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UNITED STATES BANKRUPTCY COURT

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NORTHERN DISTRICT OF CALIFORNIA

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In re

Case No. 96-59506-ASW

11

Kenneth Lee Mickens,

Chapter 7

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Debtor

U-Save Auto Rental of America,

Adversary No. 99-5250

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Plaintiff,

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vs.

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Kenneth Lee Mickens and

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Yvette Mickens,

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Defendants.

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In re

Case No. 99-53743-ASW

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Yvette Mickens,

Chapter 7

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Debtor

U-Save Auto Rental of America,

Adversary No. 99-5249

21

Plaintiff,

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vs.

23

Kenneth Lee Mickens and

24

Yvette Mickens,

25

Defendants.

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MEMORANDUM DECISION
DETERMINING DEBT TO BE
NON-DISCHARGEABLE

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Before the Court are identical amended complaints by U-Save

1 Auto Rental of America ("Creditor") against Kenneth Lee Mickens
2 ("Kenneth") and Yvette Mickens ("Yvette"). Kenneth and Yvette
3 are married to each other and are, respectively, the debtors in
4 the above-numbered Chapter 7¹ cases (collectively, "Debtors").

5 Creditor's amended complaints allege that the Debtors are
6 indebted to Creditor, and seek a determination that such debt is
7 excepted from the Debtors' Chapter 7 discharges pursuant to
8 §523(a)(6) as arising from willful and malicious damage to
9 property, and/or pursuant to §523(a)(4) as arising from
10 embezzlement or larceny.

11 The amended complaints were tried together and the matters
12 have been submitted for decision after post-trial briefing.
13 Creditor is represented by Sharon L. Kinsey, Esq. and the
14 Debtors are represented by Stanley A. Zlotoff, Esq. The Debtors
15 did not appear at trial and called no witnesses, but excerpts of
16 their deposition testimony were submitted by both parties --
17 Creditor also submitted Kenneth's responses to discovery, and
18 the Debtors also submitted a declaration by Kenneth that was
19 filed on November 16, 2001 ("Declaration") in support of a
20 motion for partial summary judgment. Creditor called the
21 following witnesses at trial:

22 Thomas Sinnott ("Sinnott"), who participated with the
23 Debtors in a business known as Automart U.S.A. LLC ("Automart").

24 Maria Flemate ("Flemate"), who participated with the
25 Debtors in various business activities.

26 ¹ Unless otherwise noted, all statutory references are to
27 Title 11, United States Code ("Bankruptcy Code"), as applicable
28 to cases commenced on December 10, 1996 when Kenneth filed his
Chapter 7 petition, and on May 27, 1999 when Yvette filed her
Chapter 7 petition.

1 Edward Pearson ("Pearson"), Creditor's Fleet Director.

2 James Kevern ("Kevern"), who was hired by Creditor to
3 locate vehicles that Creditor had leased to Automart.

4 Sylvia Hernandez ("Hernandez"), an investigator for the
5 California Department of Motor Vehicles ("DMV").

6 This Memorandum Decision constitutes the Court's findings of
7 fact and conclusions of law, pursuant to Rule 7052 of the
8 Federal Rules of Bankruptcy Procedure.

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I.

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FACTS

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It is undisputed that the Debtors, Sinnott, and Sinnott's then-wife Dori Sinnott ("Dori") formed Automart in March 1997 as a limited liability company, with each member holding an equal share of the company. Sinnott testified that Automart's business operation initially consisted of selling used vehicles, but he expanded it five months later to include a vehicle rental franchise with Creditor. Pearson testified that Creditor considered the franchisee to be Automart, with Sinnott "kind of like a managing general partner for the legal owner of the franchise", and with the franchisee's obligations to Creditor guaranteed by each member of Automart.²

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According to Sinnott, he and Kenneth met with Creditor's representative and "went over the entire program" for the franchise. He said that the representative told them that Automart could lease vehicles from Creditor only for use in

² The record does not include a copy of the franchise agreement, but the Debtors have not disputed Pearson's testimony concerning it.

1 renting them to Automart's customers -- at the end of a lease
2 term, Automart would have the option of returning a vehicle to
3 Creditor or selling it to an Automart customer and paying
4 Creditor for it. Pearson's testimony confirmed that those were
5 the terms of the franchise agreement, with the franchisee being
6 required to pay Creditor the "book value" of any vehicle that
7 was not returned to Creditor.³ Kenneth testified at his
8 deposition that he understood, both from the meeting with
9 Creditor's representative and from Sinnott's report of training
10 given by Creditor, that Automart had the right to sell the
11 vehicles provided by Creditor, but he knew that Creditor held
12 title and so "of course" must be paid for the vehicles. Sinnott
13 testified that Automart sold only one of Creditor's vehicles
14 while he was with the business -- he said that a renter wanted
15 to buy the car and Pearson "made an exception" and authorized
16 Sinnott to sell it, but Sinnott did not know whether any of the
17 proceeds were turned over to Creditor because "once I told
18 [Kenneth] we'd sold it, I had nothing more to do with it".

19 Sinnott testified that he had eighteen years' experience in
20 the automobile industry, but none with rentals. He said that he
21 and Yvette attended a week-long training seminar conducted by
22 Creditor in Baltimore, where the "whole [Creditor] program" was
23 again explained, including the use and disposition of vehicles.
24 According to Sinnott, Kenneth arranged for Yvette to take over
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26 ³ The term "book value" refers to a contractually fixed
27 amount (reflecting depreciation that occurs during the lease
28 term) that Creditor agrees to accept in lieu of a vehicle being
returned at the end of its lease term. The evidence did not
suggest that "book value" was or was not intended to reflect the
actual market value of any given vehicle.

1 from Dori as business manager of both the rental and sales parts
2 of Automart, to "make sure the books were up to date, handle all
3 the money, be sure the taxes and DMV fees were sent out
4 properly", etc. He said that Kenneth "really didn't
5 participate" in the rental business while Sinnott was with
6 Automart and Sinnott did "99%" of that work, although Yvette
7 kept the books and handled the funds. Kenneth testified at his
8 deposition that Automart "delegated responsibilities out" and
9 Sinnott "was the one that was over the [Creditor] program".
10 Sinnott testified that he met with representatives of Creditor
11 weekly in person or by telephone, and never refused to talk to
12 Creditor's representatives -- Kenneth testified at his
13 deposition that he recalled one time when Sinnott did refuse to
14 talk to a representative of Creditor who visited Automart for
15 the purpose of meeting with Sinnott.

16 Sinnott testified that he left Automart in February 1998
17 because he had "seen some different philosophies of how to run a
18 business and thought it would be best" to leave. He said that,
19 though the members held regular meetings at first, he "couldn't
20 get the answers I wanted" about Automart's finances and had
21 asked to see financial statements ten or twelve times, but the
22 records were "never there, always at home". Kenneth testified
23 in his deposition that Sinnott "left and ran", and "just left us
24 holding the bag. And I picked up the responsibilities and went
25 and paid people off the best that I could. I paid the auction
26 off \$60,000, \$70,000, that he caused a problem with. And the
27 same thing with [Creditor]. We struggled". Kenneth testified
28 at his deposition that the Debtors did not receive salaries from

1 Automart and "the only income we took was to pay our mortgage"
2 of approximately \$3,700 per month.

3 Sinnott testified that, while he was with Automart, the
4 company purchased a house in Oakland because Kenneth "thought it
5 would be a good investment" to remodel and sell it "to put money
6 back into the business". According to Sinnott, Kenneth wrote
7 checks from the Automart account to purchase the house but "the
8 majority" of the remodeling expense was charged to Sinnott's
9 credit card. He said that he did the remodeling work with help
10 from an Automart employee over a five week period and it was
11 "probably 90% finished" when he left Automart; it needed only
12 carpet installation at a cost of \$700 or \$800 and he was told
13 that Kenneth intended to complete the work. Sinnott
14 acknowledged that title to the property was held by both
15 Automart and himself, but said that he did not remember why his
16 name was on title; he later filed bankruptcy and scheduled the
17 property as an asset of Automart, but it was sold in his
18 bankruptcy case. Sinnott stated that he did not know what the
19 property was worth at any point and did not know what it was
20 sold for -- he said that he was originally told that the
21 property was unencumbered but later learned that there was a
22 mortgage. Kenneth stated in his Declaration that the property
23 was "purchased cheap as a fixer-upper" and was intended to be an
24 investment for Automart. He said that Automart's funds were
25 used for the remodeling work but Sinnott "refused to release
26 himself from the title" so that Automart could sell the
27 property, and the court handling Sinnott's bankruptcy case ruled
28 that the property belonged to Sinnott's bankruptcy estate.

1 Kenneth testified at his deposition that the property was
2 purchased for \$42,000, was remodeled by himself and Sinnott, and
3 was then worth \$100,000 with a mortgage of \$19,000. He said
4 that "what we were going to do was sell it and pay off some of
5 our bills and get our bills paid off", "the whole purpose of the
6 home was to pay off all of the bills" -- but Sinnott "made
7 promises and he made promises, and he refused to sign off on the
8 title, on the deed. If he would have signed off on the deed, we
9 wouldn't be sitting here right now because the bills would have
10 been paid".

11 Pearson testified that he learned in late March 1998 that
12 Automart was delinquent in its lease payments to Creditor, but
13 the Comptroller's department decided to defer collection
14 attempts. In August 1998, payments remained in arrears and
15 Pearson found that Automart's telephone was not being answered.
16 He sent a representative to visit the lot, who reported there
17 were no vehicles or people there. Pearson then terminated the
18 franchise and the parties agree that thirteen vehicles owned by
19 Creditor were unaccounted for by Automart at that time. As
20 noted below, Creditor recovered four of those from an auction
21 facility and then sold them for amounts less than their book
22 value, Creditor recovered more than the book value of one from a
23 third party, and Automart sold five without remitting any of the
24 proceeds to Creditor. It is undisputed that Creditor recovered
25 all or part of the other three vehicles' book value: one was
26 turned over by Sinnott and sold by Creditor for \$1,793 more than
27 its book value; one was sold by Automart and Creditor received
28 \$7,484 less than its book value from a third party; Creditor

1 located one at a painting facility and sold it for \$7,509 less
2 than its book value.

3 Hernandez testified that she had been an investigator with
4 the DMV for seven years and had been employed by the State of
5 California since 1981 in other positions where she performed
6 inspections and investigations. She said that, in July 1998,
7 the DMV received "a number" of complaints about Automart from
8 customers who had purchased vehicles without receiving
9 registration or title documents. Hernandez met with Kenneth on
10 July 6 about the complaints and he "assured" her that he would
11 complete the paperwork necessary to transfer registration and
12 title "within a reasonable period". At that meeting, Hernandez
13 asked Kenneth about Automart's financial condition and he said
14 "there was an issue of some refunds" owed to customers for
15 overcharges of registration and license fees, but he was
16 refinancing his home and would use some of those proceeds to pay
17 those refunds -- he also told her that Automart would cure sales
18 tax arrears by the next month, and was "current and sound" with
19 payments to auto auctions. At a further meeting on July 29,
20 Kenneth told Hernandez that he had applied for a new DMV dealer
21 license for a Nevada corporation formed June 6 under the name
22 Competitive Advantage Force-1, which would do business under the
23 name East Bay Auto Mart using Kenneth's home address in San
24 Jose, with Yvette as Chief Financial Officer and Kenneth as
25 General Manager. Hernandez said that she asked Kenneth if he
26 would be leaving California and he replied that he would not,
27 and would "assure that all vehicle transfers would be processed
28 accordingly". Hernandez then received a letter from Kenneth

1 dated July 31, stating that Automart had ceased doing business
2 and enclosing the DMV dealer license. Hernandez sent Kenneth a
3 demand for turnover of all dealer supplies, including the
4 "vehicle report of sale books" that DMV required dealers to
5 maintain; that material was not immediately forthcoming, but was
6 eventually turned in to the DMV. On August 19, Hernandez told
7 Kenneth that she had recently received a complaint from Creditor
8 about Automart's failure to account for thirteen vehicles, and
9 asked whether he had sold those. According to Hernandez,
10 Kenneth replied that he was permitted to sell them after 120
11 days, he did not have title to them, and he had "made the
12 payoffs last week" by sending Creditor two checks; he said that
13 he had not sold the vehicles to customers and five or six of
14 them were at Bay Cities Auction ("Bay Cities") where he "was
15 running them through the auction". Hernandez testified that
16 Automart's records showed six of those vehicles to have been
17 sold to customers, some of whom had filed complaints with the
18 DMV and three of whom identified a photograph of Kenneth as the
19 Automart General Manager or owner with whom they had dealt; none
20 of the buyers reported having dealt with anyone else .
21 Hernandez said that the sale transactions were all the same
22 except for a sale to Wallace Haynes ("Haynes"); that sale was
23 the only one that Automart purported to have financed and Haynes
24 received a letter dated September 22, 1998 signed by Yvette,
25 which directed him to make his monthly payments of \$318.72 to
26 Automart's post office box in California. Hernandez testified
27 that her investigation showed that Automart owed approximately
28 \$40,000 in sales taxes and its seller's permit was eventually

1 revoked: returns signed by Dori had been filed for April 1997
2 through August 1997 with payments enclosed; returns were filed
3 for September 1997 through November 1997 without payments;
4 returns signed by Yvette were filed in February 1998 and March
5 1998 without payments; a payment of \$2,300 was received on July
6 31, 1998 and applied to the taxes owed for February. Hernandez
7 also testified that she learned through her investigation that
8 Kenneth had filed a petition under the Bankruptcy Code in
9 December 1996, which he did not disclose on his application for
10 a DMV dealer license. Hernandez completed her investigation and
11 prepared a report of it dated December 21, 1999, which she
12 submitted with a recommendation to the District Attorney that
13 Kenneth be charged with theft and perjury. She testified that
14 no criminal charges were brought and the only administrative
15 action taken by the DMV was revocation of Automart's dealer
16 license. Hernandez' report lists six instances where Automart
17 sold vehicles owned by Creditor without paying Creditor (and
18 without submitting title or registration information to the
19 DMV): to Butler on November 8, 1997 for \$13,539; to Moncrease
20 on December 13, 1997 for \$14,099.04; to Dinkins on June 6, 1998
21 for \$12,142.04;⁴ to Brooks on June 10, 1998 for \$12,485.62; to
22 Haynes on June 17, 1998 for \$7,599.53; to Coelho on July 31,
23 1998 for \$12,963.79. Kenneth admitted in his Declaration that
24 Automart made those sales and deposited the proceeds into
25 Automart's general operating account, though the Debtors offered
26 no corroborating evidence, nor explain a reason for it being

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28 ⁴ Creditor eventually recovered from a third party an amount exceeding the book value of the vehicle sold to Dinkins.

1 unavailable. He said that the proceeds were not remitted to
2 Creditor because Automart was "operating at a deficit" but the
3 Debtors believed at the time of the sales that "they would be
4 able to generate income thereafter in sufficient amounts to
5 repay" Creditor. It is undisputed that the book values of the
6 five vehicles for which Creditor received nothing (excluding
7 that sold to Dinkins) totaled \$37,355.

8 Kenneth testified at his deposition that, when Automart
9 closed down, "Whatever we had that was on the lot, we took to"
10 an auto auction facility and "when I delivered them, I don't
11 remember which vehicle it was, there was a repo guy there, and I
12 had the keys and he kept on going. ... We never received any
13 proceeds. We can't. Once we dropped the vehicles off and we
14 walked away". Kenneth said that he did not tell Creditor he was
15 taking the vehicles to the auction facility but did tell Sinnott
16 "that the vehicles were to be dropped off there. And then -- I
17 don't remember, some guy, and I don't remember the guy, but we
18 had to give the keys to him and that was it. ... There was a
19 guy that was there. We didn't take the cars into the auction.
20 We didn't take the cars to the auction -- I mean, inside the
21 auction. They were in the parking lot of the auction, and the
22 keys were handed off to a representative from [Creditor]."

23 Kenneth stated that he did not take the vehicles to the auction
24 for the purpose of selling them and they were merely "dropped
25 off in the parking lot of the auction, and your repo guy, or
26 whoever the guy is, the representative of [Creditor], was there
27 and picked the vehicles up. Whatever he did after that, I don't
28 know". Hernandez testified that it is possible to sell a

1 vehicle through an auto auction without having title, if the
2 auction has received an application from a dealer or licensee
3 who is deemed creditworthy and is willing to accept the vehicle
4 without title documents; however, her investigation did not find
5 any such applications from Automart for sale of the vehicles
6 owned by Creditor.

7 Kevern testified that Creditor hired his firm on August 19,
8 1998 to locate and recover vehicles that had been leased to
9 Automart. He said that he visited Automart's lot and was told
10 by some men who were "hanging out there" that they had seen
11 "somebody removing cars" and gave Kevern a "tip to go look at"
12 Bay Cities. Kevern found some⁵ of Creditor's vehicles in the
13 parking lot at Bay Cities, reported to Creditor, and was told to
14 take them into the auction for storage. Kevern said that he was
15 preparing to tow the vehicles out of the parking lot when a man
16 who identified himself as Kenneth "came running out" of the
17 auction, was "very upset", said that he owned the vehicles, and
18 told Kevern that he was picking them up to take "someplace" but
19 did not say where. When Kevern explained that he was
20 repossessing the vehicles for Creditor, Kenneth "got a little
21 nervous and jumped in his car and left". Kevern then made a key
22 for each vehicle and prepared a "condition report" for Creditor
23 -- it is undisputed that the four vehicles repossessed by Kevern
24 were ultimately sold by Creditor at auction for prices totaling
25 \$4,237 less than their book values. According to Kevern,
26 vehicles that are to be sold by being "run through the auction"

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28 ⁵ Kevern said that the number was seven or eight, but the
parties agree that it was four.

1 are "checked into the auction" and then labeled with a number
2 and a letter -- he said that the ones he found in the parking
3 lot bore such labels, which meant that they had been checked in
4 for sale but removed to the parking lot by a manager. Kevern
5 stated that "apparently there was a reason the auction couldn't
6 sell them, the auction wouldn't have taken them out of the
7 auction and put them back in the parking lot after they'd
8 already been checked into the auction", and he believed the
9 reason to be that title was held by Creditor. Kevern explained
10 that the parking lot where he found the subject vehicles was
11 distinct from storage lots that are provided by Bay Cities, and
12 vehicles checked in for storage are labeled differently from
13 those intended for sale; the subject vehicles were labeled for
14 sale rather than for storage.

15 Flemate testified that she had known Kenneth since 1995 and
16 "gave" him some \$40,000 or \$50,000 with which to purchase
17 vehicles for Automart, under a written agreement whereby she was
18 to receive \$1,300 for each vehicle sold. She believed that
19 Automart did purchase and sell vehicles pursuant to that
20 agreement, but she collected only \$1,300 because Kenneth "was
21 having financial problems with the dealership and wasn't able to
22 pay me back". She said that one Automart check to her for
23 \$12,000 labeled "investment" was actually repayment of a loan
24 that she had made prior to the written agreement, and denied
25 that various Automart checks made payable to "cash" represented
26 payments to her. Flemate testified that a corporation known as

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1 CAF-1⁶ commenced doing business in Nevada under the name Pahrump
2 Auto Center ("PAC") in December 1998, with Yvette and Flemate as
3 officers. Flemate provided the funds to start the business and
4 was to share in profits as an offset for her unpaid loans to
5 Automart, with Yvette receiving 60% of profits -- Kenneth did "a
6 lot of legwork" to start the business but invested no money in
7 it and was not to share in profits (although he was to receive a
8 salary as General Manager). She said that she believed PAC
9 received some vehicles from Automart, but none with title held
10 by Creditor. Flemate also commenced operating a Practical Rent-
11 a-Car ("Practical") franchise in Nevada during November 1998,
12 which "fell under the corporation [CAF-1] after awhile".
13 Flemate testified that she and Yvette handled receipt of
14 payments at PAC and that she was not aware of PAC receiving
15 funds belonging to Automart, although she acknowledged that
16 three checks made payable to Automart by Haynes were deposited
17 at Nevada banks where PAC held accounts. According to Flemate,
18 PAC never made a profit (or even enough to pay salaries), CAF-1
19 filed a Chapter 11 petition in October 1999, and PAC "lost our
20 license" and was "ordered to close our doors" in late November
21

22 ⁶ Flemate described Competitive Advantage Force-1 as "the
23 business in California, Automart" and CAF-1 as "the one that was
24 specific to Pahrump, with no connection between the two
25 entities. Kenneth stated in his Declaration that the former was
26 a Nevada corporation that "bore a relationship to Automart" and
27 the latter was a Delaware corporation that "was affiliated with
28 the Nevada businesses", and "[t]he reason for the use of the
Competitive Advantage Force-1 entity with respect to Automart,
U.S.A. was that, toward the end of its existence, Automart owed
tax debt and was being subjected to tax levies on bank accounts.
The use of a bank account under Competitive Advantage Force-1
for purposes of transacting Automart business was simply a way
to avoid the interruption of business entailed by tax levies".

1 1999. As for Practical, Flemate testified that she stopped
2 operating the business in early 1999 after Creditor acquired the
3 franchise and failed to provide training that Flemate had
4 expected to receive. She said that Practical was permitted to
5 sell vehicles and pay Creditor upon sale, which was done for all
6 sales. Flemate stated that Practical was in possession of some
7 thirty vehicles when it ceased operations, some of which were
8 returned or sold, and some of which were in the hands of long
9 term lessees -- when she left, eight vehicles were unaccounted
10 for and Debtors "had all of the paperwork and everything".

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12 II.

13 ANALYSIS

14
15 A. Standards For Determination of Dischargeability

16 The Bankruptcy Code is "designed to afford debtors a fresh
17 start, and we interpret liberally its provisions favoring
18 debtors", see In re Bugna, 33 F.3d 1054, 1059 (9th Cir. 1994).
19 The Code's limited exceptions to the general policy of discharge
20 are found in §523(a) and are to be construed narrowly, see In re
21 Riso, 978 F.2d 1151 (9th Cir. 1992). The plaintiff in an action
22 for determination of dischargeability under §523(a) bears the
23 burden of proving all elements of the claims for relief asserted
24 by a preponderance of the evidence, see Grogan v. Garner, 498
25 U.S. 279, 111 S.Ct. 654 (1991).

26
27 B. Exceptions To Discharge

28 Creditor seeks a determination that its claim against

1 Debtors is non-dischargeable pursuant to either or both of two
2 exceptions to discharge that are provided by §523(a):
3 §523(a)(6), regarding willful and malicious damage to property;
4 and/or §523(a)(4), regarding embezzlement or larceny. Creditor
5 alleges that sale of its vehicles without turnover of any
6 proceeds to Creditor constituted one or more of those torts.

7 As a threshold matter, it must be noted that, according to
8 the testimony of Creditor's employee Pearson, Creditor's
9 franchisee was Automart, not the Debtors. Therefore, it was
10 Automart that was contractually bound to pay Creditor the book
11 value of the subject vehicles if they were sold. The Debtors
12 guaranteed the debts of Automart under the franchise agreement
13 with Creditor, so they are contractually liable for any such
14 debts that Automart did not pay
15 -- but such liability would merely constitute a dischargeable
16 breach of contract unless an act under §523(a)(6) or (4) was
17 performed by one or both of the Debtors.

18 With respect to the sales, Hernandez testified that three of
19 the subject vehicles were sold to buyers who identified Kenneth
20 as the Automart representative with whom they dealt, and that
21 none of the buyers reported dealing with anyone else. Sinnott
22 testified that he did "99%" of the rental work and Kenneth
23 "really didn't participate" in that, which is consistent with
24 Kenneth's deposition testimony that Automart "delegated
25 responsibilities out" and Sinnott "was the one that was over the
26 [Creditor] program". However, it is undisputed that Sinnott
27 left Automart in February 1998, and only two of the subject
28 sales occurred prior to that time (in November and December

1 1997, respectively, to Butler and Moncrease); and Sinnott
2 testified that he was aware of only one sale while he was with
3 the business. There is no indication that Sinnott was
4 responsible for anything that occurred after he left the
5 business, and none of Hernandez' witnesses reported dealing with
6 anyone other than Kenneth when they bought vehicles from
7 Automart. Accordingly, the evidence supports a finding that
8 Kenneth is the one who acted on behalf of Automart to make the
9 sales.

10 Insofar as failing to remit any of the sale proceeds to
11 Creditor is concerned, Sinnott testified without contradiction
12 that he did not handle the proceeds from the one sale that he
13 knew about and that Yvette handled Automart's funds and
14 bookkeeping, so the evidence does not show that Sinnott
15 participated in the disposition of sale proceeds either before
16 or after he left the business. Kenneth admitted that all of the
17 subject sale proceeds were deposited into Automart's operating
18 account, and he did not allocate responsibility for that
19 decision as between himself and Yvette -- even if Yvette did not
20 participate in making that decision, she was the bookkeeper and
21 so must have known of the sale proceeds, and known that they
22 were not remitted to Creditor. Therefore, the evidence supports
23 a finding that the Debtors were both responsible for failing to
24 turn over any of the sale proceeds to Creditor.

25 Accordingly, if the sales and failure to remit proceeds
26 constituted acts within the meaning of §523(a)(6) or (4), the
27 evidence shows that Kenneth made the sales and that both Debtors
28 failed to remit any proceeds to Creditor.

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(1) §523(a)(6)

A debt arising from willful, malicious damage to the property of another is excepted from discharge pursuant to §523(a)(6). The elements of a claim under §523(a)(6) have been established by In re Jercich, 238 F.3d 1202, 1208-09 (9th Cir. 2001) ("Jercich"):

We hold, consistent with the approaches taken by the Fifth and Sixth Circuits, that under [Kawaauhau, et vir., v. Geiger, 523 U.S. 57, 118 S.Ct. 974 (1998)], the willful injury requirement of § 523 (a)(6) is met when it is shown either that the debtor had a subjective motive to inflict the injury or that the debtor believed that injury was substantially certain to occur as a result of his conduct. ... A malicious injury involves (1) a wrongful act, (2) done intentionally, (3) which necessarily causes injury, and (4) is done without just cause or excuse. [internal quotation marks and citation omitted]

The Ninth Circuit noted in In re Su, 290 F.3d 1140, 1148 (9th Cir. 2002) ("Su") that willfulness and malice are two separate requirements that are not to be "conflated" into a single inquiry, and made it clear that each alternative prong of the willfulness showing must be based on a subjective standard:

The subjective standard correctly focuses on the debtor's state of mind and precludes application of § 523(a)(6)'s nondischargeability provision short of the debtor's actual knowledge that harm to the creditor was substantially certain.

Su, at 1146.

(a) Sales

With respect to selling Creditor's vehicles, Pearson testified that Automart had the option of selling vehicles at the end of their lease terms, and the evidence does not clearly

1 establish whether any of the subject sales occurred prior to
2 those times. If sales were made at a time when Automart had no
3 contractual right to sell, such sales would constitute
4 conversion under California law, see In re Peklar, 260 F.3d
5 1035, 1037 (9th Cir. 2001) ("Peklar"):

6 Conversion is defined under California state law
7 as "the wrongful exercise of dominion over the
8 personal property of another." Taylor v. Forte
9 Hotels Int'l, 235 Cal.App.3d 1119, 1124, 1 Cal.
10 Rptr.2d 189 (1991). "The act must be knowingly
11 or intentionally done, but a wrongful intent is
12 not necessary." Id. (citing Poggi v. Scott, 167
13 Cal. 372, 375, 139 P. 815 (1914); 5 Witkin Summary
14 of Cal. Law (9th ed. 1988) Torts § 624, pp. 717- 18).
15 Under California law, "a conversion is not per se
16 always a willful and malicious injury to the prop-
17 erty of another." Larsen v. Beekmann, 276 Cal.App.2d
18 185, 189, 80 Cal.Rptr. 654 (1969).

19 Assuming for the sake of argument that the sales were made
20 too early and therefore did constitute conversion, the issue is
21 not whether Automart was actually entitled to sell any given
22 vehicle at the time it was sold, but whether Kenneth reasonably
23 believed that Automart had such a right, see, Davis v. Aetna
24 Acceptance Co., 293 U.S. 328, 332-3, 55 S.Ct. 151, 153 (1934)
25 ("Davis"):

26 [A] wilful and malicious injury does not follow
27 as of course from every act of conversion,
28 without reference to the circumstances. There
may be a conversion which is innocent or
technical, an unauthorized assumption of
dominion without wilfulness or malice. There
may be an honest, but mistaken belief,
engendered by a course of dealing, that powers
have been enlarged or incapacities removed. In
these and like cases, what is done is a tort,
but not a wilful and malicious one.... The
discharge will prevail as against a showing of
conversion without aggravated features.

27 Kenneth's uncontradicted testimony was that he believed Automart
28 had a right to sell Creditor's vehicles, based on what he was

1 told by Creditor's representative and also on Sinnott's report
2 of training received from Creditor. That is consistent with
3 Hernandez' testimony that Kenneth told her the vehicles could be
4 sold "after 120 days". Sinnott testified that Pearson "made an
5 exception" and authorized Automart to sell one vehicle during
6 Sinnott's tenure, which suggests that the sale occurred prior to
7 expiration of the lease term but Creditor was willing to permit
8 it. The evidence supports a finding that Kenneth reasonably
9 believed that Automart was contractually entitled to make the
10 subject sales. Under Davis, the sales were not willful and
11 malicious acts within the meaning of §523(a)(6) even if any of
12 them did constitute conversion due to being made prior to the
13 time permitted by Automart's franchise agreement with Creditor.

14
15 (b) Failure To Turn Over Proceeds

16 As for the failure to remit any sale proceeds to Creditor,
17 the exception of Davis does not apply. Kenneth's testimony was
18 that he knew Creditor owned the vehicles and "of course" must be
19 paid if they were sold, and there is no evidence that Yvette had
20 any reason to believe otherwise.

21 The Debtors' failure to turn over any of the sale proceeds
22 to Creditor was clearly a conversion as defined by Peklar, and
23 the issue is whether that act was performed with the subjective
24 intent required by Jercich and Su to make it a willful and
25 malicious one within the meaning of §523(a)(6). In this case,
26 the crucial element of that test is whether the Debtors had
27 "actual knowledge" that harm to Creditor was "substantially
28 certain to occur as a result of [their] conduct". Debtors argue

1 that this was not the case, because Creditor's vehicles were
2 sold in the ordinary course of Automart's business and they were
3 hoping to make the business solvent (perhaps by selling the
4 Oakland investment property)⁷ so that Creditor could be paid.
5 Kenneth's testimony on the subject was that the sale proceeds
6 were deposited into Automart's operating account and never
7 turned over to Creditor because the business was "operating at a
8 deficit", but that Debtors believed when the sales were made
9 that "they would be able to generate income thereafter in
10 sufficient amounts to repay" Creditor. That testimony is not
11 corroborated by other evidence, and it is not credible in light
12 of the evidence as a whole.⁸

13 First, on the issue of the Debtors' credibility in general,
14 the Court notes that they chose not to appear at trial, which
15 tends to support a negative inference that they may have sought
16 to avoid cross-examination under oath -- since Hernandez' report
17 did not result in criminal charges against them, their
18 reluctance to testify in person does not seem to be based on the
19 constitutional protection against self-incrimination, and
20 Debtors did not offer any excuse for their failure to appear.
21 The Court also notes that Kenneth admitted that Automart used a
22 bank account in the name of Competitive Advantage Force-1 in
23 order to "avoid the interruption of business entailed by tax
24

25 ⁷ Sinnott testified that Automart purchased the Oakland
26 property while he was there, that he left in February 1998, and
27 that the property was administered in his bankruptcy estate, but
28 the evidence does not show when that occurred. The Court notes
that most of Creditors' vehicles were sold in June 1998.

⁸

1 levies", a ploy that might be considered equivalent to
2 defrauding creditors. Overall, the Debtors' attitude did not
3 appear to be forthcoming and candid.

4 Second, Kenneth first met with Hernandez about customer
5 complaints on July 6, 1998, then wrote to her on July 31, 1998
6 to surrender Automart's DMV dealer license and announce that the
7 business had closed. The sale to Coelho was made on the date of
8 that letter, and four other sales were made during the month of
9 June. Hernandez testified that she asked Kenneth on August 19
10 whether he had sold Creditor's thirteen missing vehicles and he
11 told her that he had not but had paid Creditor for them, both of
12 which statements were false.

13 Third, Hernandez said that Kenneth also told her that he
14 planned to sell five or six of the vehicles at Bay Cities, yet
15 his testimony was that he did not take them there to sell but
16 only to deliver to Creditor, and that he gave the keys to a
17 "repo guy". However, Kevern testified that, when he found some
18 of Creditor's vehicles at Bay Cities, Kenneth represented
19 himself as the owner and said that he was picking them up to
20 take away, but became "very upset" and "nervous" when he learned
21 that Kevern wanted to repossess the vehicles for Creditor, and
22 Kevern had to make keys for the vehicles after Kenneth left.
23 Kevern also testified credibly that the vehicles appeared to
24 have been placed for sale at the auction but later removed to
25 the parking lot by a Bay Cities manager because Kenneth did not
26 have title certificates for them.⁹

27 _____
28 ⁹ Kevern testified that he found seven or eight of
Creditors' vehicles at Bay Cities, yet the parties agree that

1 Fourth, there is no evidence that the Debtors communicated
2 with Creditor about intending to pay Creditor the book value of
3 the vehicles that were sold, nor that the Debtors made any
4 efforts to pay. Kenneth testified that "we struggled" to pay
5 Automart's creditors after Sinnott left, but the Debtors offered
6 no evidence in corroboration. Instead, the evidence shows that,
7 less than six months after Automart closed, the Debtors formed a
8 corporation to open two new automobile dealerships in Nevada
9 (although Kenneth told Hernandez on July 29, 1998 that he did
10 not intend to leave California), which did not last a year, lost
11 its license to operate the businesses, and filed bankruptcy.

12 In short, the evidence does not suggest that, when most of
13 the subject sales were made in June 1998, the Debtors had some
14 kind of good faith plan (even an ultimately futile one) to raise
15 funds with which to pay Creditor the amounts that should have
16 been paid upon sale. There was no apparent attempt to keep
17 Automart operating after those sales -- its dealer license was
18 surrendered to the DMV just a month later, on the same day that
19 the last sale was made and only some three weeks before Kenneth
20 attempted to sell still more of Creditor's vehicles at Bay
21 Cities. Since Automart was not going to continue operations,
22 its insolvency should not have prevented the Debtors from
23 remitting the book value portion of the sale proceeds to
24 Creditor and leaving someone else unpaid when the business was

25 _____
26 there were only four. However, that event occurred five years
27 prior to trial and his testimony was credible overall. His
28 explanation about the difference between identification and
location of vehicles placed at Bay Cities for sale vs. for
storage was plausible and was not impeached or discredited.

1 closed a month after making most of the sales. And the Debtors
2 did not offer evidence showing that Automart was paying at least
3 some of its bills in an effort to stay afloat during the time
4 that most of Creditors' vehicles were sold, nor any evidence
5 showing a pattern of prior sales for which Creditor was paid.

6 The evidence includes copies of many checks drawn on the
7 Automart account, which Creditor contends show that the Debtors
8 were improperly using company funds for themselves, including
9 the sale proceeds that should have been turned over to Creditor.
10 However, that evidence is inconclusive, since there was little
11 testimony about the checks and the most that can be discerned
12 from the quasi-legible copies is that many are payable to "cash"
13 and some are for large amounts of several thousand dollars -- as
14 the Debtors point out, the copies do not usually show the
15 purpose of the checks, which could have been for payment or
16 reimbursement of legitimate business expenses.

17 The Court also notes, without relying on it, that Hernandez
18 concluded after her investigation that the Debtors had committed
19 theft and perjury.

20 Taken together, the evidence does not support the Debtors'
21 position that they failed to remit any proceeds to Creditor
22 because Automart was insolvent but they hoped to acquire other
23 funds in future that could be given to Creditor. Rather, it
24 suggests that the Debtors knew they were going to close the
25 business and they were attempting to extract as much money from
26 it as possible, whether to pay selected creditors (perhaps the
27 sales taxes for which they could remain liable despite
28 bankruptcy) or to pay themselves or for some other purpose of

1 their own, but not for the benefit of Creditor whose vehicles
2 had been sold, or even in an attempt to save the struggling
3 business. Since there is no evidence of when the Oakland
4 property was purchased or lost in Sinnot's bankruptcy case, the
5 Debtors have not shown that they were planning to repay Creditor
6 with funds obtained from sale of that property. Accordingly,
7 the Debtors must be charged with "actual knowledge" that harm to
8 Creditor was "substantially certain to occur as a result of
9 [their] conduct" in selling Creditors' vehicles without
10 remitting any of the proceeds to Creditor. The Debtors' failure
11 to turn over to Creditor the book value portion of the proceeds
12 from sale of the subject vehicles constitutes non-dischargeable
13 willful and malicious damage to Creditor's property pursuant to
14 §523(a)(6).

15
16 (2) §523(a)(4)

17 A debt arising from embezzlement or larceny is excepted from
18 discharge pursuant to §523(a)(4).

19 The elements of a claim based on embezzlement are:

20 (1) property owned by another is rightfully in the
21 possession of a bankruptcy debtor;

22 (2) the bankruptcy debtor appropriates such property to
23 a use other than the use for which the property was entrusted to
24 the bankruptcy debtor; and

25 (3) circumstances indicating fraud.

26 See, In re Littleton, 942 F.2d 551, 555 (9th Cir. 1991)

27 ("Littleton"); In re Wada, 210 B.R. 572, 576 (9th Cir. BAP

28 1997). To any extent that the vehicle sales were made at times

1 authorized by Automart's franchise agreement with Creditor, the
2 Debtors were rightfully in possession of the sale proceeds.

3 The elements of a claim based on larceny differ from those
4 of a claim based on embezzlement only in that a larcenous
5 bankruptcy debtor has come into possession wrongfully, 4 King,
6 Collier on Bankruptcy (15th ed. rev. 1997), §523.10[2]. To any
7 extent that the vehicle sales were made at times not authorized
8 by Automart's franchise agreement with Creditor, the Debtors
9 were wrongfully in possession of the sale proceeds.

10 The Debtors argue that the third element is not present
11 because there are no circumstances of fraud, since they were
12 merely attempting to salvage a failing business and hoped to pay
13 Creditor in future, citing Littleton. In that case, the
14 bankruptcy debtors were found to have "acted with the intent to
15 benefit the corporation by securing financing so that the
16 company could pay all its debts[,] ... [which] ... negates any
17 contention that the debtors intended to defraud" the creditor,
18 and they "applied their entire effort and resources to make the
19 business survive[,] ... [which] ... was their dominant
20 motivation", Littleton, at 556. As discussed above, the
21 evidence in this case does not even remotely begin to support
22 that description for what these Debtors did and failed to do,
23 whereas it does show that their failure to turn over any sale
24 proceeds to Creditor was marked by circumstances indicating
25 fraud. The Debtors knowingly transferred Creditors' vehicles to
26 third parties and received proceeds in exchange, which they knew
27 they were required to turn over and intentionally did not --
28 unlike the circumstances of Littleton, the Debtors' failure to

1 remit any proceeds to Creditor was not part of a good faith
2 effort to save their business in the hopes of being able to pay
3 Creditor later. Accordingly, such failure constitutes non-
4 dischargeable embezzlement and/or larceny pursuant to
5 §523(a)(4).

6
7 CONCLUSION

8 Automart's franchise agreement with Creditor entitled
9 Creditor to receive either thirteen vehicles or their book
10 value. It is undisputed that Debtors failed to remit the
11 proceeds from selling five of the vehicles with book values
12 totaling \$37,355, and that Creditor recovered (or accepted money
13 for) the other eight vehicles. Creditor proved no damages under
14 §523(a) beyond the \$37,355 total book values of the five
15 vehicles that were sold by Automart.¹⁰ Debtors are liable for
16 that debt of Automart's under their guarantees, and it is
17 excepted from their bankruptcy discharges as one for willful and
18 malicious damage to property pursuant to §523(a)(6), and as one
19 for embezzlement and/or larceny pursuant to §523(a)(4).

20
21
22

23 ¹⁰ Creditor referred in argument and briefs to other
24 damages, such as lease payments and fees called for by the
25 franchise agreement, and Creditor's net receipt of less than
26 book value for some of the vehicles that were recovered. As
27 discussed above, the former arise from dischargeable breach of
28 contract rather than from non-dischargeable conversion,
embezzlement, or larceny. With respect to the latter, the
evidence does not establish the amounts of such losses, nor did
Creditor establish that such losses actually arose from the
Debtors' failure to remit the book value portion of sale
proceeds.

UNITED STATES BANKRUPTCY COURT
For The Northern District Of California

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Counsel for Creditor shall submit a form of judgment so providing, after review by counsel for Debtors.

Dated:

ARTHUR S. WEISSBRODT
UNITED STATES BANKRUPTCY JUDGE