UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF NEW YORK

In re

ADRIENNE WEIGAND, d/b/a Ambassador Credit Reporting — Case No. 96-10528 K

Debtor

NORTHEASTERN LEASING & FINANCE CORP.

Plaintiff

-vs- — AP 96-1117 K

ADRIENNE WEIGAND, d/b/a Ambassador Credit Rating

Defendant

In re

ROBERT T. WEIGAND, SR. — Case No. 96-11595 K

Debtor

NORTHEASTERN LEASING & FINANCE CORP.

Plaintiff

-vs- — AP 96-1149 K

ROBERT T. WEIGAND, SR.

Defendant

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DECISION AFTER TRIAL

On May 14, 1996, Northeastern Leasing & Finance Corp. ("Northeastern" or "Plaintiff") filed an adversary proceeding in the bankruptcy case of Adrianne Weigand ("Adrianne" or "Mrs. Weigand") d/b/a Ambassador Credit Reporting, No. 96-10526, alleging that Mrs. Weigand should be denied a discharge under 11 U.S.C. §§ 727(a)(3)[1] and (a)(5). The complaint also alleged that Mrs. Weigand's debt to the Plaintiff in the sum of $33,793.28 should be declared nondischargeable pursuant to 11 U.S.C. § 523(a)(2)(A) and (a)(4).

On June 10, 1996, Northeastern also filed an adversary proceeding in the separate bankruptcy case of Robert T. Weigand ("Robert" or "Mr. Weigand), No. 96-11595, alleging that Mr. Weigand's debt to Plaintiff (as guarantor of a lease agreement between Northeastern and Adrianne) in the sum of $35,393.28 is nondischargeable pursuant to 11 U.S.C. § 523(a)(4).

At the conclusion of the presentation of the Plaintiff's case at trial on July 31, 1997, Robert Weigand, through counsel, orally moved to dismiss under Federal Rule of Civil Procedure 41(b) all causes of action against Robert Weigand. That motion was taken under submission. At the same time, Adrianne Weigand, through counsel, orally moved to dismiss the causes of action against her arising under 11 U.S.C. §§ 523(a)(2)(A) and 727(a)(3) and (a)(5). At

[1] Although Plaintiff cites § 727(a)(3) in its complaint, the allegations made in the substance of the complaint mirror § 727(a)(2).

that time, those causes of action were voluntarily withdrawn by the Plaintiff.

The only causes of action remaining in these two adversary proceedings are under § 523(a)(4). Plaintiff contends that both Adrianne Weigand and Robert Weigand (in his capacity as guarantor), engaged in "fraud or defalcation while acting in a fiduciary capacity." Alternatively, Plaintiff argues that either or both Debtors should be found to have embezzled property of the Plaintiff. *See* 11 U.S.C. § 523(a)(4).

This is a core proceeding under 28 U.S.C. §§ 157 and 1334. The pertinent burden of proof is a "fair preponderance" of the evidence.[2] After due deliberation, the Court rules as follows under Rule 52.

FINDINGS OF FACT

1. On September 23, 1993, Adrianne Weigand d/b/a Ambassador Credit Reporting entered into a lease agreement with Northeastern Leasing & Finance ("Northeastern"), whereby Adrianne agreed to lease from Northeastern, for 48 months, various equipment listed on the attached Schedule A. Robert Weigand did not sign the lease. (See Plaintiff's Exhibit #1)

2. This was one of a series of financing transactions by which Northeastern made cash or

[2] *Grogan v. Garner,* 498 U.S. 279 (1991).

equipment available to Adrianne either on a secured loan basis or on a sale-leaseback basis. The transaction at issue was secured partially by office equipment, but the equipment in issue (the Woodworking Equipment") was the subject of a sale leaseback. In other words, the Woodworking Equipment was owned by the Weigands, conveyed to Northeastern, and then leased back to Adrianne Weigand, as part of a broader transaction that refinanced earlier debt and perhaps yielded "new money" as well.

3. Both Adrianne Weigand and Robert Weigand ("Jointly and Severally Responsible") signed a security agreement, specifically granting Northeastern a security interest in all of the property listed on Schedule A, as well as a blanket lien on all "business equipment, inventory, supplies, fixtures, furnishings, receivables, accounts and other personal property of every nature whatsoever, wherever located and whether now owned or hereafter acquired." (See Plaintiff's Exhibit #1)

4. Robert Weigand also signed an individual guaranty of Adrianne's performance under the lease. (See Plaintiff's Exhibit #1)

5. Pages 1, 3 and 4 of Schedule A list various pieces of office equipment and furniture. This equipment was located at 960 Kenmore Avenue, Buffalo, the business premises of Ambassador Credit Reporting.

6. Page 2 of Schedule A lists various pieces of Woodworking equipment labeled "Additional Equipment to be used as Security." The woodworking equipment was located in a garage at 17 Wendel Avenue, Buffalo, then the Weigand's marital residence.

7. Nolan B. Allen, the President of Northeastern, testified that at the time of the sale and lease agreements, Robert Weigand estimated that the Woodworking Equipment was worth $15,000 at its depreciated value.

8. Gregory Streamer, Adrianne's son from a previous marriage, had lived with the Weigands at 17 Wendel up until a few months before June 1995.

9. Gregory frequently used the Woodworking Equipment even after he moved out of 17 Wendel. At times he would take pieces of the equipment to other locations, but usually returned it to 17 Wendel.

10. Gregory and Adrianne both had keys to open the garage at 17 Wendel Avenue.

11. On or about June 21, 1995, Adrianne Weigand moved out of the marital residence at 17 Wendel Avenue with just a few of her belongings.

12. On September 15, 1995 at about 10:30 or 11:00 pm, while Robert Weigand was at his

place of full-time employment, Adrianne Weigand returned to 17 Wendel Avenue with a rental truck and approximately eight (8) friends and/or family members to help her move all of her belongings out of the house. (During discovery, Adrianne swore that she had no recollection of the move or of who helped her move. By the time of trial, friends and family had helped her to recall. Now she is sure that her present recollections are correct.)

13. In approximately 45 minutes to 1 hour, these 8 people, under Adrianne's direction, packed up in boxes and loaded into the rental truck, almost the entire contents of the house.[3]

14. Adrianne and her son, Gregory, and his girlfriend, Laurie Kowalski, all testified that to their knowledge, none of the Woodworking Equipment was taken from the garage the night of September 15, 1995.

15. A neighbor, Barbara Schykoff, saw the rental truck arrive and called Robert Weigand at work. She also called the police, who were unable to take any action because Adrianne Weigand was entitled to access the house. Barbara Schykoff did see a light on in the garage.

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[3] Testimony presented at trial indicated that there was only a kitchen table and mattress left in the house the next day.

16. The contents of the rental truck were taken to 744 Niagara Street and unloaded at an apartment building owned by a friend of Adrianne's, Sam Saia, but no participant in the move was produced who could testify as to whether the leased equipment was or was not on the truck.

17. Sometime in 1995, Adrianne Weigand had begun to fall behind in lease payments to Northeastern. At that time Northeastern demanded return of the leased property and turnover of the collateral and sought an order of seizure and attachment in state court.

18. Northeastern was able to recover some of their leased equipment and collateral from the business premises of Ambassador Credit Reporting. This equipment was sold by Northeastern for about $6,800-$7,000.

19. In attempting to recover the Woodworking Equipment from 17 Wendel Avenue, Nolan Allen and/or William F. Metcalfe, an independent contractor commercial collection agent who was working for Northeastern, attempted to contact both Robert and Adrianne Weigand about gaining access to the Woodworking Equipment.

20. Both Metcalfe and Allen testified that Adrianne Weigand was difficult to contact and generally unresponsive to their inquiries, while Robert Weigand was more forthcoming.

21. On September 21, 1995, Robert Weigand invited Metcalfe and Allen to 17 Wendel Avenue so that they could pick up whatever equipment remained on the premises. Although Robert Weigand had noticed on September 16, 1995 that the lock to the garage had been broken and that some of the Woodworking Equipment was missing from the garage, he did not tell this to Metcalfe or Allen on September 21, 1995.

22. On September 22, 1995, Robert Weigand was present when Metcalfe and Allen arrived to pick up the equipment. At that time some of the Woodworking Equipment was no longer in the garage, and Robert Weigand indicated that Adrianne must have taken it.[4]

23. Northeastern recovered the equipment that remained in the garage and was able to sell it for $800.

24. Nolan Allen estimated that the missing collateral was worth about $6,000-7,000, based on the Robert Weigand's own representation of value at the time of the loan transaction, as discussed below.

DISCUSSION, CONCLUSIONS OF LAW, AND FURTHER

[4] Allen and Metcalfe testified that Robert Weigand made a comment to the effect that Adrianne "cleaned him out." Robert Weigand testified that he only told them that Adrianne "took what she thought was hers." Either way, the implication is that Adrianne took the missing Woodworking Equipment.

FINDING OF DISPOSITIVE FACTS

The issue of whether a lessee/bailee is a fiduciary of the lessor with respect to leased property was briefed by the parties. With respect to the "fraud or defalcation" aspect of the Plaintiff's complaint it is not necessary, however, for the Court to determine whether a bailee is a fiduciary for purposes of 11 U.S.C. § 523(a)(4), because the Court concludes that a fair preponderance of the evidence demonstrates that Adrianne Weigand did indeed embezzle the property in question.

In so finding it is first essential to determine the true nature of the sale and lease back agreement and who was the true owner of the equipment in 1995 when the property disappeared.[5] To sustain an embezzlement cause of action, the property in question must be found to be the property of another.

The Defendants miscomprehend the significance of the security agreement in the case at bar. In order to determine whether the missing property was property of the Debtors or property of the lessor, Northeastern, we must focus both on the sale to Northeastern and on the lease back to Adrianne Weigand. While it is true that a Bill of Sale absolute on its face can be shown to have been intended only as security, it is essential that there also be some concurrent defeasance such as a repurchase option. *See* 95 N.Y. Jur. 2d *Secured Transactions* § 54 (1992).

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[5] Embezzlement under § 523(a)(4) is to be determined under federal law. *See e.g., Moon v. Bevilaqua (In re Bevilaqua)*, 53 B.R. 330 (Bankr. S.D.N.Y. 1985). The Supreme Court has defined embezzlement as "the fraudulent appropriation of property by a person to whom such property has been entrusted or unto whose hands it has lawfully come." *Moore v. U.S.,* 160 U.S. 268, 269 (1895).

It is also true, that Article 9 of the Uniform Commercial Code ("U.C.C.") applies regardless of the form of the transaction or the name by which the parties may have christened it, but only "when it is found that a security interest was intended." *Id.* § 19. What the Defendants miss is the fact that the execution of a security agreement does not of itself prove that every aspect of the transaction in question was intended by the parties to be a single "secured transaction."

Rather, as to the property conveyed by the Debtors to the Plaintiff, the Court has not been pointed to a repurchase agreement or option to repurchase. To the extent that the security agreement applied to property that was not previously conveyed to the Plaintiff by Adrianne Weigand, the security agreement and the filing of U.C.C. 1's was, of course, essential to the protection of the Plaintiff's interest in the property, and was, of course, a secured transaction. But the inclusion therein of property to which the Plaintiff had taken title does not strip the Bill of Sale and the "true lease" of any and all meaning. The filing of U.C.C. 1's by a vendee/lessor in a sale leaseback makes perfectly good practical sense as to personal property that is being left in the possession of the vendor/lessee. It protects the lessor against a fraudulent sale by the lessee by putting the world on notice of the fact that the lessor claims an interest in the personalty, and it does so in precisely the location that a purchaser of property would conduct a search - the U.C.C. filings. Furthermore, it protects the lessor against a finding that it is nothing but an unsecured creditor if, in the subsequent bankruptcy of the lessee, the bankruptcy court were to conclude that the lease was not a "true lease," but was instead a "financing lease," under which title actually passed to the "lessee" and in which the "lessor" was truly a seller who did not perfect a security interest in the property, by recordation.

Consequently, the Defendants make too much of the inclusion of the subject goods in the security agreement. Their effort to have the Court conclude that title to the missing goods was not in the Plaintiff fails. Title was indeed in the Plaintiff, and Adrianne Weigand was but a bailee.

The Court finds that Adrianne Weigand's testimony that she did not cause the property to be removed from the garage on the night that she was assisted by friends and relatives in removing her belongings from the residence is unworthy of belief. The fact that only the property originally purchased by Adrianne Weigand was missing from the garage, and not the property purchased by Robert Weigand, commands that either Adrianne Weigand or Robert Weigand directed the removal of the property. There is no suggestion anywhere in the evidence that Robert Weigand removed any property. Moreover, it seems to the Court to be implausible that Robert Weigand would invite the Plaintiff over to pick up the property, then remove only the property purchased by Adrianne Weigand, and turn over to the Plaintiff the property that he himself purchased. (Even if he were to have cleverly contrived a scheme to "set her up," he filed no theft report, and the bankruptcy filings only came months later.)

As to Adrianne Weigand, however, the evidence offered by her son, Gregory Streamer, her son's girlfriend, Laurie Kowalski, and Adrianne Weigand herself, is simply too convenient to be true. None of them saw anyone go into the garage, none of them saw any of the Woodworking Equipment on the truck, none of them knew who drove the truck or where the truck went between the time it left 17 Wendel Avenue and the time that Adrianne Weigand, after going to shelter provided by Sam Saia in the Southtowns, showed up at 744 Niagara Street the

next day (or perhaps several days later) to finish the unloading of the truck at a building or apartment of Sam Saia. The truck was already partially unloaded when she arrived. Adrianne's son and his girlfriend never knew where the furniture that they were loading was going. Adrianne's son has never since discussed this move with his mother until it became the subject of the lawsuit, despite the fact that he has never seen any of the furniture since the move, and describes his relationship with his mother as being a close relationship at all pertinent times. (It seems more likely than not that the missing equipment ended up in either Gregory Streamer's garage or the garage of someone else involved in the move.

The fact that the lock on the garage was broken rather than opened with the key that Adrianne Weigand had and that Gregory Streamer had is of no consequence. It is clear from the testimony of Barbara Schykoff that a great deal of work was accomplished by a significant group of people in a period of only forty-five minutes to one hour. It is more likely than not that someone was instructed by Adrianne Weigand to start moving things out of the garage, and smashed the padlock in order to get into the garage quickly, either not knowing that a key was available, or not wanting to take the time to locate the key. Once the garage was opened, however, it is clear that either Adrianne Weigand or her son carefully directed whoever was doing the moving as to which items to take and which items to leave, the distinction being whether the item was purchased by Adrianne Weigand or by Robert Weigand.

The Court further finds that regardless of who ultimately ended up with the equipment or with its value, and regardless of whether Adrianne Weigand did or did not have any active involvement in what happened to the equipment after the move, her obvious involvement

in the misappropriation of the Plaintiff's property would of itself be enough to sustain a finding of embezzlement for purposes of § 523(a)(4) even if the Court were to believe her testimony that she does not know what happened to the equipment, which the Court does not, in fact, believe.

Judgment will be awarded to the Plaintiff against Adrianne Weigand in an amount to be discussed later in this decision.

As to Robert Weigand, the Court concludes that the obligation that he has as a guarantor is dischargeable in bankruptcy despite the fact that the obligation guaranteed has been declared not dischargeable as against the principal obligor, Adrianne Weigand. The Court believes that because it is axiomatic that exceptions to discharge must be construed liberally in favor of the debtor, each exception to discharge must be proven personally as against each debtor and cannot result in a declaration of dischargeability as against a debtor who is without fault and who is as much a victim of the turpitude of the principal obligor as is the obligee.

Although it is only § 523(a)(4) that is before the Court today, the Court offers the dictum that if a guarantor had no knowledge of the falsity of a "false financial statement" which resulted in the grant of a loan to the principal obligor, the fact that the obligation would be non-dischargeable under § 523(a)(2)(B) as to the borrower would not result in a judgment of non-dischargeability against the guarantor. This is not a proposition of suretyship law; indeed, a guarantor is liable for any obligation that is left unpaid by the principal obligor even if the principal obligor has acted fraudulently or criminally. Rather, the question is whether that obligation - which unquestionably exists under nonbankruptcy law - would survive a bankruptcy discharge because of the bad behavior of the principal. It seems to the Court that in the absence

of agreement to the contrary, what a guarantor guarantees is repayment of the obligation, and not the conduct of the principal obligor. Thus, while a guarantee can be determined to be non-dischargeable where the guarantor is found to have committed fraud, a wilful and malicious injury, or other basis for a determination of non-dischargeability, the court in the case of *In re Levittan,* 46 B.R. 380 (Bankr. E.D.N.Y. 1985), was correct in its conclusion that a claim against a surety who becomes bankrupt is dischargeable although the claim against his principal would not be.

DAMAGES

This Court does not require injured parties to perform the impossible, when the impossibility was caused by their opponents.[6] Northeastern cannot prove the value of property that Adrianne spirited away.[7] The best evidence of the value of the embezzled equipment is established by the Defendants' own representation to Northeastern, at the time of the financing transaction. All of the equipment, leased or liened, had an aggregate value of $15,000 at the time of the transaction in question.[8] Northeastern got about $7,800 from liquidating all of the equipment it obtained.

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[6] *See Rowe v. Reynolds (In re Reynolds),* Case No. 92-10845, A.P. No. 92-1168 (Kaplan, J., Dec. 28, 1992).

[7] Northeastern has consistently and honorably offered, from the outset, to drop the dischargeability litigation it if could have its equipment.

[8] Although Robert Weigand testified at trial that the equipment was actually worth less than $15,000, his testimony was a present estimate looking back four years at the equipment, not testimony to contradict Nolan Allen's testimony of what Robert told Allen four years ago.

Judgment is awarded to Northeastern against Adrianne in the amount of $7,200 plus interest and costs, and

Judgment is awarded as to Robert Weigand against Northeastern, dismissing the Complaint on the merits after trial. Robert Weigand is to bear his own costs.

Dated: Buffalo, New York
September , 1997

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Michael J. Kaplan, U.S.B.J.