UNITED STATES BANKRUPTCY COURT
DISTRICT OF SOUTH DAKOTA
Western Division

In re:	)	Bankr. No. 01-50397
WILLIAM G. BARNES, Soc. Sec. No. 477-16-8549	)	Chapter 7
Debtor.	)	
GAIL SOHLER, dba St. Onge Livestock Co., LTD	)	Adv. No. 01-5014
Plaintiff,	)	
-vs-	)	DECISION RE: DISCHARGEABILITY OF CLAIM HELD BY PLAINTIFF
WILLIAM G. BARNES,	)	
Defendant.	)	

The matter before the Court is the complaint filed by Plaintiff Gail Sohler regarding the dischargeability of his claim against Defendant-Debtor. This is a core proceeding under 28 U.S.C. § 157(b)(2). This Decision and accompanying Order shall constitute the Court's findings and conclusions under Fed.R.Bankr.P. 7052. As set forth below, the Court concludes that Plaintiff's pre-petition claim against Defendant-Debtor is not excepted from discharge under 11 U.S.C. § 523(a)(4) as a debt arising from embezzlement.

I.

Based on an earlier business relationship, Gail Sohler[1]

[1] For the purpose of this adversary proceeding, the Court is treating Gail Sohler to be the same entity as St. Onge Livestock Company, Ltd. The Court, however, takes no position on which of these two separate, legal entities actually owns the claims against Defendant-Debtor.

employed William G. Barnes beginning in 1988 to work at Sohler's livestock auction barns. From 1994 until the spring of 2001, Sohler employed Barnes to manage the sale barn in Bowman, North Dakota. Sohler had great confidence in Barnes and in his management of the sale barn, and he gave Barnes a bit more independence than managers at his other sale barns.

Sohler offered his higher-level employees the opportunity to participate in a program that allowed the employee to purchase livestock, usually cattle, with funds furnished by Sohler. After the livestock were resold, the employee kept any profits or suffered any losses from the deal. Often Sohler paid the expenses associated with caring for the livestock until they were resold, and he deducted these expenses from the livestock sale proceeds. Occasionally, the employee would pay the expenses directly. For each participating employee, Sohler's bookkeeper, Robert C. Burbach, kept track of the funds advanced for purchases and expenses, the interest on the funds advanced, and the sale proceeds that were deposited with him. These were known as "dealer" accounts. The interest that Sohler charged against the funds utilized through the dealer accounts equaled the interest rate that Sohler was charged by his bank, First Dakota National Bank, where

he borrowed the funds. Sohler did not have any signed agreements[2] with the employees who participated in the dealer account program, and Sohler did not have any formal security interest in the livestock that was purchased with the funds. Sohler considered himself the owner of all the livestock purchased through the dealer accounts. The sale slips, however, generally indicated that the employee was the purchaser, not Sohler. There was no fixed policy between Sohler and his employees on which brand the livestock would carry for those that were kept in brand inspection areas. Burbach occasionally would update the employees on the status of their dealer account. There was an informal limit of $50,000 to each account.

Nathan Franzen, an agricultural finance manager for First Dakota National Bank, acknowledged that his bank loaned funds to Sohler that Sohler in turn used in the dealer accounts to allow his employees to purchase livestock. Franzen said it was his bank's understanding that the livestock purchased with the dealer account funds belonged to Sohler and that the bank had a lien on the livestock based on a blanket lien on Sohler's business assets.

Sohler would sometimes purchase livestock in a more direct

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[2] Subsequent to the time material to the debts related to this adversary proceeding, Sohler executed two written agreements (one for some sheep and one for some cattle) with one employee who was participating in the dealer account program.

partnership with some employees. In those instances, Sohler shared proportionally with his partners in both expenses and any profits and losses.

Barnes participated in the dealer account program offered by Sohler. The parties had only an oral understanding of their agreement; Barnes did not sign any contract before using funds through his dealer account.

Barnes made his last cattle purchases through the dealer account in mid-1998. Between July and December 1998, Barnes paid into the account $37,898.85. At the end of 1998, Burbach reported that the cattle he had purchased through his dealer account included 94 cows and 200 calves. He advised Burbach that "there are more cows that we paid for." In 1999, Barnes paid into his dealer account $10,000. Burbach did not pay any expenses to Barnes that year. At the end of 1999, Barnes reported to Burbach that he had 146 cows, 2 bulls, and 250 calves. Burbach understood that not all these cows had been purchased through Barnes' dealer account, but he assumed that the reported total included all the cows that had been purchased through the dealer account. In 2000, Barnes paid in $25,000. Burbach did not pay any expenses. At the end of 2000, Barnes reported to Burbach that he had 150 cows, 100 calves, and 300 lambs, and an unreported number of ewes. Again, Burbach understood that not all the cows and none of the sheep had been

purchased by Barnes through his dealer account. Burbach assumed that the two large payments that Barnes made in 1999 and 2000 were proceeds from calves born to the cows that Barnes had purchased through his dealer account. Burbach also understood and trusted that Barnes had deducted some expenses, including pasture rent, before he forwarded the calf sale proceeds. Barnes did not pay anything into his dealer account in 2001. The last payment into Barnes' dealer account was made in April 2001 when $900 in insurance proceeds were received by Burbach. By mid-June 2001, Barnes' dealer account had a balance due of $81,144.23.

Between 1998 and 2001, Barnes purchased and resold other sheep and cattle using his own funds or credit provided by Dakota Western Bank of Bowman. Barnes purchased some of this livestock in cooperation with Rod Diede, a loan officer with Dakota Western Bank, and split the expenses with him. Barnes did not keep all the livestock separate, and he generally branded the cattle with his own brand if he was going to keep them for awhile before reselling them, regardless of whether he purchased them through his dealer account with Sohler or through another means. Barnes' net income from his livestock sales was $5,475 in 1998, <$1,388> in 1999, and <$39,730> in 2000. By January 3, 2000, Barnes' debt with Dakota Western Bank totaled $302,400, and his reported assets totaled $816,770, which included livestock valued at about $300,000.

Barnes did not list the total, revolving debt to Sohler on a balance sheet prepared for Dakota Western Bank on August 17, 1998. Sohler, however, acknowledged the dealer account program he had with some of his employees in notes to St. Onge Livestock Company's financial statements for the years 1997-2000. The notes described these dealer accounts as partnerships between the St. Onge Livestock Company and employees that were intended to provide market support. The notes also stated that the employees agreed to repay all advances plus interest and that St. Onge Livestock Company would share in the profits and losses.

Tom Kuchta, another high level employee for Sohler for many years, also participated in Sohler's dealer account program. He stated that under the program he would purchase livestock that he thought could eventually turn a profit for him. He said sometimes the livestock were purchased through various partnerships involving himself, Plaintiff Gail Sohler, Jay Sohler, and Duane Otterman. All the expenses were paid by Gail Sohler with the accounting handled by Burbach. Kuchta acknowledged that Sohler did not have any security agreements that protected Sohler's interest in the livestock purchased through the dealer account funds. He did not know what Barnes' specific arrangements were with Sohler under his dealer account.

Sometime in 2000, Sohler decided to end his operation of the

Bowman auction market. Around this time, he or Burbach advised Barnes that he needed to start settling up his dealer account. In June 2001, Sohler ceased operating the sale barn in Bowman. In conjunction with the closure, Sohler or Burbach more closely scrutinized Barnes' dealer account so that the parties could settle up. In late May 2001, Barnes told Burbach in a telephone conversation that he had inflated his total livestock number in one or more earlier reports and that he had mortgaged some of the livestock purchased through his dealer account with Sohler. He also stated that he (Barnes) was trying to find funds to repay Sohler. That telephone conversation prompted Burbach and Sohler to visit Barnes on June 7, 2001. At that time, Barnes stated he still had some of the livestock purchased through the dealer account. He acknowledged that he had not remitted all proceeds into his dealer account and he also acknowledged that he should not have mortgaged any dealer account livestock. Barnes stated that he wanted to work with Sohler to get the funds repaid.

Burbach was never able to determine when Barnes actually sold all the livestock he had purchased through his dealer account nor was he able to calculate the amount of proceeds that Barnes did not deposit into his dealer account. Though Burbach was aware that Barnes paid some dealer account livestock expenses directly and that Barnes purchased cattle by means other than through his dealer

account, Burbach did not know that Barnes was using proceeds from livestock purchased through his dealer account to purchase more livestock without, in the interim, remitting the proceeds to his dealer account. Burbach's records indicate that on June 1, 2001, Barnes' dealer account had a balance due of $80,026.06.

Barnes also did not know exactly when he sold the cows he had purchased through his dealer account with Sohler.[3] He had not kept these cattle separate from the other cattle he had purchased and he had not kept good records. He admits he may have mortgaged some or all of them to the Dakota Western Bank, and that he lost money on his later livestock deals. However, he stated he never intended to "cheat" Sohler. Instead, Barnes said he "ran out of cattle and ran out of money" and had to file bankruptcy.

In the spring of 2001, Sohler filed a complaint with the South Dakota State Brand Board against Barnes regarding the livestock proceeds that were not deposited into Barnes' dealer account with Sohler. During a conversation on June 15, 2001, Barnes acknowledged to State Brand Board investigator Jerry W. Derr that he had a revolving loan from Sohler to purchase livestock and pay

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[3] Sohler's post-trial brief states that Barnes testified that he (Barnes) resold the cattle he purchased through his dealer account in 1998 shortly after he purchased them. The Court reviewed Barnes' testimony. He actually stated that, though he sometimes quickly resold livestock that he had purchased through his dealer account, he did not know when he resold the cattle he had purchased in 1998.

related expenses and that he presently was indebted to Sohler for $80,000 to $100,000. During the conversation, Barnes first told Derr that cattle located at the Gary Buckley Ranch included cows in which Sohler had an interest and that these cows had been mortgaged to Dakota Western Bank. Later in the conversation, Barnes told Derr that he had sold all the cattle purchased with funds supplied by Sohler's dealer account and that the cattle remaining at the Buckley Ranch were mortgaged to Dakota Western Bank.

Barnes filed his Chapter 7 petition on July 5, 2001. He scheduled Sohler as a general, unsecured creditor holding a claim for $80,310.46.[4] Sohler timely commenced this adversary proceeding seeking a determination of whether his claim was excepted from discharge under §§ 523(a)(2) or (a)(4). A trial was held where the above-stated facts were received through testimony and exhibits.

At the conclusion of the evidence, the Court dismissed Sohler's counts for general fraud under § 523(a)(2)(A), fraud by a fiduciary under § 523(a)(4), or larceny under § 523(a)(4). The Court retained for consideration Plaintiff Sohler's count for embezzlement under § 523(a)(4). Post-trial briefs on the issue

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[4] The parties do not appear to dispute how much Barnes owed Sohler under his dealer account, though the claim amounts stated in Sohler's Complaint and in Barnes' schedules are slightly different. Another claim held by Sohler, which was described as "Business losses of Bowman Auctions" on Barnes' schedules, was not included in this adversary proceeding.

were received.

II.

Embezzlement under § 523(a)(4) is the fraudulent taking of another person's property by a debtor to whom such property was entrusted. *First National Bank v. Phillips (In re Phillips)*, 882 F.2d 302, 304 (8th Cir. 1989). In other words, the creditor must establish that the debtor improperly used the creditor's property or funds before complying with some obligation to the creditor. *Werner v. Hofmann*, 5 F.3d 1170, 1172 (8th Cir. 1993)(cite therein); *Belfry v. Cardozo (In re Belfry)*, 862 F2d 661, 662 (8th Cir. 1988). Implicit in an embezzlement claim under § 523(a)(4) is a showing that the debtor acted with malevolent intent. *Neff v. Knodle (In re Knodle)*, 187 B.R. 660, 664 (Bankr. D.N.D. 1995). It differs from larceny in that the debtor's original possession of the property was lawful or authorized. *Kansas Bankers Surety Co. v. Eggleston (In re Eggleston)*, 243 B.R. 365, 378 (Bankr. W.D. Mo. 2000); *see Werner*, 5 F.3d at 1172. Accordingly, a debtor cannot embezzle his own property. *Belfry*, 862 F.2d at 662.

> Obligations sufficient to support a claim of embezzlement are ones which make the debtor's discretionary use of the payment, prior to complying with the obligations, improper. [Cite therein.] On the other hand, terms which manifest nothing more than the 'hope [] that no problem will ensue after a carefully and skillfully negotiated agreement is set forth in a legally enforceable contract, (cite omitted) will not support a claim of embezzlement.'

Id. at 663 (cites therein).

The creditor seeking a determination of nondischargeability under § 523(a) bears the burden of proof by a preponderance of the evidence. *Grogan v. Garner*, 498 U.S. 279, (1991).

> [E]vidence presented must be viewed consistent with the congressional intent that exceptions to discharge be narrowly construed against the creditor and liberally against the debtor, thus effectuating the fresh start policy of the [Bankruptcy] Code. [Cite therein.] These considerations, however, "are applicable only to honest debtors."

Caspers v. Van Horne (In re Van Horne), 823 F.2d 1285, 1287 (8th Cir. 1987)(quoting *In re Hunter*, 771 F.2d 1126, 1130(8th Cir. 1985)); *see The Merchants National Bank of Winona v. Moen (In re Moen)*, 238 B.R. 785, 790-91 (B.A.P. 8th Cir. 1999).

III.

The Court is unable to conclude that Barnes' debt to Sohler arose from embezzlement as provided by § 523(a)(4). The evidence does not establish that Barnes acted with any malevolent intent when he failed to turnover immediately all proceeds from the livestock he purchased through his dealer account with Sohler. Instead, the evidence shows that Sohler and Barnes' oral agreement was very loose. Though Sohler and his accountant, Burbach, generally expected Barnes to deposit all proceeds into his dealer account upon receipt, Burbach knew and acquiesced to Barnes' retention of some proceeds to pay related expenses. Moreover,

Barnes testified that he thought Sohler knew that he was purchasing other cattle with proceeds from cattle purchased through the dealer account. Though that presumption may have been incorrect, it was not unreasonable when the surrounding circumstances are considered. These circumstances include: Sohler was not involved in any of Barnes' decision-making regarding when and what to buy with the dealer account funds, what expenses to incur, and when to sell; Sohler and Burbach did not require Barnes to furnish regular, detailed reports; the computer-generated reports that Barnes received from Burbach identified the dealer account as a lender-borrower transaction; Burbach knew that Barnes owned other livestock than that which was purchased through Barnes' dealer account; Barnes was not required to segregate his own cattle from cattle purchased through the dealer account; Sohler did not require his brand to be placed on any dealer account cattle kept in a brand inspection area; and Sohler and Burbach let Barnes' dealer account balance exceed the expected cap of $50,000. Thus, the Court cannot identify a place in time when Barnes used the proceeds from the dealer account livestock with an intent contrary to his loose agreement with Sohler.

As noted above, the Bankruptcy Code dictates that the nondischargeability exceptions be construed narrowly. *Belfry*, 862 F.2d at 662. When the embezzlement exception under § 523(a)(4) is

construed narrowly here, the Court concludes that the exception does not apply. Instead, the evidence shows that Barnes breached his oral contract terms with Sohler regarding his dealer account and accumulated a large balance that he was unable to repay. That breach of contract debt is dischargeable. *Werner*, 5 F.3d at 1172.

An appropriate order will be entered.

Dated this 30 day of July, 2002.

BY THE COURT:

Irvin M. Hoyt
Bankruptcy Judge

ATTEST:
Charles L. Nail, Jr., Clerk

By: Deputy Clerk

(SEAL)

NOTICE OF ENTRY
Under F.R.Bankr.P. 9022(a)
Entered
JUL 30 2002
Charles L. Nail, Jr., Clerk
U.S. Bankruptcy Court
District of South Dakota

I hereby certify that a copy of this document was electronically transmitted, mailed, hand delivered or faxed this date to the parties on the attached service list.

JUL 30 2002

Charles L. Nail, Jr., Clerk
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