In the United States Bankruptcy Court

for the Northern District of Iowa

ROBERT THOMAS VANDAVER dba ROBERT'S AUTO SERVICE and ANNE ELIZABETH VANDAVER *Debtor(s).*	Bankruptcy No. 99-02175-C Chapter 7
MODERN MARKETING & MANAGEMENT *Plaintiff(s)* vs. ROBERT THOMAS VANDAVER dba ROBERT'S AUTO SERVICE *Defendant(s)*	Adversary No. 99-9188-C

ORDER

This matter came on for trial before the undersigned on Plaintiff's Complaint to Determine Dischargeability of Debt on February 24, 2000. Plaintiff Modern Marketing & Management Co. was represented by Attorney David Nadler. Debtor-Defendant Robert Vandaver d/b/a Roberts Auto Service was represented by Attorney Rick Sole. After the presentation of evidence and argument, the Court took the matter under advisement. This matter is now ready for resolution. This is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(C), (I).

STATEMENT OF THE CASE

Plaintiff Modern Marketing & Management Co. brought this adversary proceeding against Debtor Robert Vandaver asserting its claim of $1036.75 is nondischargeable under 11 U.S.C. § 523(a)(4). Debtor filed a compulsory counterclaim for breach of contract pursuant to Rule 7013(a), as well as a claim for attorney's fees under 11 U.S.C. § 105(a). Plaintiff moved for dismissal of Debtor's counterclaims or, alternatively, abstention under 28 U.S.C. § 1334. At trial, in the interest of judicial economy, Plaintiff agreed to withdraw these motions and allow the Court to resolve the claims before it.

FINDINGS OF FACT

In November 1998, Plaintiff Modern Marketing & Management and Debtor-Defendant Robert Vandaver entered into a contract whereby Plaintiff agreed to finance Debtor's efforts to purchase, repair, and resell a wrecked 1998 Chevrolet Tahoe. Plaintiff agreed to purchase the vehicle and the

parts necessary to make repairs. Debtor agreed to perform the labor at no cost, sell the vehicle, and split the profits with Plaintiff. The share of profits for each party changed over time: the longer the project took to complete, the greater share Plaintiff would receive.

In Plaintiff's view, the total cost of the project could not exceed $19,500 and remain economically viable. According to Plaintiff, any higher cost would extinguish the profit margins for both parties. Plaintiff believed the resale value of the rebuilt Tahoe to be in the range of $22,000. Debtor testified otherwise at trial, having a more favorable view of the rebuilt Tahoe's resale value, which he estimated at around $25,000. The contract contained no explicit limits to available financing based on the total cost of the project.

Plaintiff's $19,500 limit was based on the cost of the wrecked Tahoe ($14,500) and Debtor's estimate of the cost of repair parts ($5000). Debtor, who has been in the business of automotive repair for over 15 years, made the estimate after a visual inspection of the vehicle. Plaintiff, having little or no knowledge of automotive repair, relied upon the estimate when it agreed to finance the project. However, Plaintiff included no clause limiting Debtor's available financing to $19,500 when drafting the contract. Rather, Plaintiff agreed to advance funds to Debtor "upon presentation of a[n] invoice for parts necessary to make said repairs." (Pl.'s Ex. 1 at ¶ 1).

The question of financing limits became an issue soon after Debtor began work on the Tahoe. During the course of his work, Debtor discovered damage beyond that originally estimated. Specifically, Debtor determined that the vehicle frame needed to be replaced. The cost of a new frame pushed the total cost of repair parts above $5000, and Plaintiff refused to pay the difference. Debtor, having no funds of his own, borrowed money from another lender to cover the cost of the frame.

Up until this point, Plaintiff had paid two invoices for parts from a local dealer and a portion of a third. Debtor retained possession of these parts. After Plaintiff refused to pay any more toward the project, Debtor returned some of the parts to the dealer in exchange for cash. Debtor testified that he used this cash to pay off the loan for the vehicle frame and to reimburse himself for work performed. The contract explicitly stated that Debtor would supply all labor at no cost to Plaintiff.

By June 1999, Debtor had not completed repairs on the Tahoe. Plaintiff hired a third party to take possession of the vehicle, complete repairs, and sell it (the vehicle ultimately sold for $20,000). Prior to repossession, an inventory of replacement parts was taken and Plaintiff discovered some parts missing. Presumably, the missing parts were those that Debtor had returned. Plaintiff claims that Debtor used these parts to repair other vehicles in violation of their contract.

Plaintiff argues Debtor's conduct amounts to embezzlement under 11 U.S.C. § 523(a)(4). Debtor counterclaims for breach of contract and attorney's fees.

APPLICABLE LAW

In order to resolve Plaintiff's claims of embezzlement and larceny, it is first necessary to interpret the parties' contract and their conduct under it. When interpreting contracts, a bankruptcy court must apply the law of the state in which the contract was executed. See In re Madeline Marie Nursing Homes, 694 F.2d 433, 439 (6th Cir. 1982); In re Rega Properties, Ltd., 894 F.2d 1136, 1139 (9th Cir. 1990). In this case, Iowa law governs.

CONTRACT ANALYSIS

Under Iowa law, the parties' intent controls the construction of contracts. Iowa R. App. P. 14(f)(14). Where possible, this intent is gleaned from the words of the contract. Id. Words are not considered in isolation; a contract must be interpreted as a whole in order to give effect to all of its parts. Iowa Fuel & Minerals v. Board of Regents, 471 N.W.2d 859, 863 (Iowa 1991).

The parties' contract is sparse. Many important issues are not addressed in the document. This allows much room for ambiguity and controversy. Nevertheless, viewing the document as a whole, it is evident that the parties intended to purchase, repair, and resell a wrecked Chevy Tahoe. Plaintiff expected Debtor to perform repairs at no cost. In exchange, Debtor expected Plaintiff to provide the cash to purchase the vehicle and parts for the repair, and to split the proceeds upon resale. On this much, the parties agree.

The parties disagree as to the extent of their obligations. Plaintiff testified at trial that it entered the contract in reliance upon Debtor's estimate that the total cost of repair would be $5000. Once the cost of repair exceeded that estimate, Plaintiff refused to provide Debtor with further financing. Debtor claims this refusal constituted a breach of contract.

BREACH OF CONTRACT BY PLAINTIFF

In order to determine whether Plaintiff breached, the Court must examine what the contract itself says. Berryhill v. Hatt, 428 N.W.2d 647, 654 (Iowa 1988). Where the words are not ambiguous, the contract will be enforced as written. Iowa Fuel & Minerals, 471 N.W.2d at 862-63. Ambiguity exists if the disputed language is "fairly susceptible to two interpretations." Central Bearings Co. v. Wolverine Ins. Co., 179 N.W.2d 443, 445 (Iowa 1970).

In this case, the written terms contain no numerical limit on available financing for repair parts. Paragraph 1 contains the only limit in which Plaintiff agrees to pay for parts "necessary" to make repairs:

> 1. MM&M will advance funds necessary to RV upon the presentation of the Automobile title. . . . and MM&M will issue a purchase check directly to the seller or parts supplier/dealer of said vehicle (and/or parts), and MM&M will also advance to seller upon presentation of a[n] invoice for parts necessary to make said repairs.

(Pl.'s Ex. 1 at ¶ 1). The term "necessary" is not defined in the contract, nor is it explicitly stated which party makes the determination of necessity. Paragraph 1 could reasonably be interpreted to give either party power to decide which parts are "necessary" to repair the vehicle. Therefore, an ambiguity exists.

If ambiguities exist, they will be strictly construed against the drafter. Iowa Fuel & Minerals, 471 N.W.2d at 863. Plaintiff drafted the contract. The contract nowhere mentions the $5000 estimate as a limit to available financing; instead, Plaintiff agreed to provide funds for "necessary" parts. Plaintiff cannot now claim that the $5000 figure, which the parties agree was only an estimate, is somehow an implied or collateral term of the contract.

Nor can Plaintiff claim the right to determine which parts were "necessary" to Debtor's repair efforts. Plaintiff testified that Debtor was in the best position to determine which parts were "necessary." The parties understood that Debtor, an experienced mechanic, would make this determination.

While a contract will generally not be interpreted in a manner that gives one party unlimited discretion, Midwest Management Corp. v. Stephens, 291 N.W.2d 896, 913 (Iowa 1980); such is not the case here. The term "necessary" contains limits upon Debtor's discretion in choosing automotive parts. Debtor could only choose parts required to repair the Tahoe. There is no suggestion that the frame was unnecessary or that Debtor's determination was unreasonable. Plaintiff's refusal to pay for a new frame, a part that Debtor deemed necessary to his repair efforts, constituted a breach of contract.

At trial, Debtor testified that he believed this breach "voided" the contract. Consequently, he sold some of the auto parts in his possession and kept the cash as payment for the labor he had performed. This conduct violates paragraph 2 of the contract, which stated "Robert Vandaver will supply all the labor necessary to make said repairs at no cost or charge to MM&M." (Pl.'s Ex. 1 at ¶ 2). Plaintiff maintains that Debtor used the auto parts on another repair project. Whichever version is correct, Debtor's acts were not justified unless Plaintiff's initial breach was material.

PLAINTIFF'S BREACH AS MATERIAL BREACH

If Plaintiff's initial breach was material, or so substantial as to defeat the object or purpose of the contract, then Debtor had a right to rescind the contract. Beckman v. Carlson, 372 N.W. 2d 203, 208 (Iowa 1985). As mentioned, the object of this contract was the purchase, repair, and resale of a Chevy Tahoe made possible through the combined financial resources of Plaintiff and the technical skills of Debtor. Plaintiff's breach substantially defeated this purpose. Without financing, Debtor could not afford to complete repairs. Without Plaintiff's cooperation, Debtor could not achieve the object of the contract.

Debtor did manage to obtain a loan from a third party to pay for the new vehicle frame, suggesting that the project could be completed without Plaintiff's further involvement. However, Plaintiff's involvement was intended by the parties and formed an essential part of the bargain. Furthermore, given both parties' testimony regarding the difficulty Debtor had in finding financial backers in the first place, it is doubtful he could have completed performance without Plaintiff's help.

The idea that Plaintiff would provide cash for parts was a basic assumption on which the contract was made. Plaintiff violated this assumption and materially breached its contract with Debtor. Plaintiff's breach being material, Debtor had a right to rescind the contract. Beckman, 372 N.W.2d at 208.

RESCISSION BY DEBTOR

Once a party has materially breached the terms of a contract, the non-breaching party may either rescind the contract or stand upon it and have damages. See Krotz v. Sattler, 586 N.W.2d 336, 339 (Iowa 1998); 17A C.J.S. Contracts § 422(1). The non-breaching party must elect its remedy within a reasonable time after the breach and give notice of its intent to rescind the contract. Binkholder v. Carpenter, 152 N.W.2d 593, 597 (Iowa 1967). Notice may be given in writing or by some definite act inconsistent with an intention to perform under the contract. Id. The rescinding party must make or offer to make restoration of the status quo in order to complete the rescission. Id.

Debtor testified that he considered the contract "voided" after Plaintiff refused to fund further repairs. Upon learning of Plaintiff's breach, Debtor immediately stopped work on the Tahoe. He sold some of the parts in his possession in order to cover the costs of approximately 40 hours of labor on the project. Rather than continue performance and sue for damages, Debtor instead elected to rescind the contract.

Plaintiff had notice of Debtor's election. Plaintiff observed that Debtor had ceased repair on the Tahoe when it repossessed the vehicle. Plaintiff testified that Debtor admitted to using some auto parts for purposes other than repairing the Tahoe in a conversation between the parties. Combined, these facts demonstrated to Plaintiff definite action inconsistent with an intent to be bound by the contract. In other words, Plaintiff had notice of Debtor's rescission.

Notice of recission must be given within a reasonable time after the election to rescind is made. National Bank of Decorah v. Robison, 203 N.W. 295, 297 (Iowa 1925). Reasonableness in this context is a question of fact determined with reference to the surrounding circumstances. Brennan& Cohen v. Nolan Laundry Co., 229 N.W. 321, 321-22 (Iowa 1930). Generally, unreasonable delay in rescinding a contract does not depend as much on the time elapsed as on whether such time has been long enough to prejudice the other party. Hanson Silo Co. v. Bennett, 119 N.W.2d 764, 767.

Plaintiff learned of Debtor's rescission about 5 months after the fact. While sooner notice would have been preferable, it was not necessary under the circumstances of this case. The contract contained no time limit for performance. Neither Plaintiff's contractual rights nor its financial interests were prejudiced by the delay. Debtor's delay in notifying Plaintiff of his election to rescind gave Plaintiff time to salvage the contract by resuming funding of necessary parts. Under these circumstances, the delay was not unreasonable.

Debtor's rescission was complete upon Plaintiff's repossession of the Tahoe and remaining auto parts. This restored Plaintiff to the status quo minus the value of the auto parts Debtor converted to his own use. While this restitution was less than total, absolute and complete restitution is not required. Sjulin v. Clifton Furniture Co., 41 N.W.2d 721, 727 (Iowa 1950). Only that restitution which is reasonably possible and demanded by the equities of the case is necessary to complete a rescission. Id. Testimony at trial indicates that the value of the parts sold by Debtor matched closely the value of his labor. In addition, Debtor was entitled to some restitution for his labor from Plaintiff. Equity requires no further restitution from Debtor in order to effectuate rescission.

In sum, Plaintiff materially breached its contract with Debtor by refusing to provide funds for necessary parts. Debtor then enjoyed a right to elect between the remedies of rescission or damages. Debtor chose to rescind the contract as evidenced by his termination of performance and sale of auto parts. Plaintiff gained notice of rescission by its own observations and conversations with Debtor. Rescission was perfected when Plaintiff repossessed the Tahoe and remaining auto parts.

PLAINTIFF'S NONDISCHARGEABILITY CLAIMS UNDER 11 U.S.C § 523(a)(4)

Plaintiff's complaint alleges that Debtor committed embezzlement and larceny when he converted auto parts owned by Plaintiff to his own use. Plaintiff's cause of action arises under 11 U.S.C. § 523 (a)(4), which provides:

> (a) a discharge under section 727. . . of this title does not discharge an individual debtor from any debt--
>
> . . .
>
> (4) for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny.

Because a primary goal of the Bankruptcy Code is providing debtors with a "fresh start," exceptions to discharge are generally construed narrowly. In re Kline, 65 F.3d 749, 751 (8th Cir. 1995). The party seeking an exception to discharge under § 523 bears the burden of proving each element of its claim by a preponderance of the evidence. Grogan v. Garner, 498 U.S. 279, 283 (1991).

SECTION 523(a)(4): EMBEZZLEMENT

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." In re Phillips, 882 F.2d 302, 304 (8th Cir. 1989). In order to prove embezzlement, Plaintiff must show that (1) Debtor was entrusted with property or lawfully came into possession of property of another; (2) Debtor was under a prior restraint, whether written or verbal, as to the use of the property; and (3) the terms of restraint were violated Debtor's use of the property. In re Belfry, 862 F.2d 661, 663 (8th Cir. 1988).

Because Debtor successfully rescinded the parties' contract, Plaintiff cannot prove the second element of embezzlement under § 523(a)(4). Rescission renders the entire contract null and void with neither party having any rights or duties under it. Recker v. Gustafson, 279 N.W.2d 744, 755 (Iowa 1979). The contract being rescinded, Debtor was under no prior restraint regarding the use of parts lawfully in his possession apart from his duty to make restitution to Plaintiff. As explained above, Debtor adequately discharged this duty.

SECTION 523(a)(4): LARCENY

Although Plaintiff clarified its theory as one of embezzlement at trial, the Court will briefly address the claim of larceny since it is raised in the complaint. An exception to discharge for larceny under 11 U.S.C. § 523(a)(4) requires proof that the debtor wrongfully and intentionally took another's property. In re Purdy, 231 B.R. 310, 312 (Bankr. E.D. Mo. 1999). The larceny exception cannot apply where the debtor's original possession of the things in question was lawful. Werner v. Hoffman, 5 F.3d 1170, 1172 (8th Cir. 1993). As Plaintiff correctly noted at trial, Debtor's original possession of the auto parts in question was lawful. Indeed, it was essential to the purpose of the parties' contract. Therefore, any conversion of those parts to his own use cannot constitute larceny under § 523(a)(4). Id.

DEBTOR'S COUNTERCLAIMS

Because Debtor successfully rescinded the contract, neither party has any rights or duties under it. Recker, 279 N.W.2d at 755. Because the rights and duties under the contract no longer exist, Debtor cannot prevail on his claim for breach of contract. Debtor, after choosing to rescind, was entitled to restitution for the work he performed on the Tahoe. Debtor achieved this restitution when he sold parts in his possession and kept the proceeds to cover the cost of his labor.

Debtor also seeks attorney's fees and costs pursuant to 11 U.S.C. § 105(a), which authorizes the Court to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title." As a general rule, attorney's fees are not awarded in bankruptcy unless a specific provision of the Code so allows. In re Ryan's Subs, Inc., 165 B.R. 465, 467 (Bankr. W.D. Mo. 1994) (considering request for fees under §365(b)(1)(B)). In the absence of a Code provision allowing fees and costs, a party cannot rely on contract provisions allowing attorney fees in these situations. In re Fobian, 951 f.2d 1149, 1153 (9th Cir. 1991).

Debtor provides no evidence or argument that favors granting attorney's fees in this proceeding. Debtor has not suggested any provision of the Code that might be carried out by an award of fees. Debtor's request for attorney fees is denied.

SUMMARY AND CONCLUSION

The parties contracted to purchase, repair, and resell a wrecked Chevy Tahoe. Their agreement was founded upon two basic assumptions evidenced in the contract: (1) that Plaintiff would provide cash for necessary repair parts; and (2) that Debtor would perform repairs at no cost. Plaintiff materially breached the contract when it refused to provide cash for necessary parts. Debtor elected to rescind the contract rather than perform. Both parties were then entitled to restitution for their contributions to the project. Debtor took restitution by selling some of the parts in his possession and keeping the proceeds. Plaintiff took restitution when it repossessed the vehicle and the remaining parts.

Rescission of the contract rendered it null and void. The parties' claims in this proceeding are based on a contract that no longer exists. Neither party is entitled to the relief requested.

Debtor is not entitled to an award of attorney's fees and costs due to a lack of evidence supporting the claim.

WHEREFORE, Plaintiff materially breached the parties' contract, thereby justifying rescission by Debtor.

FURTHER, Debtor successfully rescinded the contract and both parties have made restitution.

FURTHER, Both parties' claims in this adversary proceeding are based on a contract that no longer exists and are DENIED.

FURTHER, Debtor's claim for attorney's fees and costs relative to this proceeding is DENIED.

SO ORDERED this 10th day of April, 2000.

Paul J. Kilburg
Chief Bankruptcy Judge