

**UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF OHIO
EASTERN DIVISION**

IN RE:)	
)	
RUSSELL BROOKS PAYNE, SR. and)	CHAPTER 7
ANNETTE LEWIS PAYNE,)	CASE NO. 02-64405
)	
Debtors.)	JUDGE RUSS KENDIG
)	
DAVID MCCARGO,)	ADV. PRO. NO. 03-6005
)	
Plaintiff,)	
)	
vs.)	
)	MEMORANDUM OF DECISION
RUSSELL BROOKS PAYNE, SR.,)	
)	
Defendants.)	

This matter is before the court on David McCargo’s (hereafter “Plaintiff”) motion for summary judgment filed on July 1, 2003. A response was filed by debtor/defendant Russell Brooks Payne, Sr. (Hereafter “Defendant”) on July 11, 2003, to which Plaintiff replied on July 21, 2003.

The court has jurisdiction over this matter pursuant to 28 U.S.C. § 1334(b) and the general order of reference entered in this district on July 16, 1984. This is a core proceeding under 28 U.S.C. § 157(b)(2)(I). The following constitutes the court’s findings of fact and conclusions of law pursuant to Federal Rule of Bankruptcy Procedure 7052.

FACTS AND ARGUMENTS

Defendant and Annette Payne commenced a proceeding under Chapter 7 of the United States Bankruptcy Code on September 17, 2002. Plaintiff initiated this adversary proceeding by filing a complaint on January 10, 2003. In the complaint, Plaintiff alleged that a Pennsylvania Court of Common Pleas entered a judgment against Defendant and that this judgment is excepted from discharge pursuant to 11 U.S.C. §§ 523(a)(4), (6), and § 727. Debtor’s answer denies that this debt is exempt from discharge.

The parties to this proceeding were before the Pennsylvania court to determine who was the rightful owner of a number of firearms. Defendant was the executor of the estate of his father, who died while in possession of the firearms. Plaintiff alleged that he purchased

the guns from decedent and then loaned them back to him for display in decedent's gun museum. Plaintiff brought an action in the Pennsylvania Court of Common Pleas, Orphans' Division to force Defendant to turn over the guns in his possession and to pay Plaintiff the fair market value of any guns no longer in his possession. The court determined that Plaintiff proved by clear and convincing evidence that he was the rightful owner of the guns and granted him the relief that he requested. Defendant appealed and the appellate court upheld the common pleas court decision. Defendant has not complied with the court order. He returned only seven of the guns in his possession, and has not paid Plaintiff the fair market value of the balance of the guns.

In his motion for summary judgment, Plaintiff argues that the judgment of the Pennsylvania Court of Common Pleas is excepted from discharge pursuant to 11 U.S.C. § 523(a)(4). Specifically, Plaintiff argues that Defendant committed "fraud or defalcation while acting in a fiduciary capacity." 11 U.S.C. § 523(a)(4). Plaintiff asserts that the findings of fact and conclusions of law by the Pennsylvania court are *res judicata* as to the issue of whether Defendant owes a debt to Plaintiff. The only remaining issue for this court to decide is whether said debt is dischargeable. Plaintiff asserts that the debt is not dischargeable because Defendant was acting in a fiduciary capacity when he incurred the debt due to the fact that he was acting as the executor of his father's estate when he took possession of, and refused to turn over, the firearms in question. Plaintiff argues that since Defendant was found by the Pennsylvania court to be in possession of certain guns that belonged to Plaintiff, was ordered to return these guns to Plaintiff, and failed to comply with this order that Defendant committed a defalcation while acting in a fiduciary capacity which resulted in a loss to Plaintiff.

Defendant primarily argues two points. He argues that the state court did not determine the issue of defalcation, but merely found that the guns in Defendant's possession belonged to Plaintiff. Therefore, *res judicata* does not apply to the issue of whether there was a defalcation. Secondly, Defendant argues that he owed no fiduciary duty to Plaintiff. Since a finding that a defalcation was committed while acting in a fiduciary capacity is necessary in order to find a debt to be excepted from discharge under 11 U.S.C. § 523(a)(4), Defendant reasons that the debt in question is not exempt.

Plaintiff, in his reply, admits that there was no finding of defalcation at the time the state court rendered its decision. Rather, the defalcation occurred when Defendant failed to comply with the Pennsylvania court's order. Thus the findings of the state court together with Defendant's failure to comply with its order constitute a defalcation. Plaintiff further argues that under Pennsylvania law Defendant owed a fiduciary duty to Plaintiff as a creditor of decedent's estate.

ANALYSIS

I. Standard of Review

The procedure for granting summary judgment is found in Federal Rule of Civil

Procedure 56(c), made applicable to this proceeding through Federal Rule of Bankruptcy Procedure 7056, which provides in part that

[j]udgment sought shall be rendered forthwith if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law.

Federal Rule of Civil Procedure 56(c).

The evidence must be viewed in the light most favorable to the nonmoving party. Adickes v. S.H.Kress & Co., 398 U.S. 144, 158-59 (1970). Summary judgment is not appropriate if a material dispute exists over the facts, “that is, if evidence is such that a reasonable jury could return a verdict for the nonmoving party.” Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 248 (1986). Summary judgment is appropriate, however, if the opposing party fails to make a showing sufficient to establish the existence of an element essential to that party’s case and on which that party will bear the burden of proof at trial. Celotex Corp. v. Catrett, 477 U.S. 317, 322 (1986). *See also* Matsushita Elec. Indus. Co., Ltd. v. Zenith Radio Corp., 475 U.S. 574 (1986).

The Sixth Circuit Court of Appeals has recognized that Liberty Lobby, Celotex, and Matsushita effected “a decided change in summary judgment practice,” ushering in a “new era” in summary judgments. Street v. J.C. Bradford & Co., 886 F.2d 1472, 1476 (6th Cir. 1989). In responding to a proper motion for summary judgment, the nonmoving party “cannot rely on the hope that the trier of fact will disbelieve the movant’s denial of a disputed fact, but must ‘present affirmative evidence in order to defeat a properly supported motion for summary judgment.’” Street, 886 F.2d at 1479 (quoting Liberty Lobby, 477 U.S. at 257). The nonmoving party must introduce more than a scintilla of evidence to overcome the summary judgment motion. Street, 886 F.2d at 1479. It is also not sufficient for the nonmoving party merely to “show that there is some metaphysical doubt as to the material facts.” Matsushita, 475 U.S. at 586. Moreover, “[t]he trial court no longer has the duty to search the entire record to establish that it is bereft of a genuine issue of material fact.” Street, 886 F.2d at 1479. That is, the nonmoving party has an affirmative duty to direct the court’s attention to those specific portions of the record upon which it seeks to rely to create a genuine issue of material fact.

This line of cases emphasizes the point that when one party moves for summary judgment, the nonmoving party must take affirmative steps to rebut the application of summary judgment. Courts have stated that:

Under *Liberty Lobby* and *Celotex*, a party may move for summary judgment asserting that the opposing party will not be able to produce sufficient evidence at trial to withstand a directed verdict, and if the opposing party is thereafter unable

to demonstrate that he can do so, summary judgment is appropriate. “In other words, the movant could challenge the opposing party to ‘put up or shut up’ on a critical issue [and] . . . if the respondent did not ‘put up,’ summary judgment was proper.”

Fulson v. City of Columbus, 801 F. Supp. 1, 4 (S.D. Ohio 1992) (citations omitted) (quoting Street, 886 F.2d at 1478).

II. Issue Preclusion

The doctrine of collateral estoppel, also referred to as issue preclusion, bars the same parties from relitigating facts and issues that were fully litigated in a previous suit. *Thompson v. Wing*, 637 N.E. 2d 917, 923, 70 Ohio St.3d 176, 183 (1994). Collateral estoppel applies to bankruptcy proceedings and litigants can use it in nondischargeability proceedings to prevent the relitigation of issues that were previously decided in state court. *Murray v. Wilcox (In re Wilcox)*, 229 B.R. 411, 415 (Bankr. N.D. Ohio 1998). Federal common law does not apply when applying collateral estoppel from a state court judgment to a nondischargeability action. *Marrese v. American Academy of Orthopaedic Surgeons*, 470 U.S. 373, 374 (1985). A bankruptcy court must give the same issue preclusive effect to a state court judgment as it would be given under that state’s law pursuant to the full faith and credit principles of 28 U.S.C. § 1738. *Id.* Pennsylvania law dictates that in order for collateral estoppel to apply, the issue previously litigated must have been “necessary to final judgment on the merits, and the party against whom the plea is asserted must have been a party, or in privity with a party, to the prior action and must have had a full and fair opportunity to litigate the issue in question.” Balent v. City of Wilkes-Barre, 669 A.2d 309, 313 (1995) (citing Allen v. McCurry, 449 U.S. 90, 94-95 (1980)).

Plaintiff asserts that this court cannot relitigate the conclusion of the Pennsylvania court that Defendant owes a debt of \$23,950.00 to Plaintiff.¹ This court agrees. The state court’s finding that Defendant owed a debt to Plaintiff was the central issue of the state court proceeding, and thus was necessary to a final judgment on the merits. Further, both parties before this court were parties to the state court action. Finally, there is nothing to suggest that either party did not have a full and fair opportunity to litigate this issue below. This court therefore finds that Defendant is estopped from relitigating the issue of whether he owes a debt of \$23,950.00 to Plaintiff.

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The Pennsylvania court directed Defendant to pay Plaintiff the “fair market value” of the guns according to a formula set forth in the opinion. Attorney for Plaintiff then submitted an affidavit to the state court which calculated the fair market value of the guns to be \$23,950.00 and an affidavit in this proceeding that nothing was paid. Defendant did not contest either affidavit.

Defendant argues that issue preclusion does not apply with respect to the issue of defalcation. This court agrees. However, Plaintiff does not argue that the lower court's decision gives preclusive effect to the issue of defalcation. Plaintiff merely asserts that this court cannot disturb the finding of the state court with respect to whether a valid debt is owed by Defendant to Plaintiff.

III. Application of 11 U.S.C. § 523(a)(4)

Debt is excepted from discharge under § 523(a)(4) “for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny.” 11 U.S.C. § 523(a)(4). The phrase “while acting in a fiduciary capacity” qualifies “fraud or defalcation” but not “embezzlement” or “larceny.” 4 Collier on Bankruptcy, ¶ 523.10[1][c] (15th ed. rev. 2002). In his motion for summary judgment, Plaintiff only argues that Defendant's debt is excepted from discharge due to “fraud or defalcation while acting in a fiduciary capacity.”

In order to prove defalcation under § 523(a)(4) it must be shown that: 1) there is a fiduciary relationship; 2) the fiduciary relationship was breached; and 3) the breach produced a resulting loss. R.E. America, Inc. v. Garver (In re Garver), 116 F.3d 176, 178 (6th Cir. 1997). The fiduciary relationship is limited to those instances where a technical or express trust has been created. Cashway v. Johnson (In re Johnson), 691 F.2d 249 (6th Cir. 1982). “The debtor must hold funds in trust for a third party to satisfy the fiduciary relationship element of the defalcation provision of § 523(a)(4).” Garver, 116 F.3d at 179. In analyzing the predecessor to §523(a)(4), the Sixth Circuit noted that the question of who is a fiduciary is one for federal law to decide, but state law is useful to determine when a trust relationship exists. Carlisle Cashway, Inc. v. Johnson (In re Johnson), 691 F.2d 249, 251 (6th Cir. 1982). Thus, in order to determine whether Defendant was in a fiduciary relationship with Plaintiff, the law of Pennsylvania will be considered.

A. The Fiduciary Relationship

Plaintiff argues that Defendant was acting in a fiduciary capacity as executor of his father's estate, and owed a fiduciary duty to Plaintiff as a creditor of the estate. Defendant disputes that he owed a fiduciary duty to Plaintiff. He argues that the fiduciary obligations extended to the beneficiaries of the decedent's estate and not to its creditors. This court finds that Pennsylvania law extends the fiduciary obligations of an executor to creditors of the estate, that such a holding is wholly logical, and therefore Defendant owed a fiduciary duty to Plaintiff.

Pennsylvania law is clear that an executor, sometimes called a personal representative under Pennsylvania law, has a duty to distribute the decedent's estate to decedent's creditors and beneficiaries. “A decedent's personal representative is under a duty to take custody of the estate and administer it in such a way as to preserve and protect the property for distribution to the proper persons within a reasonable time. In the discharge of this duty, he is regarded as a fiduciary and is held to the highest degree of good faith.” In re Estate of Kurkowski, 487 Pa. 295 (1979)(citations omitted). The “proper persons” referred to by the Kurkowski court

include not only beneficiaries of the estate, but creditors of the estate as well. “It may be said by way of preface to the discussion, that executors and administrators owe a duty to creditors of a decedent quite as important as that to heirs or legatees. The former duty may be said to be primary, since the heirs and legatees take only after creditors are paid.” Rastaetter’s Estate, 15 Pa. Super 549 (Pa. Super. Ct. 1901). This duty is further evidenced by 20 Pa. Cons. Stat. Ann. § 3392 which states:

If the applicable assets of the estate are insufficient to pay all proper charges and claims in full, the personal representative, subject to any preference given by law to claims due the United States, *shall* pay them in the following order, without priority as between claims of the same class:

(1) The costs of administration.

(2) The family exemption.

(3) The costs of the decedent’s funeral and burial, and the costs of medicines furnished to him within six months of his death, of medical or nursing services performed for him within that time, of hospital services including maintenance provided him within that time, and of services performed for him by any of his employees within that time.

(4) The cost of a gravemarker.

(5) Rents for occupancy of the decedent’s residence for six months immediately prior to his death.

(6) *All other claims*, including claims by the commonwealth.
(Emphasis added).

Note that the above statute makes payment of claims in the proscribed order mandatory as is indicated by the term “shall.” Hence, a duty is imposed upon an executor of an estate under Pennsylvania law to pay valid claims of creditors.

The Defendant in this case held the possessions of decedent in trust for the creditors and beneficiaries of decedent’s estate. The law of Pennsylvania clearly dictates that he had a fiduciary duty toward Plaintiff to preserve the guns which were in his father’s possession at the time of his death and to distribute those guns to Plaintiff. As such, the court finds that Defendant was acting in a fiduciary capacity as that term is contemplated in 11 U.S.C. § 523(a)(4).

B. Defalcation

In addition to acting in a fiduciary capacity, Plaintiff must also demonstrate that a defalcation occurred while Defendant was acting in this capacity. The court believes that

Plaintiff has met this burden.

“‘Defalcation’ is defined as encompassing embezzlement, the ‘misappropriation of trust funds held in any fiduciary capacity,’ and the ‘failure to properly account for such funds.’” Capitol Indemnity Corp. V. Interstate Agency, Inc. (In re Interstate Agency, Inc.), 760 F.2d 121, 125 (6th Cir. 1985)(quoting Black’s Law Dictionary, 375 (5th ed. 1979)). There is no requirement that the debtor benefit from such defalcation. In re Reed, 155 B.R. 169 (Bankr. S.D. Ohio 1993)(“a finding of defalcation may be found even though the debtor derived no personal gain therefrom.”)

In the instant case, Defendant clearly committed a defalcation. He held the possessions of decedent in trust for the creditors and beneficiaries of the estate, and refused to turn over property to Plaintiff/creditor even after the Pennsylvania court ordered him to do so. The administration of decedent’s estate is now complete as is evidenced by the status report attached to Plaintiff’s Reply. Hence, during administration of the estate, Defendant failed to turn over property as ordered by the state court to a creditor of the estate to which he owed a fiduciary duty. Thus he misappropriated property held in his fiduciary capacity and committed a defalcation. As such, Plaintiff has proven that elements of § 523(a)(4).² Defendant is unable to discharge the debt which he incurred as a result of this defalcation pursuant to 11 U.S.C. § 523(a)(4).

CONCLUSION

For the foregoing reasons, the court find that the state court judgment against Defendant in the amount of \$23,950.00 is excepted from discharge. Plaintiff’s motion for summary judgment is granted.

An appropriate order shall enter forthwith.

RUSS KENDIG
UNITED STATES BANKRUPTCY JUDGE

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Even if Defendant was not a fiduciary due to some technical hocus pocus, he would still be unable to discharge the judgment of the state court. Defendant’s acts constituted larceny as that term is used in 11 U.S.C. § 523(a)(4). Federal common law defines larceny as a “felonious taking of another’s personal property with intent to convert it or deprive the owner of the same.” In re Barret, 156 B.R. 529 (Bankr. N.D. Tex. 1993). Although claiming an altruistic purpose, it does not change the fact that Defendant took property that he knew was not his. That is theft, whether from the vantage point of the courtroom or the person on the street. Whether he believed that this belonged to the estate or to the Plaintiff, he knew it was not his when he took it.

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Debtors.)	JUDGE RUSS KENDIG
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DAVID MCCARGO,)	ADV. PRO. NO. 03-6005
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Plaintiff,)	
)	
vs.)	
)	ORDER
RUSSELL BROOKS PAYNE, SR.,)	
)	
Defendants.)	

For the reasons set forth in the accompanying Memorandum of Decision, the court finds Plaintiff David McCargo's motion for summary judgment is well taken and **GRANTED**.

IT IS THEREFORE ORDERED that the judgement against Russell Payne, Sr. in the Court of Common Pleas of Westmoreland County Pennsylvania, Orphans' Court Division Case No. 65-97-207 is excepted from discharge pursuant to 11 U.S.C. § 523(a)(4).

RUSS KENDIG
UNITED STATES BANKRUPTCY JUDGE

SERVICE LIST

David McCargo
PO Box 100767
Anchorage, AK 99510

Robert P Harbert
149 Wilbur Dr NE
North Canton, OH 44720

Russell Brooks Payne, Sr.
844 Phillips Rd NE
Massillon, OH 44646

Edwin H Breyfogle
11 Lincoln Way W
Lincoln Professional Bldg, #2B
Massillon, OH 44647