

UNITED STATES BANKRUPTCY COURT

DISTRICT OF IDAHO

In Re:

SKIPPER T. MORTON and
MEGAN J. MORTON,

Debtors.

**Bankruptcy Case
No. 08-40166-JDP**

NICKLAUS MORRARTY,

Plaintiff,

vs.

SKIPPER T. MORTON and
MEGAN J. MORTON, d.b.a
All Star Angus,

Defendants.

Adv. Proceeding No. 08-8046

MEMORANDUM OF DECISION

Appearances:

Allen Browning, CURTIS AND BROWNING, Idaho Falls, Idaho,
Attorney for Plaintiff Morrarty.

Robert J. Maynes, Idaho Falls, Idaho, Attorney for Defendants.

Introduction

Chapter 12 debtor Skipper Morton agreed to sell cattle to Nicklaus Morrarty. But when what was intended to be a simple deal went south, this complicated litigation, originally involving not only Morrarty and Morton, but also at one point, Morton's business partners and his bank, resulted.¹

Morrarty contends that this broken transaction cannot be dismissed "as a couple of good ol' boys who, dagnabbit, just did not have sufficient paperwork to keep their accounts straight[.]" Morrarty's Response to Mortons' Closing Argument, Docket No. 79. Instead, Morrarty contends that Morton engaged in fraud, and consequently, Morrarty's claim for

¹ On the same day that Morrarty initiated this adversary proceeding against him, Morton's cattle business partners, Joe and Barbara Riggins, filed another action alleging that Morton had violated his partnership duties in connection with these events and was liable to them for nondischargeable damages under §§ 523(a)(2), (a)(4), and (a)(6). *Riggins v. Morton*, Adv. Proc. No. 08-8047. The Court later consolidated the two adversary proceedings. Docket No. 20. Morton filed a counterclaim against Morrarty, Docket No. 6, and a Third-Party Complaint against his bank, Docket No. 9. Morrarty then filed a Third-Party Complaint against the Riggins, Docket No. 11, but it was later dismissed on summary judgment. Docket No. 58. Shortly before trial, Morton and the bank agreed to settle their dispute. Docket No. 65. As a result, only the claims between Morrarty and Morton were left for trial.

damages against the Mortons² should be excepted from discharge pursuant to §§ 523(a)(2), (a)(4), and (a)(6).³

Mortons deny that Morrarty's claim should be excepted from discharge. Moreover, in their counterclaim, Mortons assert that Morrarty's claim for his alleged damages should be disallowed in the bankruptcy case.

The Court conducted a trial in this action on June 25, 2009, at which Morrarty and Mortons appeared and presented evidence and testimony. At the conclusion of the trial, the Court granted the parties' request to submit closing arguments via written briefs.⁴ After considering the evidence and testimony, the arguments of the parties, and the relevant

² Morrarty names Megan Morton, Skipper's spouse and a co-debtor in the chapter 12 case, as a defendant. However, as discussed later, there is no proof that Megan Morton engaged in any of the objectionable conduct Morrarty alleges to have occurred in connection with this deal.

³ Unless otherwise indicated, all chapter and section references are to the Bankruptcy Code, 11 U.S.C. §§ 101 - 1532, and all rule references are to the Federal Rules of Bankruptcy Procedure, Rules 1001 - 9037.

⁴ Both parties submitted opening briefs, and Morrarty submitted a reply brief. Mortons' counsel informed the Court that no reply brief would be filed.

legal authorities, the Court makes the following findings of fact and conclusions of law. Fed. R. Bankr. P. 7052.

Facts

Skipper and Megan Morton reside in Roberts, Idaho, where for some time they have engaged in farming and ranching operations under the business name Morton Land and Livestock. Mortons owned cattle, and managed and maintained cattle owned by others on land which they leased.

Mortons were also partners in a partnership with Joe and Barbara Riggins known as Allstar Angus (“Allstar”). Allstar was formed in 1996 to establish a herd of purebred Black Angus cattle. At some point after the Allstar partnership was formed, the Mortons and the Riggins signed a partnership agreement which was intended to memorialize their relationship and to set forth the partners’ respective interests in the partnership. Ex. 100. Under that agreement, Mortons agreed to care for the Allstar herd and were entitled to possession of the herd, though Mortons were required to keep the Allstar herd, including all calves born

into the herd, segregated from other cattle they owned or possessed.

Skipper Morton was designated in the agreement to act as Allstar's general manager with authority to conduct the day-to-day affairs of the partnership. Notwithstanding this management authority, however, he was not empowered to unilaterally sell or encumber partnership property. Specifically, the parties agreed that female calves born into the herd, or acquired by Allstar, would be owned by the partnership, and could not be sold or encumbered without the consent of the partners. On the other hand, Morton was authorized, without the Riggins' consent, to sell all bull calves which were born into the Allstar herd. The proceeds from the sale of bull calves were to be used to pay the operating and other expenses of the partnership, but if a surplus remained after payment of all expenses, Mortons were entitled to retain those funds.

In 2004, Morrarty came to know Morton, and from time to time assisted him in his farming and ranching operations. By early 2006, Morrarty became interested in acquiring his own herd of cattle. He had several conversations with Morton about getting an operation started. In

one of those conversations, Morrarty inquired whether any of the cattle on Morton's ranch were for sale. Morton told Morrarty that, indeed, some of the cows were for sale. Morton indicated to Morrarty that although some of the cows on the ranch were owned by another person, he had the owner's permission to sell them. Morton did not identify who the other owner of the cattle was, though Morrarty later learned it was Richard Schwarz ("Schwarz").

Morrarty and Morton struck a deal. Morrarty agreed to purchase a portion of the herd. Morrarty planned to finance the purchase through a loan from Farm Service Agency ("FSA"). Although the parties orally agreed to the material terms of the deal, no written contract was prepared at that time. Later, though, apparently to satisfy FSA, Morton prepared a crude handwritten document memorializing the agreement, which in total, provided:

I Skipper Morton sold Nick Morrarty 125 head of crossbreed [sic] cow calf pairs on May 8th, 2006 for \$1,000.00 and 4 angus bulls for \$2,000.00 a head. Plus transportation cost at \$4,500.00. Cattle

are branded with ⁵ on the left shoulder.

Ex. 112. Morrarty and Morton signed this document, and it was delivered to FSA. FSA loaned funds to Morrarty to buy the cattle and some rudimentary equipment to use in his new operation. Morrarty used the loan proceeds, in part, to pay several bills on Morton's behalf, and then delivered a certified check to him for \$117,500 made payable solely to "Skipper Morton."

Morton promptly deposited the check in a checking account at his local bank. He authorized the bank to apply most of the funds to pay down his outstanding operating loans, thinking that if he did so, his bank would accommodate his need for both more credit, and additional time to pay off his debts to the bank.

At about this time, Morton's plans went awry. Before Morton could deliver the cattle to Morrarty, and unbeknownst to Morton, Schwarz loaded up the herd at the Morton ranch and sold them to a buyer in Nebraska. Realizing that he had taken (and spent) Morrarty's money but

⁵ Schwarz testified that the " ⁵ " symbol was his brand.

was now unable to deliver cattle to him, over the next several months, Morton scrambled to transfer other cattle to Morrarty in a desperate attempt to fulfill his contract obligations. As it turned out, many of the substitute cattle given by Morton to Morrarty bore the Allstar brand.

Morrarty left the cattle in Morton's possession. In December, 2006, Morton approached Morrarty and suggested that some of Morrarty's new calves should be moved to a feed lot to fatten up. Morrarty agreed.

However, Morton did not take the calves to a feed lot, but rather had them sold at auction. Morrarty testified that he did not authorize Morton to sell any calves and that he never saw any of the proceeds from the auction.

While Morton never claimed that he had been given the authority to sell the calves, he testified that he used the auction proceeds to purchase additional cows for Morrarty.

After this episode, Morrarty decided to move his remaining cattle, and he contacted several other land owners in an attempt to locate pasture. It was through one such a contact that Joe Riggins first learned that Morton had transferred some Allstar cattle to Morrarty. Riggins informed

Morrarty that Morton was not authorized to transfer the Allstar cattle, and he demanded that Morrarty return them.

This development prompted a meeting between Morrarty, the Mortons, and the Riggins at Riggins' attorneys' office. A three-way settlement of the parties' rights in the cattle was negotiated. Under this arrangement, Morrarty agreed to transfer all cows in his possession bearing the Allstar brand to the Riggins. They, in turn, agreed that Morrarty could sell the other cattle which he had obtained from Morton free and clear of any of Riggins' claims to those animals. Finally, Mortons agreed to deliver additional replacement cows to Morrarty, and to pasture and feed the herd in the interim, by the end of April, 2007.

Morrarty transferred the Allstar cows to the Riggins, but Morton never delivered additional replacement cows to Morrarty. Under pressure for payment from FSA, Morrarty sold the cows in his possession, his hopes of becoming a rancher dashed.

On March 6, 2008, Mortons filed a petition for relief under chapter 12

of the Bankruptcy Code.⁶ On August 11, 2008, Morrarty commenced this litigation.

Discussion

I.

Although Morrarty alleged in his Complaint that claim for damages against Mortons for breach of the cattle sale agreement should be deemed nondischargeable in their bankruptcy case pursuant to §§ 523(a)(2), (a)(4), and (a)(6), remarkably, his closing argument makes no reference to these Code provisions, nor to the applicable standards or quantum of proof they demand. *See* Morrarty's Closing Argument, Docket No. 78. Instead, Morrarty cites the elements of fraud found in the Idaho Pattern Civil Jury Instructions, and briefly argues how each of those elements are satisfied in this case. *Id.* Then in his reply brief, Morrarty makes cursory references to

⁶ Case No. 08-40166. On September 15, 2009, the Court confirmed Mortons' Second Amended Chapter 12 Plan. The plan provides for no payments to be made to Morrarty as a secured creditor, and a total of \$6,000 in pro rata payments to the holders of allowed unsecured claims. The confirmation order provides that the plan will be modified, if necessary, to address the outcome of this litigation.

Morton's alleged breach of a fiduciary duty and conversion. *See* Docket No. 79.

Construing all these arguments liberally, the Court will assume that Morrarty alleges that his claims against Mortons should be excepted from discharge under § 523(a)(2) for "actual fraud," under § 523(a)(4) for fraud by a fiduciary, and under § 523(a)(6) as a debt for a willful and malicious injury. Morrarty bears the burden of proving an exception to discharge under § 523(a) by a preponderance of the evidence. *Grogan v. Garner*, 498 U.S. 279, 291 (1991). But while the Court will endeavor to fairly consider Morrarty's arguments in the context of an action under §§ 523(a), it must also be remembered that the statutory exceptions to discharge are to be strictly construed against the plaintiff and liberally in favor of the debtor in order to effectuate the fundamental policy of providing debtors a fresh start. *Spokane Ry. Credit Union v. Endicott (In re Endicott)*, 254 B.R. 471, 475 n.5 (Bankr. D. Idaho 2002) (citing *Snoke v. Riso (In re Riso)*, 978 F.2d 1151, 1154 (9th Cir. 1992)).

The Court also notes that while both Skipper and Megan Morton are

named as defendants in Morrarty's Complaint, all the allegations of misconduct in the cattle sale deal are aimed solely at Skipper. At the trial, Morrarty conceded that Megan Morton had not participated in the sale transaction, and in particular, that she was not privy to any of the oral discussions between Morrarty and Skipper regarding the sale, nor did she sign the bill of sale prepared by her husband. Moreover, the evidence shows that Megan was not involved in Skipper's various attempts to provide replacement cattle, including his scheme to sell Morrarty's calves at auction to raise money to buy additional cows. Accordingly, there is no evidence that any claim Morrarty may hold against Megan is not dischargeable in the bankruptcy case, and Morrarty's claims against her for such relief should be dismissed.

Morrarty's damage claims against Skipper Morton, on the other hand, are clearly nondischargeable, since for purposes of the Bankruptcy Code, his conduct amounted to fraud, as is explained below.

A. Fraud under § 523(a)(2)(A).⁷

“A discharge under section . . . 1228(a) [or] 1228(b) . . . of this title does not discharge an individual debtor from any debt . . . for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by . . . false pretenses, a false representation, or actual fraud[.]” 11 U.S.C. § 523(a)(2)(A). To fall within this exception to discharge, a creditor must prove that (1) the debtor made a representation; (2) which at the time the debtor knew was false; (3) the representation was made with the intent to deceive; (4) the creditor justifiably relied on the representation; and (5) the creditor sustained the a loss as the proximate result of the representation. *Diamond v. Kolcum (In re Diamond)*, 285 F.3d 822, 827 (9th Cir. 2002); *Am. Express v. Hashemi (In re Hashemi)*, 104 F.3d 1122, 1125 (9th Cir. 1996); *Wells Fargo Bank Northwest, N.A. v. Covino (In re Covino)*, 04.3 I.B.C.R. 98, 103-04 (Bankr. D. Idaho 2004).

⁷ Section 523(a)(2)(B) is not implicated under these facts because none of Morton’s alleged misrepresentations were presented in writing.

1. Representations.

Morton agreed to sell to Murrarty 125 cow/calf pairs and 4 Angus bulls. Ex. 112. Murrarty alleges that, prior to making their deal, Morton represented to him that Morton had cattle to sell to Murrarty, that some of those cattle were owned by Schwarz, and that Morton owned the rest. Murrarty alleges that Morton specifically told him that he was authorized to sell the cattle that belonged to Schwarz.

In his testimony at trial, Morton acknowledged that he made each of these representations to Murrarty. The first element of proof under § 523(a)(2)(A) is satisfied.

2. Falsity and knowledge.

Murrarty must prove that these representations were false, and that Morton knew them to be false at the time they were made.

Murrarty argues that the evidence shows that all of the cattle that were the subject of the deal were owned by Schwarz, not Morton, and therefore, Morton's representation that he owned some of the cattle was false. The Court disagrees.

The evidence as to actual ownership of the cattle to which Morton was referring in his discussions with Morrarty is murky. Although there is some evidence to support that 105 of the cow/calf pairs in Morton's herd were owned by Schwarz,⁸ the ownership of the additional 20 pairs that were to be subject to the deal with Morrarty is uncertain. Apparently, Morton did own some cattle, but it unclear from the record whether his cattle were to be part of the Morrarty sale. In addition, the trial evidence did not establish whether the four bulls to be sold to Morrarty were owned by Morton, Schwarz, or some other party. On this record, Morrarty has not shown by a preponderance of the evidence that the first representation was false.

There is no confusion in the evidence, though, with respect to the latter representation - that Morton had the authority to sell Schwarz' cattle. Morton repeatedly testified that while Schwarz had not actually authorized him to sell the cattle Morton was pasturing, Morton assumed that, under his arrangement with Schwarz, he held a right of first refusal

⁸ See, e.g., Ex. 300 and Morton's testimony.

with respect to Schwarz' cattle. Morton contends that, as a result, Morton believed in good faith that, if he so desired, he could buy the cattle from Schwarz at any time. Because he thought he could easily acquire the Schwarz cattle, Morton argues that Morrarty has not shown that Morton knew at the time he allegedly represented his ability to sell the Schwarz cattle that such representation was false. Mortons' Closing Argument at 3-4, Docket No. 77.

Morton's argument blurs the issue. The relevant focus is not whether Morton thought he could acquire the cattle at some future date after exercising his right of first refusal, but rather whether he knew at the time he negotiated the Morrarty deal that he lacked the legal authority to sell the cattle. Schwarz testified, without contradiction, that he never authorized Morton to sell his cattle. And Morton testified that he understood that his right of first refusal as to the Schwarz cattle would only arise *if and when* Schwarz decided to sell his cattle to another buyer. At that time, Schwarz agreed to give Morton an opportunity to purchase the cattle for the same price. Although Morton complained that Schwarz

eventually sold the cattle without allowing him the opportunity to exercise his right, Morton conceded that his “first refusal” right was not equivalent to having the present right to sell Schwarz’ cattle on his behalf.

In sum, the uncontroverted testimony of Schwarz shows that Skipper’s representation to Morrarty that he had the present authority to sell Schwarz’ cattle was false. Morton’s own testimony shows that he knew that his statement to Morrarty was false at the time he made it. Accordingly, the second element is satisfied.

3. Intent to deceive.

Rarely is fraud admitted. However, whether representations are made with an intent to deceive is usually a disputed question of fact to be resolved by inference drawn from the surrounding circumstances. *Cowen v. Kennedy (In re Kennedy)*, 108 F.3d 1015, 1018 (9th Cir. 1997); *Bell v. Smith (In re Smith)*, 232 B.R. 461, 466 (Bankr. D. Idaho 1998). “A promise made with a positive intent not to perform or without a present intent to perform satisfies [Section] 523(a)(2)(A)” *McCreary v. Barrack (In re Barrack)*, 217 B.R. 598, 606 (9th Cir. B.A.P. 1998) (quoting *In re Rubin*, 875 F.2d 755, 759

(9th Cir. 1989)). A promise which Morton knew or should have known was outside of his prospective ability to perform is also sufficient to satisfy the intent element. *Id.* (citing *In re Firestone*, 26 B.R. 706, 715 (Bankr. S.D. Fla. 1982)).

Morton insists that he did not intend to deceive Morrarty. Morton hints that the reason this transaction fell apart was because Schwarz unscrupulously removed his cattle from Morton's pasture without any prior notice, and in particular, without allowing Morton the opportunity to exercise his right of first refusal to buy the Schwarz cattle. Morton points out that, after this occurred, he did everything he could to provide replacement cattle to Morrarty. Unfortunately, shortly thereafter Morton's home was severely damaged by fire, and Morton says his focus understandably changed.

The Court is not persuaded by Morton's arguments. That Morton's were victims of unfortunate circumstances does not mask Skipper's resort to deception in his dealings with Morrarty. To be sure, it appears that Schwarz denied Morton the chance to exercise his right of first refusal to

buy his cattle, and it was certainly bad luck that Mortons suffered the house fire. The fact remains, however, that in making the deal with Morrarty, Morton saw an opportunity to make a profit, and to do so, he attempted to sell Morrarty cattle he neither owned nor had authority to sell. While Morton may have presumed that he could acquire title to the cows, at least eventually, he also clearly knew that at the time he agreed to sell them to Morrarty he was unable to do so. Morton did not explain to Morrarty that in order to sell him Schwarz' cattle, he must first buy them from Schwarz. And Morton's attempt to supply replacement cattle after the deal soured is irrelevant, as the deception had already occurred.

Simply put, the Court finds that Morton intended to defraud Morrarty when he told him he could sell him the cattle.

4. Justifiable reliance.

Morrarty must show that he was justified when he relied upon Morton's false representations. Justifiable reliance is a subjective standard, which is a "matter of the qualities and characteristics of the particular plaintiff, and the circumstances of the particular case, rather than of the

application of a community standard of conduct to all cases.” *Field v. Mans*, 516 U.S. 59, 71 (1995) (quoting Restatement (Second) of Torts § 545A cmt. B (1976)). This standard requires the Court to consider the “knowledge and relationship of the parties” and “all of the circumstances surrounding the particular transaction.” *Eugene Parks Law Corp. Defined Benefit Pension Plan v. Kirsh (In re Kirsh)*, 973 F.2d 1454, 1456-60 (9th Cir. 1992); see also *Tallant v. Kaufman (In re Tallant)*, 218 B.R. 58, 67 (9th Cir. B.A.P. 1998).

Justifiable reliance does not require that the claimant investigate the truth of the representation in each case. See *Field*, 516 U.S. at 70-71 (stating that “a person is justified in relying on a representation of fact ‘although he might have ascertained the falsity of the representation had he made an investigation.’”). Instead, an investigation is required “where under the circumstances, the facts should be apparent to one of his knowledge and intelligence from a cursory glance, or he has discovered something which should serve as a warning that he is being deceived.” *Field*, 516 U.S. at 71 (quoting W. Prosser, *Law of Torts* § 108, p. 718 (4th ed. 1971)). Morrarty

cannot recover under § 523(a)(2)(A) if he “blindly relie[d] on a misrepresentation the falsity of which would be patent to him if he utilized his opportunity to make a cursory examination or investigation.” *Id.* (quoting Restatement (Second) of Torts § 541 cmt. a (1976)). *See also Citibank (South Dakota), N.A. v. Eashai (In re Eashai)*, 87 F.3d 1038, 1090-91 (9th Cir. 1996) (stating that “although a person ordinarily has no duty to investigate the truth of a representation, a person cannot purport to rely on preposterous representations or close his eyes to avoid discovery of the truth.”); *Anastas v. Am. Sav. Bank (In re Anastas)*, 94 F.3d 1280, 1286 (9th Cir. 1996) (stating that reliance is not justifiable where a creditor ignores red flags prompting him to conduct an investigation into the representation).

All things considered, the Court finds Morrarty’s reliance upon Morton’s untruthful statements was justified. Morrarty had never before owned his own cattle. As observed by the Court from his testimony, Morrarty is obviously not a sophisticated business person. While he may have been generally aware of ranching practices, Morrarty was not particularly experienced in the ways of the commercial cattle market.

Indeed, this transaction represented his first foray into unfamiliar business territory, and unfortunately for him, was a bust.

Morrarty had been working with Morton in various capacities for several years. He knew that Morton raised, managed, bought and sold cattle, including those that were owned by others. He had observed Morton's exercise of control over those cattle on multiple occasions, which gave him no reason to suspect Morton was attempting to sell him the Brooklyn Bridge.

Certainly, by making additional appropriate inquiries,⁹ Morrarty might have been able to determine that Morton did not have the present authority to sell Schwarz' cattle. But as explained by the Supreme Court in *Field*, under these facts, Morrarty was not required to make such an investigation. In other words, that with additional sleuthing Morrarty may have prevented his loss does not provide Morton an excuse to escape

⁹ Morrarty actually attempted to do due diligence on Morton's interest in the cattle by performing a UCC check with the Secretary of State. Of course, this research merely disclosed whether creditors may claim a security interest in the herd, not ownership of the herd. Satisfied that there were no existing lien interests under Morton's name, Morrarty's investigation apparently gave him false confidence that all was on the up-and-up in his dealings with Morton.

responsibility for his bad conduct.

Morrarty was justified in relying upon Morton's misrepresentations.

5. Proximate cause and damages.

Morrarty must show that he sustained a loss as the proximate result of Morton's misrepresentations. The evidence shows he did. Morrarty agreed to purchase a herd of cattle from Morton. He paid the purchase price, but Morton failed to deliver all the cattle. Morrarty was therefore deprived of the benefit of his bargain measured by the value of the cattle he did not receive, and the lost opportunity to generate income or a profit from those cattle. Obviously, Morrarty's loss was the proximate result of Morton's fraud.

Before commencing the adversary proceeding, Morrarty filed a proof of claim in Mortons' bankruptcy case. He listed the total amount of his claim against Mortons as \$429,952.60. Of this sum, Morrarty alleged that \$168,952.60 was a secured claim, and the balance, or \$261,000, was unsecured. Ex. 305.

However, at trial, Morrarty did not rely upon his proof of claim in

proving up his claim. Instead, he offered the testimony and report of an expert, economist Dr. Tyler Bowles,¹⁰ to quantify the extent of his loss. In his written report, Dr. Bowles calculated the total amount of Morrarty's economic loss as \$247,585. Ex. 125. In the report, and in his testimony at trial, Dr. Bowles clearly and concisely explained how he arrived at this loss figure. He cogently quantifies the value of the cattle that were purchased by Morrarty but not delivered, the associated costs and expenses incurred by Morrarty in reliance upon the cattle deal, and Morrarty's lost future income associated with not receiving what he had purchased. With the two exceptions addressed below, the Court is persuaded to accept Dr. Bowles expert's opinion in fixing the amount of Morrarty's loss.

First, Dr. Bowles explained that in order to make Morrarty whole, in addition to reimbursement for the expenses he incurred in reliance upon his deal with Skipper, and the value of the cattle which he did not receive, Morrarty should receive either interest or lost profits. Dr. Bowles

¹⁰ Morrarty and Mortons stipulated that Dr. Bowles could testify as an expert witness.

explained that while he estimated what Morrarty's lost profits would have been and included that estimate in his report, he testified that, under these circumstances, he was more comfortable relying upon "lost interest" as a measure of Morrarty's future losses. Dr. Bowles calculated the interest figure starting with the date that Morrarty incurred the loss, and extending through the approximate date that he was told the trial would occur. *See* Ex. 125.

As Mortons' counsel brought out during his cross-examination of the witness, while using the trial date as an end date for the interest calculations may have been appropriate in some other context, Mortons' petition date is the more proper ending point in this analysis for bankruptcy purposes. *See* § 502(b) (requiring that the Court compute the amount of creditor's claims for allowance "as of the date of the filing of the petition . . ."). Dr. Bowles calculated the interest for the cattle and the expenses Morrarty incurred separately, and then summed the two figures

to arrive at the total.¹¹ Using this same approach, but adjusting for the March 6, 2008 petition date, the Court calculates the interest on the cattle to be \$30,060, and the interest on the expenses to be \$4,592, for a total of \$34,652.¹²

Second, in his report, Dr. Bowles acknowledged that Morrarty had been able to sell some of the replacement cows he received from Morton in March and April of 2007. He therefore offset Morrarty's total loss by the amount he received from those sales. *See* Ex. 125. However, the lost interest which Dr. Bowles calculated was based on the total herd. When the Court queried the witness about why the total amount of interest had not been adjusted since Morrarty was able to receive the benefit of the sales, Dr. Bowles acknowledged he had over-calculated the interest on \$30,000 for two years, or \$6,000. Dr. Bowles' ad hoc adjustment was based on the approximate dates and amounts of the sales, and the trial date.

¹¹ Dr. Bowles calculated the interest on the cattle to be \$52,298, and the interest on the expenses incurred to be \$10,428.

¹² Like Dr. Bowles, the Court used a 10% interest rate, compounded annually.

However, a more accurate adjustment would be based upon the actual dates and amounts of the sales, and Mortons' petition date. Using these dates and figures, the Court calculates the proper adjustment to be \$2,607.¹³

With these two adjustments to Dr. Bowles' report, the Court finds Morrarty's loss is as follows:

Value of cattle:	\$158,000
Expenses incurred:	\$38,550
Interest:	\$34,652
Value of Morrarty's labor:	\$16,000
Offset for 3/27/2007 sale:	(\$25,600)
Offset for 4/2/2007 sale:	(\$2,091)
Offset for interest:	<u>(\$2,607)</u>
Total economic loss:	\$216,904

In sum, the Court finds and concludes that \$216,904 is the amount of Morrarty's loss proximately caused by Morton's false representation and breach of contract. Morrarty's claim in this sum is excepted from Skipper Morton's discharge in bankruptcy under § 523(a)(2)(A).

¹³ The proceeds of the March 27, 2007 sale were \$25,600. Interest on that amount through the March 6, 2008 petition date at 10%, compounded annually, is \$2,413. The proceeds of the April 2, 2007 sale were \$2,091. Interest on that amount through the petition date is \$194. Accordingly, the total amount of the adjustment is \$2,413 plus \$194, or \$2,607.

B. Fiduciary Fraud under § 523(a)(4).

Section 523(a)(4) of the Bankruptcy Code excepts from discharge any debt “for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny[.]” 11 U.S.C. § 523(a)(4). Morrarty argues that because some of the cattle were actually owned by Schwarz, there was a “fiduciary obligation placed upon Morton to make sure the money paid for the cattle found its way into the owner’s hands.” Morrarty’s Closing Argument, Docket No. 79.

Morrarty misunderstands the scope of § 523(a)(4). “It is not sufficient for purposes of § 523(a)(4) to show merely that one party occupies a position of trust toward another, even such as to impose equitable responsibilities under state law.” *Wussler v. Silva (In re Silva)*, 00.2 I.B.C.R. 66, 69 (Bankr. D. Idaho 2000). The meaning of the term “fiduciary capacity” is a question of federal law, and has been limited to situations in which an express trust, a technical trust, or a statutory trust exist between the claimant and the debtor. *Id.* (citing *Lewis v. Scott (In re Lewis)*, 97 F.3d 1182, 1185 (9th Cir. 1996)).

There was no evidence offered at trial to show that Morton occupied any fiduciary role as to Morrarty in this case. Morrarty's § 523(a)(4) argument lacks merit.

C. Willful and Malicious Injury under § 523(a)(6).

Section 523(a)(6) of the Bankruptcy Code provides that a debtor may not discharge any debt "for willful and malicious injury by the debtor to another entity or to the property of another entity." 11 U.S.C. § 523(a)(6).¹⁴

Damages for a breach of contract can conceivably be nondischargeable under § 523(a)(6) but only if the breach is accompanied by otherwise tortious conduct. *Lockerby v. Sierra*, 535 F.3d 1038, 1040-41 (9th Cir. 2008).

Conduct is tortious for purposes of § 523(a)(6) only if it constitutes a tort

¹⁴ The willful injury requirement of § 523(a)(6) is separate from the malicious injury requirement. See *Barboza v. New Form, Inc. (In re Barboza)*, 545 F.3d 702 (9th Cir. 2008). Willfulness requires a "deliberate or intentional *injury*, not merely . . . a deliberate or intentional *act* that leads to injury." *Kwaauhau v. Geiger*, 523 U.S. 57, 61 (1998); *Ditto v. McCurdy*, 510 F.3d 1070 (9th Cir. 2007). This requires that the Morton "desires to cause consequences of his act, or that he believes the consequences are substantially certain to result from it." *Ditto*, 510 F.3d at 1078. "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.'" *Carrillo v. Su (In re Su)*, 290 F.3d 1140, 1146-47 (9th Cir. 2002) (quoting *Petrolia v. Jercich (In re Jercich)*, 238 F.3d 1202, 1209 (9th Cir. 2001)).

under state law. *Id.* at 1041.

In his closing argument, Morrarty did not specifically refer to § 523(a)(6). However, he argued:

As to the conversion count,¹⁵ Morton stole calves from the substitute cows and secretly sold them [at auction] and kept the proceeds for himself. That's conversion. However, the damages were included in the fraud count.

Docket No. 79. Morrarty is correct in that the value of the calves sold by Morton at auction is included in the fraud damages calculated above. Moreover, Morrarty's claim against Morton is, at bottom, for breach of contract. The Court assumes, perhaps incorrectly, that Morrarty's conversion argument in the briefs is intended to address the tortious conduct required by *Lockerby*.

In Idaho, conversion is defined as a "distinct act of dominion wrongfully asserted over another's personal property in denial of or

¹⁵ Morrarty's Complaint does not include a conversion claim against Mortons. Morrarty did file a Third-Party Complaint against Mortons' partners, Joe and Barbara Riggins, which included a conversion claim, however that claim was dismissed on summary judgment. *See* Docket No. 58.

inconsistent with rights therein.” *Peasley Transfer & Storage Co. v. Smith*, 979 P.2d 605, 616 (Idaho 1999). Morrarty has not shown that, in addition to a breach of contract, Morton committed this tort. Accordingly, Morrarty is not entitled to relief under § 523(a)(6).

II.

In Mortons’ counterclaim, they argue that Morrarty has overstated the amount of his unsecured claim, and that he has not adequately proven that any portion of his claim against them is secured. Mortons are correct.

As previously indicated, Morrarty filed a proof of claim which listed an unsecured claim of \$261,000, and a secured claim of \$168,952.60. *See Ex. 305*. Morrarty testified that his attorney prepared and filed the proof of claim on his behalf, and that he had not seen it prior to trial. At trial, Morrarty conceded that Dr. Bowles’ report represented a more accurate estimate of his losses than his proof of claim. Therefore, the amount of damages as estimated by Dr. Bowles, and as adjusted above by the Court, is fixed as the amount of Morrarty’s creditor’s claim in Mortons’ bankruptcy case.

Morrarty also maintained in the proof of claim that he held a security interest in Mortons' cattle. In order for Morrarty to hold a valid and enforceable security interest in Mortons' cattle, the following requirements must be satisfied:

- (1) Value has been given;
- (2) Mortons have rights in the collateral, or the power to transfer rights in the collateral to a secured party; and
- (3) Mortons have authenticated a security agreement that provides a description of the collateral.

See Karle v. Visser, 118 P.3d 136, 138 (Idaho 2005) (citing Idaho Code § 28-9-203). Mortons' counsel inquired of Morrarty about whether a written security agreement or a UCC filing existed to support his secured claim. Morrarty responded that he had a bill of sale, but conceded that he had not filed a UCC financing statement yet.

The bill of sale admitted at trial, Ex. 112, is insufficient to satisfy the requirement of an authenticated security agreement. Moreover, Skipper testified that Mortons no longer owned cattle, nor did they at the time he filed the bankruptcy petition. In other words, even if Morrarty held a valid security interest, there was no collateral in which to assert a security

interest, and his claim would be unsecured in the bankruptcy case. *See* § 506(a).

Morrarty has not proven he holds a security interest in any of Mortons' assets. Morrarty's alleged secured claim will be disallowed.

Conclusion

Skipper Morton defrauded Morrarty when he told him that he could sell him cattle when he knew he could not do so. As a proximate result of this fraud, Morrarty is entitled to recover damages from Skipper Morton in the amount of \$216,904. This claim is excepted from Skipper Morton's discharge in the chapter 12 case pursuant to § 523(a)(2)(A).

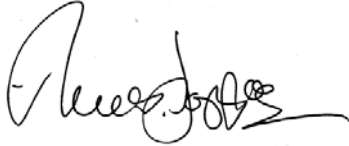
Morrarty's claim for damages is subject to discharge in bankruptcy as against Megan Morton.

Morrarty holds no allowed secured claim in Mortons' bankruptcy case. However, his claim for damages in the amount set forth above, will be allowed as a nonpriority, unsecured claim, subject to treatment and payment under the terms of Mortons' chapter 12 plan.

Counsel for Morrarty and Mortons are directed to cooperate in the

submission of an approved form of judgment for entry by the Court which incorporates these rulings.

Dated: August 3, 2009



Honorable Jim D. Pappas
United States Bankruptcy Judge