United States Bankruptcy Court
Western District of Wisconsin

Cite as: [Unpublished]

Grain Guard, Inc., and James Foseid, Plaintiffs, v.
David E. and Vincenza B. Walford, Defendants
(In re David E. Walford, Debtor)
Bankruptcy Case No. 91-3146-7, Adv. Case No. 91-3161-7

United States Bankruptcy Court
W.D. Wisconsin

March 16, 1993

Steven A. Brezinski, Axley Brynelson, Madison, WI, for plaintiffs.
Frank A. Ross, Ross & Chatterton, Madison, WI, for defendant.
Jerome M. Ott, Lawton & Cates, S.C., Madison, WI, for Vincenza Walford.

Robert D. Martin, United States Bankruptcy Judge.

MEMORANDUM DECISION

The plaintiffs seek to except certain debts from discharge pursuant to 11 USC § 523(a). This is a core proceeding under 28 USC § 157(b)(2)(I) and this court has jurisdiction over this matter pursuant to 28 USC § 1334.

On April 25, 1991 the debtor David Walford ("Walford"), filed a petition under chapter 7 of the Bankruptcy Code. On July 29, 1991 plaintiffs James Foseid ("Foseid") and Grain Guard, Inc. ("Grain Guard"), filed this adversary proceeding against David and Vincenza Walford[(1)] to determine that certain debts arising from Walford's relations with Foseid and Grain Guard are nondischargeable pursuant to 11 USC §§ 523(a)(2), (4), and (6). The plaintiffs filed their first amended complaint on November 22, 1991. A trial was held on August 4, 1992. Upon the evidence presented, I then made the following findings of facts and conclusions of law.

In 1987, Foseid and Walford organized Grain Guard, a Wisconsin corporation, to market and sell a trap for catching insects to determine the insect infestation of stored grains ("the trap"). Foseid invested $20,000 in Grain Guard and Walford contributed assets and rights to the trap. Each party became a fifty percent shareholder and the sole officers and directors of Grain Guard. According to Grain Guard's initial minutes, the parties agreed that yearly salaries of the officers would be deferred until a later date.[(2)] Foseid and Walford agreed that Walford would be primarily responsible for overseeing the day-to-day operations of Grain Guard and that Foseid would become involved in the daily management in the future. In this proceeding, Foseid objects to Walford's conduct

while managing Grain Guard.

Grain Guard entered into a manufacturing agreement with Superior Machining, Inc. ("Superior Machining") whereby Superior Machining manufactured, assembled, and packaged the trap. Walford was a shareholder of Superior Machining. Evidence presented at trial established that Walford caused Grain Guard to pay money to Superior Machining. Foseid argues that these payments constituted conversion of corporate funds to Superior Machining.

Subsequent to its incorporation, Grain Guard obtained a credit card from State Bank of Cross Plains. Walford used the corporate credit card to pay the expenses incurred attending trade shows and doing sales work to market the trap. Walford also used his personal credit card to pay the expenses of Grain Guard. Grain Guard then reimbursed him for these expenses by repaying him with corporate checks made out in round dollar amounts.

At the trial, evidence was presented that, with respect to certain checks made out to Walford from Grain Guard, check stubs had been torn out of the corporate check register. Plaintiffs' Exhibit 2 evidenced that eleven check stubs were missing from the register. Foseid had obtained copies of the checks corresponding to the torn-out stubs from the State Bank of Cross Plains. The check numbers and amounts for these torn-out checks are:

321	$1000
337	$1000
420	$300
453	$500
454	$600
491	$2000
508	$1000
521	$1000
535	$500
646	$500
728	$500

The checks total $8,900. Walford offered some evidence that he paid some of Grain Guard's expenses and then caused Grain Guard to reimburse him; however, an examination of the exhibits reveals only that his alleged payment amounts do not correspond to the alleged reimbursement amounts above. Assessing the amount and the timing of the alleged payments is made difficult by Walford's apparent lack of documentation regarding the original payments and repayment.

In addition to paying corporate expenses, Walford used the corporate credit card and wrote checks on the corporate checking account to purchase personal items. In particular, Walford made several personal purchases at different hobby stores on the corporate credit card and checking account. The only evidence of repayment is Walford's testimony that he reimbursed Grain Guard in full. Foseid argues that, through the use of the corporate credit card and checking account, Walford converted corporate funds for his personal use. According to Foseid these payments constituted

embezzlement under § 523(a)(4) and are nondischargeable under §§ 523(a)(4) and (6). Moreover, Foseid asserts that Walford breached his fiduciary duty to Grain Guard in violation of § 523(a)(4).

Walford set his salary and periodically withdrew monies from Grain Guard's bank account as salary. Walford never informed Foseid that he was taking this salary. Foseid argues that Walford withdrew corporate funds to pay himself a salary to which he was not entitled under the corporation agreement.

In February, 1988 Grain Guard executed a promissory note to the State Bank of Cross Plains in the principal amount of $30,000.00. Both Foseid and Walford signed a personal guaranty of the note. Conflicting testimony was presented at trial regarding the purpose of this loan. According to Foseid, Walford falsely represented that the money was needed as working capital to fulfill an order for 17,000 traps, thus inducing Foseid to execute a personal guarantee on the promissory note. Walford testified that the loan was obtained for working capital to process an increasing number of orders in general. Foseid also testified that in 1988 and 1989, Walford falsely represented to him that there was a substantial balance in Grain Guard's bank account. Foseid asserts that Walford's conduct regarding the note and the bank account balance constituted false representations under § 523(a)(2).

With respect to the billings by Superior Machining, the transactions between Grain Guard and Superior Machining, Inc. did not demonstrate any intention on Walford's part to defraud Grain Guard. Although a contract dispute may exist between the parties, the payments to Superior Machining did not constitute embezzlement. With respect to Walford's salary, payment did not raise an inference of theft or embezzlement. The agreement on officer compensation did not encompass discussion of whether an officer could be a paid employee of Grain Guard. Again, whether the salary was appropriately taken involved an issue of contract interpretation. With respect to Foseid's claim of misrepresentation regarding the substantial bank account balance and the 17,000 orders to acquire a loan, there was no proof of a false representation or false pretense made to either Foseid or the bank. The issue was solely an issue of credibility and I found no reason to believe Foseid over Walford. With respect to the claim that Walford breached a fiduciary duty under § 523(a)(4), Foseid failed to prove a fiduciary relationship arising under an express trust or statutory authority as required by the Supreme Court in Davis v. Aetna Acceptance Co., 293 US 328, 55 SCt 151, 79 LEd 393 (1934). Finally, with respect to the personal charges made on the corporate credit card and checking account, those charges did not rise to the level of embezzlement.

I took under advisement the sole issue of whether the torn-out check stubs equalling $8,900 represent an indebtedness which is nondischargeable as embezzlement under § 523(a)(4) or a willful and malicious injury under § 523(a)(6). It is now apparent that to reach that issue I must make a preliminary finding that either Foseid or Grain Guard has standing to bring this adversary proceeding in the first instance. Although the parties did not raise the issue at the hearing and only Foseid has addressed the issue in its filed papers,[(3)] I am satisfied that I can make a determination regarding the plaintiffs' standing without supplemental briefing or hearing.

RIGHT TO BRING A DERIVATIVE PROCEEDING

The plaintiffs in this adversary proceeding are Foseid and Grain Guard, Inc. As alleged in its first amended complaint, Foseid seeks to enforce Grain Guard's rights derivatively. It is apparent from the complaint and papers filed subsequently that Foseid is also asserting private injury for which he seeks personal redress. The filed papers do not clearly state which claims Foseid asserts derivatively and which claims he asserts privately. In my preliminary findings at the conclusion of the trial, I resolved the one issue which Foseid could clearly assert in his own capacity, to wit, the false representations claim under § 523(a)(2) was a claim which Foseid had standing to assert in a personal capacity. Because it is not clear whether the remaining claims of embezzlement or conversion of corporate funds under §§ 523(a)(4) and (6) are brought derivatively or privately, I must examine Foseid's standing the bring these claims derivatively as well as his standing to bring these claims in a personal capacity.

Bankruptcy Rule 7023.1 provides that Rule 23.1 of the Federal Rules of Civil Procedure ("FRCP") applies in adversary proceedings. FRCP 23.1 provides that a shareholder may bring a derivative action to enforce a right which the corporation may properly assert. The alleged embezzlement or conversion of corporate funds gives rise to an enforceable right in Grain Guard.

FRCP 23.1 details certain procedural rules which apply to derivative actions.[(4)] FRCP 23.1 requires that a derivative complaint allege with particularity the efforts made by the plaintiff to obtain the action he desires from the directors and the reasons for his failure to obtain the action or for not making the effort. Foseid argues that he did not demand action by the board of directors because, under the circumstances, demand would have been futile. Because Foseid and Walford each constitute one-half of the board, Foseid did not believe that Walford would consent to action by the Board authorizing the Board to commence an action against him.

The Supreme Court has noted that FRCP 23.1 governs pleading but does not create a demand requirement. Kamen v Kemper Financial Services, Inc., -- US --, 111 SCt 1711, 1716 (1991). Rather, the source of the rules governing the demand requirement depends upon whether the claim for relief is based on federal or state law. Id. at 1717 (federal law governs the demand requirement in a derivative action based on the Investment Company Act of 1940). The claim for relief in this case is based on federal substantive law. However, inasmuch as the demand requirement comes within the purview of corporation law, which is a creature of state law, this court must look to Wisconsin substantive law to determine whether Foseid may bring this action derivatively. See id. at 1717-1719; In re Krause, 114 BR 582 (Bankr ND Ind 1988) (court used Indiana law to determine whether plaintiff had standing to bring a derivative action under § 523(a)).

Wisconsin case law recognizes a stockholder's ability to sue derivatively without making demand upon the corporation where the circumstances indicate that demand would be useless. See, e.g., Donnelly v Sampson, 135 Wis 368, 115 NW 1089 (1908); Whitcomb v Albany Hardware Specialty Mfg. Co., 245 Wis 86, 13 NW2d 516 (1944).[(5)] The Wisconsin Supreme Court in Whitcomb stated:

Whether plaintiff has legal capacity to sue depends upon the familiar principle "that in case of a wrong to a corporation, remediable only by judicial interference, and the persons possessing the primary right as its officers to move in that regard fail upon demand or request being made by a stockholder, or stockholders, to do so, or without such request or demand in case of the circumstances being such as to indicate that the

same would be useless, any one or more of them may on behalf of all sue to protect the corporate rights, making the wrongdoer, or doers, and the corporation parties defendant."

Whitcomb, 245 Wis 86, 88, 13 NW2d 516, 517 (1944) (citing Donnelly v Sampson, 135 Wis 368, 371, 115 NW 1089, (1908)). The court in Donnelly cited Northern Trust Co. v Snyder, 113 Wis 516, 89 NW 460 (1902), in which case the court articulated the test to bring a derivative suit:

it is necessary to show that such persons [the corporate officers] will not perform their duty. That may be done in either of two ways: By showing that they have neglected or refused to proceed after being requested so to do by some person or persons whose requests in that regard should be honored; or by showing, expressly or by necessary inference, that they are so concerned in the wrong to be redressed, and hostile to any vindication or attempt to vindicate the corporate rights, that it is reasonably certain that a request to them to proceed to that end by judicial remedies would be unavailing.

Snyder, 113 Wis at 525.

When formal demand is lacking, a court may exercise its equity jurisdiction to hear the suit. Whether a case falls within the exception to demand is determined on a case-by-case basis. See Donnelly, 135 Wis at 371 ("Whether any case falls within the principle stated or not must be determined by its own peculiar circumstances"). Further, "[t]he trial court has considerable discretion in the matter." Id.

In the present case, Foseid and Walford are the only two shareholders, directors and officers of Grain Guard. Walford is the president of Grain Guard and is solely responsible for overseeing its day-to-day operations. Foseid alleges that Walford embezzled corporate funds from Grain Guard. It appears that demand upon the board of directors which consists of Foseid, the complainant, and Walford, the alleged wrongdoer in this action, would have been useless. Therefore, Foseid may bring this proceeding to enforce Grain Guard's rights derivatively notwithstanding the absence of a demand.

FOSEID'S STANDING

The conclusion that Foseid may bring this suit to enforce Grain Guard's rights derivatively does not answer whether Foseid has standing to bring this proceeding in his individual capacity. The issues that Foseid raises are based upon Walford's conduct vis-à-vis Grain Guard. A cause of action resulting from the conversion or embezzlement of corporate funds accrues to the corporation, not to Foseid personally. See In re Infantolino, 24 BR 667, 671 (Bankr D RI 1982) (court dismissed dischargeability action brought by plaintiff-vice president and secretary of corporation because, inter alia, corporation was not party to the suit).

Under the test articulated in Matter of Cullen, to establish a claim for nondischargeability under § 523(a)(6), Foseid must prove, inter alia, that he was injured and that the injury gave rise to a claim for damages in his favor. See Matter of Cullen, 71 BR 274, 278 (Bankr WD Wis 1987).[(6)] Foseid alleges that Walford embezzled or converted corporate funds. I have previously held that "injury" under § 523(a)(6) includes common law conversion "when undertaken with the requisite intention." In re Chambers, 23 BR 206, 210 (Bankr WD Wis 1982); In re Donny, 19 BR 354, 357 (Bankr

WD Wis 1982). In Wisconsin, conversion has been defined as:

[A]ny distinct act of dominion wrongfully exerted over another's personal property in denial of or inconsistent with his rights therein, such as a tortious taking of another's chattels, or any wrongful exercise or assumption of authority, personally or by procurement, over another's goods, depriving him of the possession, permanently or for an indefinite time.

Heuer v Wiese, 265 Wis 6, 8, 60 NW2d 385 (1953) (quoting Adams v Maxcy, 214 Wis 240, 245, 252 NW 598 (1934)). Money may be the subject of conversion. Regas v Helios, 176 Wis 56, 59, 186 NW 165 (1922); Meyer v Doherty, 133 Wis 398, 404, 113 NW 671 (1907). Although Grain Guard would have a claim for damages under common law conversion, the conversion of corporate funds does not give rise to a claim for damages in Foseid's favor.

To establish a claim for conversion, Foseid must prove that at the time of the alleged conversion, he was entitled to immediate possession of the converted property. Production Credit Assn of Chippewa Falls v Equity Coop Livestock Sales Assn, 82 Wis2d 5, 10, 261 NW2d 127, 129 (1978); Production Credit Assn of Madison v Nowatzki, 90 Wis2d 344, 280 NW2d 118 (1979). The cases addressing conversion typically arise in the context of conversion of chattels. Although money may be the subject of conversion, it is awkward to apply the law of conversion to a fungible good such as money.(7) Essentially, the conversion of money is tantamount to civil embezzlement. Thus, the conversion cases addressing the physical possession of tangible goods or rights to possess goods by operation of security devices are not helpful in determining whether Foseid has an injury giving rise to a claim of damages in his favor. Added to this difficulty is the fact that one of the parties is a corporation. Although a corporation is a separate legal entity, it can only act through its agents. The corporation cannot physically possess money; its agents "possess" its money. On a superficial level, it could be argued that Foseid, as Vice President and Secretary of Grain Guard, has a right to possess Grain Guard's property, including its money. Under this view, Foseid would meet the requirement of possession needed to sustain a conversion action. Yet, Foseid's "right to possession" is really the embodiment of the corporation's right to hold and use corporate funds. Because this claim represents essentially a civil embezzlement claim, Grain Guard, not Foseid, is the party with the alleged injury. It is inapposite to argue that Walford's alleged conversion or embezzlement of corporate funds injured Foseid directly and personally.

The court must also determine whether Foseid has standing to bring this proceeding in his individual capacity under § 523(a)(4). Unlike subsection (6) of § 523(a), the elements of a cause of action under subsection (4) do not explicitly refer to "injury" or "proximate damages." See Matter of Weber, 892 F2d 534, 538 (7th Cir 1989) (to prove embezzlement the plaintiff must show that (1) the debtor appropriated funds for his own benefit; and (2) the debtor did so with fraudulent intent or deceit). Nonetheless, at least one court has found that "a requirement that the creditor prove the damages resulting from the embezzlement is implicit in the embezzlement exception to discharge." In re Salamone, 78 BR 74, 77 (Bankr ED Pa 1987). In Salamone, the court reasoned that common sense dictated such a result. As stated by the court, "it is difficult to imagine a case in which a creditor seeks repayment for an embezzlement without establishing the extent of its damages." Id. at 77. The court noted that if the creditor had not proven that it suffered any injury, "a determination of nondischargeability would be both

meaningless and inappropriate." Id.

Based on the foregoing, Foseid does not have standing to bring this proceeding in his individual capacity under § 523(a)(4). Foseid alleges that Walford embezzled corporate funds. Embezzlement is predicated on the criminal interference with ownership rights. See Wis.Stat. § 943.20(b) (1992). Foseid can claim no injury or right to damages resulting from Walford's alleged embezzlement. Grain Guard alone has any right of recovery in this case.

FOSEID'S STANDING AS A CREDITOR

Foseid, as an officer and director of Grain Guard, does not have standing to bring the conversion and embezzlement claims in his personal capacity. However, if Foseid were a creditor of the corporation, he may have standing to proceed against Walford. In his schedule A-3, Walford lists Foseid as a creditor. The schedule cryptically indicates that the claim involves Grain Guard and is contingent. One can only guess that the entry refers to the personal guarantees executed by Foseid and Walford on Grain Guard's note with the State Bank of Cross Plains.

In Matter of Cullen, this court cited the bankruptcy case of Matter of Penning, 22 BR 616 (Bankr ED Mich 1982), for the proposition that a debtor, by conduct as an officer of a corporation, may incur liability to a creditor of a corporation which is nondischargeable in his individual bankruptcy proceeding. See Matter of Cullen, 71 BR 274, 281 (Bankr WD Wis 1987). In Matter of Penning, the debtor sold the corporation's collateral without accounting for the proceeds of the sale. The bankruptcy court found that:

if an officer or agent of a corporation directs or participates actively in the commission of a tortious act or an act from which a tort necessarily follows or may reasonably be expected to follow, he is personally liable to a third person for injuries proximately resulting therefrom.

. . . The debt so created is nondischargeable in the officer's or director's personal bankruptcy.

Matter of Penning, 22 BR at 619 (citations omitted). Likewise, in Matter of Cullen, the plaintiff-bank brought a § 523(a)(6) action against an individual debtor for converting the bank's proceeds from its collateral belonging to the corporation. The debtor argued that the bank must establish that the debtor individually, not the corporation, owed an underlying debt to the bank. This court rejected that argument, stating:

"[a] corporate agent cannot shield himself from personal liability for a tort he personally commits or participates in by hiding behind the corporation entity"

. . .

[The debtor] was the one who committed the tort, therefore it is he, and not the corporation, who is liable to the bank for the injuries proximately resulting therefrom.

Matter of Cullen, 71 BR 274, 281 (Bankr WD Wis 1987) (quoting Oxmans' Erwin Meat Co. v Blacketer, 86 Wis2d 683, 692, 273 NW2d 285 (1979)).

At trial, Foseid offered no evidence of payment on his personal guarantee to the bank.[(8)] On the contrary, as presented in his proposed findings of fact, the note to the bank is presently in default. The proposed findings of fact also state that neither Walford nor Foseid have made any payments on the note to the bank. Moreover, Foseid stated in his proposed findings of fact that the bank has not foreclosed on the assets securing the note. The bank has a claim against Grain Guard and, presumably, against Foseid and Walford in light of their personal guarantees. If he paid the note, Foseid may arguably have a claim against Grain Guard and Walford. However, at this time, there is no evidence or claim that Foseid has paid on the guarantee. As a guarantor who has not paid on the note, Foseid has not proven any damages or a claim for damages in his favor against Walford or Grain Guard.

Even if Foseid had paid on the note, Foseid would be required to prove that his injury was the proximate result of Walford's alleged embezzlement or conversion of corporate funds. In both Penning and Cullen, the creditor was required to establish that the converted funds constituted proceeds from that creditor's collateral. As stated by the court in Penning, "unless the proceeds from the sale of property of a creditor are traceable to an officer or director, the officer and director is not liable to each individual creditor who was not paid by the corporation." Matter of Penning, 22 BR at 620 (citations omitted).

I conclude that Foseid has no standing to bring this proceeding in his individual capacity. However, because Foseid may bring this proceeding to enforce Grain Guard's rights derivatively, I must discuss the merits of the case.

STANDARD OF PROOF ISSUE

I took this portion of this proceeding under advisement to consider one issue: whether the torn-out check stubs equalling $8,900 represent an indebtedness which is nondischargeable as embezzlement under § 523(a)(4) or a willful and malicious injury under § 523(a)(6). Specifically, the issue is whether the torn-out stubs compel inferences of concealment and intent to embezzle the funds. Central to this inquiry is the determination of the proper standard of proof for nondischargeability under § 523(a)(4) and (6) in light of Grogan v Garner, -- US --, 111 SCt 654 (1991), and the criminal nature of embezzlement.

Pursuant to § 523(a)(4),[(9)] a debtor may not discharge a debt incurred as a result of the debtor's embezzlement. A debt may be nondischargeable for embezzlement under § 523(a)(4) without the existence of a fiduciary relationship. In re Littleton, 942 F2d 551, 555 (9th Cir 1991) (citing Matter of Shuler, 21 BR 643 (Bankr D Idaho 1982); In re Talcott, 29 BR 874, 878 (Bankr D Kan 1983)). Embezzlement is the "fraudulent appropriation of property by a person to whom such property has been entrusted or into whose hands it has lawfully come." Matter of Weber, 892 F2d 534, 538 (7th Cir 1989) (citing Moore v United States, 160 US 268, 269, 16 SCt 294, 295, 40 LEd 422 (1895)). To prove embezzlement, Foseid must show that (1) the debtor appropriated funds for his own benefit; and (2) the debtor did so with fraudulent intent or deceit. Matter of Weber, 829 F2d at 538. The plaintiff has the burden of proving both elements. In re Kreps, 700 F2d 372, 376 (7th Cir 1983). Because it is difficult to prove intention, "[i]ntent may properly be inferred from the totality of the circumstances and the conduct of the person accused." Matter of Rose, 934 F2d 901, 904 (7th Cir 1991) (citation omitted).

Pursuant to § 523(a)(6), a debtor is not discharged from any debt "for willful and malicious injury by the debtor to another entity or the property of another entity." 11 USC § 523(a)(6). A debt is nondischargeable under this section only if the debtor's actions were both "willful" and "malicious." In re Kimzey, 761 F2d 421, 424 (7th Cir 1985). "Willful" has been interpreted to mean deliberate or intentional. Matter of Cullen, 71 BR 274, 281 (Bankr WD Wis 1987) (citations omitted). "Malicious" requires only that the debtor knows that his act will harm another and proceeds in the face of that knowledge. Id. at 282. In Matter of Cullen, this court stated:

To establish a claim for nondischargeability under section 532(a)(6), the [plaintiff] must prove 1) an injury to the [plaintiff]; 2) [Debtor's] actions which brought about the injury; 3) the injury was intentional and malicious; and 4) the injury gave rise to a claim for damages in favor of the [plaintiff].

Id. at 278.

To determine whether Foseid met his burden of proof under §§ 523(a)(4) and (a)(6), I must determine the proper standard of proof. In Weber, the Seventh Circuit applied the clear and convincing evidence standard to an embezzlement claim under § 523(a)(4). Weber, 892 F2d at 538. Subsequently, in Grogan v Garner, -- US --, 111 SCt 654 (1991), the Supreme Court held that the standard of proof for a claim of fraud under § 523(a)(2)(A) is the preponderance of the evidence standard. In broadsweeping language the Supreme Court extended its holding to cover all the exceptions to discharge under § 523(a). Id. at 661 (stating "we hold that the standard of proof for the dischargeability exceptions in 11 U.S.C. § 523(a) is the ordinary preponderance-of-the-evidence standard"). Despite its almost universal acceptance by courts since Grogan, this extension of the standard of proof to claims premised on subsections of § 523(a) other than § 523(a)(2)(A) is clearly dicta.

In Wisconsin, embezzlement is a criminal act included in the statute governing theft.[(10)] Reasons exist for applying a higher standard of proof to a claim for embezzlement under § 523(a)(4). Collateral estoppel concerns central to the Court's decision in Grogan are not implicated where an embezzlement conviction would permit an exception from discharge under collateral estoppel principles regardless of what standard of proof applied to the § 523(a) proceeding. Moreover, the lack of legislative history dictating a particular standard may be an indication--not of Congress's intent to require a lower, uniform standard of proof as suggested by the Court in Grogan--but rather of Congress's intent to retain the standard of proof applicable to the substantive nonbankruptcy causes of action. Additionally, although the Court in Grogan found that the grouping together of a variety of exceptions under § 523(a) supported the application of the preponderance standard to all the exceptions, § 523(c), which separates §§ 523(a)(2), (4), and (6) for different treatment, suggests an individual approach to each exception.[(11)]

In the case of embezzlement, policy concerns may also weigh against a lower standard of proof. At least one court has concluded that, in some cases, the preponderance standard may unfairly tip the balance in favor of creditors. In In re Tague, 137 BR 495 (Bankr D Colo 1991), Judge Clark opined that policy considerations argued against the preponderance standard for claims under § 523(a)(6):

Application of the preponderance standard would provide litigants with incentive to defer pursuit of certain claims in state court when a bankruptcy appears inevitable,

allowing them to proceed under a lesser standard of proof to establish their right to special damages based on intentional conduct.

Id. at 504-505. Arguably, a debtor who could not be convicted of embezzlement under the higher standard of proof, could have a debt exempted from discharge for embezzlement under the lower standard. This result seems inequitable. However, the Supreme Court has long held that obtaining a discharge in bankruptcy is not a fundamental right. Grogan, 111 SCt at 659 (citing United States v Kras, 409 US 434, 445-446, 93 SCt 631, 637-638 (1973).

Notwithstanding a determination that the preponderance standard is not compelled under §§ 523(a)(4) and (6), the Seventh Circuit has hinted its acceptance of the lower standard of proof. Shortly after Grogan, the Seventh Circuit decided a case under § 523(a)(4) without directly addressing the proper standard of proof to apply. In Matter of Rose, 934 F2d 901 (7th Cir 1991), the court excepted discharge of a debt incurred as the result of larceny. The court observed that the bankruptcy court had applied the clear and convincing evidence standard. Id. at 903. The court then noted in a footnote that "[t]he Supreme Court held [sic] this Term that the preponderance of the evidence standard applies to all exceptions from dischargeability of debts contained in Bankruptcy Code § 523(a)." Id. at 903, n 3. Elsewhere in the opinion, in response to the debtor's argument that the bankruptcy and district courts should have construed the clear and convincing evidence standard to be equivalent to the reasonable doubt standard, the court responded:

In any event, the Supreme Court recently rendered Rose's argument academic by holding in Grogan v. Garner, [citations omitted], that the standard of proof for the dischargeability exceptions in 11 U.S.C. § 523(a) is the ordinary preponderance of the evidence standard.

Id. at 904. Although this language is dicta, it appears that the Seventh Circuit would accept the breadth of the Grogan decision without hesitation. The decision in Grogan does not technically reverse the clear and convincing standard of proof stated in Weber; however, the higher standard's continued validity is doubtful in light of the Seventh Circuit's statements in Matter of Rose. In any event, neither the Supreme Court nor the Seventh Circuit appear to have contemplated a criminal standard of proof for nondischargeability under § 523(a)(4) based on embezzlement.

With respect to the standard under § 523(a)(6), the Seventh Circuit appears to agree that the standard of proof is the preponderance of the evidence standard. In Matter of Hallahan, 936 F2d 1496 (7th Cir 1991), the Seventh Circuit stated: "The Supreme Court this Term in Grogan v. Garner . . . lowered the standard of proof, holding that the preponderance of the evidence standard governs the dischargeability exceptions in 11 U.S.C. § 523(a)." Id. at 1500 n 3 (citation omitted). Again, this dicta casts doubt on the continued viability of a higher standard of proof.

Since Grogan, the preponderance of the evidence standard has been almost universally applied to nondischargeability actions arising under § 523(a). Although not conclusive, language in Matter of Rose, 934 F2d 901 (7th Cir 1991) and Matter of Hallahan, 936 F2d 1496 (7th Cir 1991), has signaled the Seventh Circuit's acceptance of the lower standard of proof. I must defer to that direction.

Although I cannot say that Walford has "beyond reasonable doubt" embezzled funds of

Grain Guard, it is a closer question whether Grain Guard has shown by a preponderance of evidence standard the elements of embezzlement. Under § 523(a)(4), Foseid must show both that Walford appropriated funds for his benefit and that he did so with fraudulent intent or deceit. Matter of Weber, 829 F2d at 538. Walford admitted that he intermingled his personal and corporate financial transactions. He testified that he paid some of Grain Guard's expenses and then caused Grain Guard to repay him. Although he claimed that the checks he received from Grain Guard reimbursed him for the expenses he paid, his testimony is the only evidence that the alleged reimbursement amounts corresponded to the original payment amounts. Because of an absence of documentation, Walford's exhibits in support of payment do not meaningfully corroborate that testimony. I found Walford to be a credible witness, but am disturbed by the overwhelming lack of supporting documentation. Also troubling are the alleged reimbursements in round hundred dollar amounts and the effort to conceal the transaction by removal of the check stubs. Under the preponderance of the evidence standard, Foseid has met his burden of proving that Walford appropriated funds for his personal benefit.

I must also determine whether Walford converted the monies with fraudulent intent or deceit. Intent may be inferred from the totality of the circumstances and the conduct of the debtor. The only evidence of an intent to embezzle are the torn-out check stubs. It is not unreasonable to infer that Walford tore out the check stubs to conceal his actions. Nor is it unreasonable to infer that Walford wished to conceal his actions because they were improper. Although the evidence apart from the torn-out check stubs suggests nothing more than careless bookkeeping and commingling of personal and corporate funds, the preponderant evidence supports a finding that Walford intended to convert corporate funds.

The analysis is similar under § 523(a)(6). To meet the requirements of § 523(a)(6), Foseid must prove that Walford's actions were "willful," meaning deliberate or intentional, and "malicious," meaning that Walford knew that his actions would harm Grain Guard and proceeded in the face of the knowledge. See In re Cullen, 71 BR 274, 281 (Bankr WD Wis 1987). As stated above, I have found that Walford intentionally used corporate funds for his personal use. Moreover, Walford's knowledge of the harm to Grain Guard may be inferred from concealment of his actions. Again, I must infer from the torn-out check stubs that Walford attempted to conceal his actions, knowing that Grain Guard would be harmed by his conversion of corporate monies. Under the preponderance of the evidence standard, Walford's actions constituted a willful and malicious injury to the property of Grain Guard within the scope of § 523(a)(6).

Upon the foregoing, judgment may be ordered in favor of Grain Guard and against Walford determining that he is liable to Grain Guard in the amount of $8,900 which is not dischargeable.

END NOTES:

1. Defendant Vincenza Walford is the non-debtor spouse of the debtor David Walford and is joined in this adversary proceeding to the extent of her interest in marital property. No personal claim is asserted against her.

2. The minutes of the first meeting of incorporators, subscribers, and shareholders states "[o]n motion duly made and carried the yearly salaries of the officers were deferred until a later date." Plaintiffs' Exhibit 1, page 3.

3. In its proposed findings of fact and conclusions of law, Foseid states "Grain Guard, Inc., is a proper party to this proceeding and there is no requirement that plaintiff Foseid make demand upon Grain Guard prior to the institution of a derivative proceeding since such demand would be futile because plaintiff and debtor Walford are the only two directors of Grain Guard." Plaintiffs' Proposed Findings of Fact and Conclusions of Law, page 4-5, ¶ 3. See also Plaintiffs' First Amended Complaint, page 2-3, ¶¶ 11-15.

4. FRCP 23.1 provides that a derivative action may be brought by a stockholder to enforce a right of a corporation, the corporation having failed to enforce a right which may be properly asserted by it. FRCP 23.1 provides that the complaint shall be verified and shall allege that the plaintiff was a shareholder at the time of the complained of transactions and that the action is not a collusive one to confer jurisdiction on the court. In accordance with FRCP 23.1, the plaintiffs' amended complaint is verified and alleges that Foseid was a shareholder during the relative time period and that the action is not a collusive one to confer jurisdiction on the court.

5. In Donnelly v Sampson, 135 Wis 368, 115 NW 1089 (1908), the defendant-president had exclusive control over the corporate affairs for years and had sold corporate real estate for taxes, procuring the tax deeds for himself. Moreover, the secretary, cognizant of the president's actions, refused to take action or to release the name of the officers and directors to the plaintiff. The court found that demand upon the president would not only be useless, but would "rather efficiently stimulate him to pass the wrongfully acquired titles on to some innocent party, or parties, and beyond the reach of the court." Id. at 372. Likewise, in Whitcomb v Albany Hardware Specialty Mfg. Co., 245 Wis 86, 13 NW2d 516 (1944), the court found that it was reasonable to infer that the plaintiff, a member of the board of directors, had presented her concerns to the directors without success and "it would therefore be useless to make a further formal demand." Id. at 89.

6. In Matter of Cullen, 71 BR 274, 278 (Bankr WD Wis 1987), this court stated:

To establish a claim for nondischargeability under section 523(a)(6), the [plaintiff] must prove 1) an injury to the [plaintiff]; 2) [Debtor's] actions which brought about the injury; 3) the injury was intentional and malicious; and 4) the injury gave rise to a claim for damages in favor of the [plaintiff].

7. As stated by one commentator,

The early law, which was preoccupied with tangible objects and the repression of physical violence, attached an undue importance to possession, as distinguished from ownership, and permitted the person in possession to recover the full value of the chattel, although the person did not own it, and might be responsible over to someone else who did.

Prosser and Keeton, The Law Of Torts, § 15 at 103 (5th ed. 1984) (footnotes omitted).

8. In the amended complaint, Foseid states "[p]laintiff Foseid has incurred attorney fees and costs in defending an action by Bank on said note and guaranty." Plaintiffs' First Amended Complaint, page 4, ¶ 18. In the subsequently filed proposed findings of fact and conclusions of law, Foseid states that "[n]either debtor Walford nor plaintiff Foseid have made any payments on the note to the Bank." Proposed Findings of Fact and Conclusions of Law, page 4, ¶ 16.

9. Section 523(a)(4) provides:

(a) A discharge under . . . 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;

10. Wis.Stat. § 943.20 entitled Theft includes as a criminal act:

(1) **ACTS.** Whoever does any of the following may be penalized as provided in sub. (3):

. . . .

(b) By virtue of his office, business or employment, or as trustee or bailee, having possession or custody of money or of a negotiable security, instrument, paper or other negotiable writing of another, intentionally uses, transfers, conceals, or retains possession of such money, security, instrument, paper or writing without the owner's consent, contrary to his authority, and with intent to convert to his own use or to the use of any other person except the owner. . . .

11. See Victoria Henges, Canons of Construction Take Aim: Ascertaining the Proper Burden of Proof for Fraud Under Section 523 (a)(2)(A), 59 UMKC L Rev 321 (1991).