In the United States Bankruptcy Court

for the Northern District of Iowa

SHERMAN PAUL HOGREFE
Debtor(s).

Bankruptcy No. 92-41695XM
Chapter 7

NORTH IOWA COOPERATIVE ELEVATOR
Plaintiff(s)

vs.

SHERMAN PAUL HOGREFE
Defendant(s)

Adversary No. 92-4266XM

ORDER RE: MOTION FOR SUMMARY JUDGMENT

The matter before the court is the Motion for Summary Judgment by the North Iowa Cooperative Elevator (Co-op). Telephonic hearing on the motion was held July 21, 1995. Appearing for the Co-op was John L. Duffy. David M. Nelsen appeared for defendant Sherman Hogrefe.

After jury trial beginning May 5, 1995, Hogrefe was convicted of theft by deception under Iowa Code § 714.1(3) in the Iowa District Court for Cerro Gordo County, Criminal No. 26851. He was found not guilty of the charge of conspiracy to commit theft by deception. The Co-op has filed a certified copy of the criminal judgment and sentence issued June 30, 1995. Document 109. The Co-op has submitted the affidavit of Paul L. Martin, County Attorney of Cerro Gordo County, and certified copies of the Trial Information, defendant Hogrefe's Request for Discovery, the jury instructions, and the forms of verdict in Hogrefe's criminal trial. Attachments to Document 107. The Co-op also has submitted a copy of the trial transcript. Because Hogrefe's crime involved a theft of property exceeding $10,000 in value, it was classified as theft in the first degree, a class "C" felony. Iowa Code § 714.2(1). Hogrefe was sentenced to serve up to ten years in prison. He was ordered to pay $505,000 to the Co-op in restitution.

The Co-op moves for summary judgment on the basis of issue preclusion on its claims under §§ 523(a)(2)(A), (a)(4), (a)(6) and 727(a)(2)(A). It does not argue for issue preclusion on the remainder of its complaint, the claims under §§ 523(a)(2)(B), 727(a)(3) and (a)(5). Hogrefe has not filed a written resistance to the motion.

The principles of issue preclusion apply in bankruptcy dischargeability proceedings. Grogan v. Garner, 498 U.S. 279, 284-85, 111 S.Ct. 654, 658 & n.11 (1991). In Johnson v. Miera (In re Miera), 926 F.2d 741 (8th Cir. 1991), the Eighth Circuit stated the four elements of issue preclusion:

1. the issue sought to be precluded must be the same as that involved in the prior action;
2. the issue must have been litigated in the prior action;
3. the issue must have been determined by a valid and final judgment; and
4. the determination must have been essential to the prior judgment.

Id. at 743. See also Restatement (Second) Judgments § 27 (stating general rule of issue preclusion).

The only statement of Hogrefe's counsel that the court can construe as an argument that issue preclusion should not apply in this case is that the criminal judgment has been appealed. This argument has no merit. The general rule is that "the pendency of an appeal does not destroy the finality of a judgment for the purpose of applying the doctrine of [issue

preclusion]." Webb v. Voirol, 773 F.2d 208, 211 (8th Cir. 1985); *accord* 18 Wright, Miller & Cooper, Federal Practice & Procedure: Jurisdiction § 4433 at 308 & n.8 (discussing cases). Although Hogrefe's criminal judgment is subject to review, it is a valid and final judgment.

Issue preclusion is applicable in the Co-op's adversary proceeding even though the Co-op was not a party in Hogrefe's criminal case. Federal law has abandoned the former requirement that issue preclusion be used only when there is a mutuality of parties. Lane v. Peterson, 899 F.2d 737, 741 (8th Cir. 1990), cert. denied 111 S.Ct. 74 (1990). "A party may rely on [issue preclusion] even though he or she is not bound by the prior judgment if the party against whom it is used had a full and fair opportunity and incentive to litigate the issue in the prior action." Id. The Supreme Court and the Eighth Circuit have been guided by the Restatement (Second) Judgments in their analyses of issue and claim preclusion. See, e.g., Grogan v. Garner, 498 U.S. at 284-85, 111 S.Ct. at 658; Lane v. Peterson, 899 F.2d at 742.

Section 85 of the Restatement provides that a criminal judgment:

> in favor of the prosecuting authority is preclusive in favor of a third person in a civil action: (a) against the defendant in the criminal prosecution as stated in § 29.

Restatement § 29 incorporates by reference the exceptions to the general rule of issue preclusion in Restatement § 28, and lists several circumstances to consider in determining whether a party should be given an opportunity to relitigate issues decided in a prior proceeding. Hogrefe has not argued that he did not have a full and fair opportunity to litigate the issue in his criminal case, and the court concludes that he did. The issues in Hogrefe's case were actually litigated; he did not plead guilty; he made use of discovery procedures. Affidavit of Paul L. Martin. The jury found each element of theft by deception beyond a reasonable doubt. The standard of proof in dischargeability proceedings is the preponderance of the evidence. Grogan v. Garner, 498 U.S. at 286, 111 S.Ct. at 659. The potential consequences of a felony conviction gave Hogrefe the incentive to vigorously defend his case.

Hogrefe has not shown that there is a genuine issue of material fact to be tried. The Co-op is entitled to summary judgment to the extent issues were decided in the criminal trial, as shown by the documents on file. Fed.R.Civ.P. 56(e), incorporated by Fed.R.Bankr.P. 7056.

Each element of theft by deception, Jury Instruction No. 8, was an issue necessary for the judgment. The last sentence of the instruction advises, "If the State has failed to prove any one of the elements, the defendant is not guilty." The jury found the State had proved that:

1. On or about the 24th day of December, 1991, the defendant received cash and/or agricultural chemicals from the [Co-op] in exchange for a series of checks written to the [Co-op].
2. The defendant deceived the [Co-op] by promising payment, the delivery of goods, or other performance which the defendant did not intend to perform or the defendant knew he would not be able to perform.
3. The defendant obtained possession, control or ownership of cash or property from the [Co-op] by the deception.

Instruction 8. The court will now determine whether the issues necessary to establish the Co-op's claims are the same as the issues decided at Hogrefe's criminal trial.

§ 523(a)(2)(A) Fraud

Bankruptcy Code § 523(a)(2)(A) provides that a Chapter 7 discharge does not discharge a debt:

> 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, other than a statement respecting the debtor's or an insider's financial condition.

11 U.S.C. § 523(a)(2)(A). The Co-op argues that Hogrefe's criminal judgment establishes a claim for actual fraud. To

prove actual fraud, a creditor must show:

1. That the debtor made a representation;
2. That at the time made, the debtor knew the representation to be false;
3. That the representation was made with the intention and purpose of deceiving the creditor;
4. That the creditor relied on the false representation; and
5. That the creditor sustained the alleged loss and damage as the proximate result of the representation having been made.

Webster City Production Credit Ass'n v. Simpson (In re Simpson), 29 B.R. 202, 209 (Bankr. N.D. Iowa 1983); Thul v. Ophaug (In re Ophaug), 827 F.2d 340, 342 n.1 (8th Cir. 1987).

A promise to perform a future act is actionable in fraud if made with an existing real intention not to perform. Grahek v. Voluntary Hospital Co-operative Ass'n of Iowa, Inc., 473 N.W.2d 31, 35 (Iowa 1991); Hagarty v. Dysart-Geneseo Community School District, 282 N.W.2d 92, 95 (Iowa 1979). Although the failure to perform a promise alone does not give rise to an inference of fraud, this rule is inapplicable when the misrepresentations relied on refer to existing facts. K.O. Lee & Son Co. v. Sundberg, 227 Iowa 1375, 291 N.W. 146, 148 (1940). Hogrefe's criminal conviction was not based on a failure to perform a promise. Hogrefe's existing state of mind at the time of making the promise was a necessary element of his crime. The jury found that Hogrefe deceived the Co-op by "promising payment, the delivery of goods, or other performance which [Hogrefe] did not intend to perform or [Hogrefe] knew he would not be able to perform." Instruction 8, 2.

The fraud elements of a false representation, known at the time to be false and made with the intention and purpose of deceiving the Co-op are issues decided by the jury finding on the second element of theft by deception, Instruction 8, 2. Hogrefe deceived the Co-op by making a false promise of performance with a present intention that he would not perform or with the knowledge that he was unable to perform. Actual reliance can be inferred from the third theft element in Instruction 8, that Hogrefe obtained possession, control or ownership of cash or property from the Co-op by the deception. The false promise to perform was a substantial factor, if not the sole factor, in the Co-op's decision to give Hogrefe cash and/or agricultural chemicals. It is not necessary for the Co-op to show that its reliance was reasonable. Thul v. Ophaug (In re Ophaug), 827 F.2d 340, 343 (8th Cir. 1987). The first and third elements of theft by deception and the order to pay the Co-op restitution in the amount of $505,000 establish that the Co-op sustained damage as a proximate result of the false representation. The court concludes that the Co-op is entitled to summary judgment on the basis of issue preclusion on its claim under 11 U.S.C. § 523(a)(2)(A).

§523(a)(4) Larceny or Embezzlement

A discharge under Chapter 7 of the Bankruptcy Code does not discharge debt:

> for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny.

11 U.S.C. § 523(a)(4). The Co-op claims that its debt is nondischargeable as a debt for either embezzlement or larceny.

Embezzlement is the "fraudulent appropriation of property of another by a person to whom such property has been entrusted or into whose hands it has lawfully come." Belfry v. Cardozo (In re Belfry), 862 F.2d 661, 662 (8th Cir. 1988). "Larceny is the fraudulent and wrongful taking and carrying away of the property of another with intent to convert such property to the taker's use without the consent of the owner." Rech v. Burgess (In re Burgess), 106 B.R. 612, 622 (Bankr. D. Neb. 1989), citing 3 Collier on Bankruptcy 523.14[3]. The primary distinction between larceny and embezzlement is the manner in which the property comes into the debtor's hands. Burgess, 106 B.R. at 622. "Embezzlement involves a lawful or authorized possession. In the case of larceny, however, the original taking and possession is unlawful." Id. Hogrefe acquired the Co-op's property through the commission of a crime. A person who obtains possession or control of property of another by deception may be convicted of theft by deception. Iowa Code § 714.1(3). The Co-op's property did not come into Hogrefe's hands lawfully. The Co-op's claim is not debt for embezzlement.

Hogrefe admitted taking and carrying away a check for $230,000 and 500 gallons of herbicide in his answers to

paragraphs four through six of the Amended and Substituted Complaint. Document 16 (complaint), Document 28 (answer). Hogrefe's criminal conviction was for taking "property of another." Iowa Code § 714.1(3). The elements of theft by deception, Instruction 8, establish that Hogrefe's conduct was fraudulent, wrongful, and done with an intent to convert the property to his own use without the consent of the Co-op. Hogrefe obtained the property by deceipt by making a false promise which he did not intend to perform or knew he was unable to perform. Instruction 8, 2, 3. The court rejects Hogrefe's argument in the joint pretrial statement, Document 86, that the property was given to him with the consent of the Co-op. Hogrefe's possession of the property was unlawful from the beginning because it was obtained through deception. The Co-op did not give its consent for Hogrefe to convert the property to his own use. The court concludes that the debt to the Co-op is nondischargeable on the additional ground that it is debt for larceny under 11 U.S.C. § 523(a)(4).

§ 523(a)(6) Willful and Malicious Injury

Debt for "willful and malicious injury by the debtor to another entity or to the property of another entity" is excepted from discharge under 11 U.S.C. § 523(a)(6). "Willful" means headstrong and knowing. Barclays American/Business Credit, Inc. v. Long (In re Long), 774 F.2d 875, 881 (8th Cir. 1985). Malicious conduct is "targeted at the creditor...at least in the sense that the conduct is certain or almost certain to cause...harm." Id. The jury was required to make a finding of willfulness when it found Hogrefe guilty of theft by deception. Jury Instruction 9 told the jury that the intent element of the crime meant "not only being aware of doing an act and doing it voluntarily, but in addition, doing it with a specific purpose in mind." In Long, the court found that the debtor had not acted with malice even though he had knowingly converted the creditor's property. The debtor's purpose was to prevent losses to creditors through a reorganization of his business. Id. at 882. In Hogrefe's case, the second and third elements of theft by deception establish malice. Hogrefe obtained property from the Co-op by deception. The conduct was targeted at the Co-op because Hogrefe did not intend to perform or knew he could not perform. This conduct was certain or almost certain to cause harm to the Co-op to the extent of the amount of the check and the value of the herbicide.

§ 727(a)(2)(A) Objection to Discharge

A debtor is not entitled to a Chapter 7 discharge under § 727(a)(2)(A) if the debtor:

> with intent to hinder, delay, or defraud a creditor ... has transferred, removed, destroyed, mutilated, or concealed ... property of the debtor, within one year before the date of the filing of the petition.

The Co-op argues that Hogrefe's disposal of the money and 500 gallons of herbicide were transfers justifying denial of a discharge pursuant to § 727(a)(2)(A). Spending money or disposing of property obtained by fraud, in itself, would not be a transfer to hinder, delay or defraud a creditor for purposes of § 727. However, it appears that the Co-op is alleging further that Hogrefe's conduct for approximately one month after taking the check and herbicide constitutes concealment to hinder, delay or defraud the Co-op. The Co-op's Amended and Substituted Complaint alleges conduct evidencing an intent to hinder, delay or defraud: rental of a truck, representations to James Dunbar that Hogrefe would obtain additional herbicide to replace the check and 500 gallons obtained previously, and a false report of theft in an attempt to make an insurance claim. Document 16, Count IV, 6. The Co-op eventually learned that Hogrefe used the $230,000 check to pay a prior debt to Midwest Soya International, Inc. See Document 28, Answer, admitting Division II, 4. However, the Co-op alleged that as of January 20, 1993, the date of filing the amended complaint, it had yet to discover the disposition of the 500 gallons of herbicide.

The facts relating to this claim may be connected to the facts in the criminal charge of conspiracy, on which Hogrefe was found not guilty. In any event, the facts were not issues necessary to the conviction of theft by deception. Therefore, the Co-op cannot establish its objection to discharge claim by issue preclusion and the claim will have to be tried. The motion for summary judgment on the § 727(a)(2)(A) claim should be denied.

ORDER

IT IS ORDERED that the Co-op's motion for summary judgment is granted in part and denied in part. Final judgment, when entered, shall provide that Hogrefe's debt to the Co-op is nondischargeable pursuant to 11 U.S.C. §§ 523(a)(2)(A),

523(a)(4) and 523(a)(6). The motion is denied as to the Co-op's objection to discharge pursuant to § 727(a)(2)(A).

SO ORDERED THIS 31st DAY OF JULY, 1995.

William L. Edmonds
Chief Bankruptcy Judge

I certify that on I mailed a copy of this order by U.S. mail to: John Duffy, David Nelsen and U. S. Trustee (also by FAX to Duffy and Nelsen).