the debt he incurred to the  
4 credit union. In addition, he has lost the value of the vehicle  
5 traded in, which was valued at \$6,995 by the parties at the time of  
6 the sale. In all, Plaintiff claims the following damages:

7 - Principal balance of PTCU loan:	\$18,045.00
8 - Payments (principal and interest) on PTCU loan	5,194.00
9 - Value of trade-in	6,995.00
10 - Value of tires and accessories added to pickup	1,209.31
11 - Replacement Vehicle	2,600.00
12 - Two day's lost income	400.00
13 - Insurance on pickup	<u>1,190.00</u>

14 TOTAL \$35,233.31

15 Not all of these items are recoverable from Debtor.

16 Specifically:

17 - Plaintiff presumably still owns the replacement vehicle, or  
18 has sold it. Either way, he has benefitted from its use to the  
19 extent of any depreciation. While he might have had other uses for  
20 the cash spent to buy the second truck, he nevertheless has either  
21 retained or recovered its value.

22 - Plaintiff cannot recover both the original balance of the  
23 loan and the subsequent principal payments. He is entitled to  
24 interest paid on the loan. An "advance voucher" from the credit  
25 union submitted by Plaintiff discloses a loan rate of 8.25% per  
26 annum, and a monthly payment of \$371. Plaintiff made 14 payments.  
Assuming ordinary means of amortization, \$3,565.82 of the payments  
was allocated to principal, and \$1,628.18 to interest.

- The insurance claim cannot be recovered. Any unearned

1 premium could have been recovered by cancellation of the policy. To  
2 the extent premiums were earned through provision of liability and  
3 other coverage while the car was in Plaintiff's possession, he has  
4 actually benefitted thereby, and has not suffered any loss.

5 - The lost income is not a foreseeable loss in this context.  
6 Moreover, the testimony was equivocal as to whether the amount  
7 claimed was actually payable for the time in question.

8 Each of the remaining items of damage were the proximate result  
9 of debtor's fraudulent conduct. Plaintiff's damages payable by  
10 Debtor are as follows:

11 - Principal balance of PTCU loan:	\$18,045.00
- Interest paid on loan	1,628.18
12 - Value of trade-in	6,995.00
- Value of tires and accessories added to pickup	<u>1,209.31</u>
13 TOTAL	\$27,877.49

### 14 III. CONCLUSION

15 Debtor sold an encumbered vehicle to Plaintiff knowing he  
16 lacked the present ability to provide clear title within the time  
17 required by law, and knowing that he could only do so by further  
18 violation of his obligations to prior customers, or by engaging in  
19 new violations with respect to new customers. Such conduct is  
20 fraudulent for the purposes of Code §523(a)(2)(A). As a result of  
21 this conduct, Debtor is indebted to Plaintiff in the sum of  
22 \$27,877.49. Plaintiff is entitled to entry of judgment of that  
23 amount, together with his taxable costs and statutory interest from  
24 the date of judgment. The debt was incurred through Debtor's  
25 fraudulent conduct, and is not subject to discharge.

1           The foregoing constitutes the court's findings of fact and  
2 conclusions of law, which will not be separately stated. Counsel  
3 for Plaintiff shall submit a form of judgment consistent with this  
4 memorandum opinion.

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FRANK R. ALLEY, III  
Bankruptcy Judge

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9 cc: Comstock, MacAfee

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