**United States Bankruptcy Court**
**Northern District of Illinois**
**Eastern Division**

**Transmittal Sheet for Opinions for Posting**

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**Bankruptcy Caption: In re Michael Rosenzweig**

Bankruptcy No. 97 B 38192

**Adversary Caption: A.V. Reilly International, Ltd. v. Michael Rosenzweig**

Adversary No. 98 A 01434

**Date of Issuance: July 12, 1999**

**Judge: John H. Squires**

**Appearance of Counsel:**

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Trustee or Other Attorneys: N/A

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

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| IN RE: | ) | |
| MICHAEL ROSENZWEIG, | ) | Chapter 7 |
| Debtor. | ) | Bankruptcy No. 97 B 38192 |
| | ) | Judge John H. Squires |
| | ) | |
| A.V. REILLY INTERNATIONAL, LTD., | ) | |
| | ) | |
| Plaintiff, | ) | |
| | ) | |
| v. | ) | Adversary No. 98 A 01434 |
| | ) | |
| MICHAEL ROSENZWEIG, | ) | |
| | ) | |
| Defendant. | ) | |

## MEMORANDUM OPINION

This matter comes before the Court on the motion of A.V. Reilly International, Ltd. ("Reilly") for summary judgment pursuant to Federal Rule of Bankruptcy Procedure 7056. For the reasons set forth herein, the Court denies the motion.

## I. JURISDICTION AND PROCEDURE

The Court has jurisdiction to entertain this matter pursuant to 28 U.S.C. § 1334 and General Rule 2.33(A) of the United States District Court for the Northern District of Illinois. This matter is a core proceeding under 28 U.S.C. § 157(b)(2)(I) and (J).

## II. FACTS AND BACKGROUND

Many of the facts are undisputed. Reilly and the Debtor, Michael Rosenzweig (the "Debtor") were the plaintiff and defendant, respectively, in a lawsuit in the Circuit Court of the Eighteenth Judicial Circuit, County of DuPage, State of Illinois, entitled A.V. Reilly International, Ltd. v. Michael Rosenzweig and Logistics Management International, Inc. (the "state court action"). The lawsuit arose out of the Debtor's former employment with Reilly.

On April 30, 1992, Reilly hired the Debtor as vice president of freight forwarding and as the second employee in the chain of command. As part of the Debtor's employment, the Debtor and Reilly entered into an employment agreement on April 30, 1992. The employment agreement contained confidentiality, non-disclosure and/or restrictive covenants. In January or February 1996, the Debtor started entertaining the idea of opening up his own freight forwarding business, and at that same time, the Debtor began looking for rental space. The Debtor made telephone calls from Reilly's office about the possibility of renting space for his own business. The Debtor kept Vince Homes and Keith Proeschild, co-employees of Reilly, advised of the Debtor's plan for a new business. The Debtor held conversations with Homes and Proeschild about customers that would go with them when they left Reilly. The Debtor also told other Reilly employees about his plan to start his own business. The Debtor did not inform Reilly that he was planning to start his own business.

The Debtor continued to work as an employee of Reilly until he resigned on April 18, 1996. The next day, the Debtor was working for his new company, Logistics Management International, Inc, an Illinois corporation, ("LMI"). In 1996, more than ninety percent of LMI's total sales came from customers that were former customers of Reilly.

LMI conducted business transactions with at least twenty-three former customers of Reilly.

On May 17, 1996, Reilly filed the state court action against the Debtor and LMI. After a trial, the state court entered a judgment on December 2, 1997 against the Debtor and LMI. The judgment included a finding of fact that "while in the employ of [Reilly] as a corporate officer and key employee, [the Debtor] owed a fiduciary duty of loyalty and honesty to [Reilly]." The judgment also found that four weeks prior to the Debtor's resignation from Reilly, the Debtor breached his duty to Reilly by setting up a competing business and enlisting the aid of other employees of Reilly to assist him. The judgment included damages in the sum of "$7,500.00 for breach of [the Debtor's] fiduciary obligation of loyalty and honesty to [Reilly]" and damages in the amount of $36,153.00 for breach of the confidentiality and non-disclosure and/or the restrictive covenants of the employment agreement and for violations of the Illinois Trade Secrets Act. The judgment order also set December 17, 1997 as a hearing date on attorney's fees requested by Reilly to be assessed against the Debtor.

After the stay of 11 U.S.C. § 362(a) was lifted to allow the state court action to proceed to its conclusion, on November 6, 1998 an additional judgment was entered in the state court action in favor of Reilly and against the Debtor in the sum of $180,008.53 for legal fees and $13,244.15 for costs.

On December 12, 1997, the Debtor filed a Chapter 13 petition, schedules and statement of affairs. Reilly is listed in the Debtor's schedules as a creditor with a contingent, unliquidated, disputed claim of $240,000.00. On December 11, 1997, the Debtor was the owner of 450 shares of stock in LMI. In his bankruptcy schedules, the Debtor listed the

value of his stock in LMI as $18,500.00. The Debtor listed LMI as a secured creditor in the sum of $60,000.00 as a result of a loan allegedly made on December 3, 1997, nine days before the filing of the Chapter 13 petition. The revolving promissory note for the loan was executed on December 11, 1997, one day prior to the filing of the Chapter 13 petition.

The Debtor never received $60,000.00 from LMI prior to the filing of the petition. According to Schedule A of the promissory note, the most that could have been borrowed by the Debtor prior to the filing of the bankruptcy petition was $8,000.00, not the $18,500.00 listed. The Debtor did not receive $60,000.00 from LMI after the filing of the bankruptcy petition.

On the line item for estimate of average income on the first page of his Schedule I, Current Income of Individual Debtor, the Debtor listed monthly gross wages of $5,000.00. The Debtor, however, on the date of filing the Chapter 13 petition, was unemployed as also stated in the first sentence of the last paragraph of the second page of his Schedule I. On the date he signed the Chapter 13 petition, the Debtor owed his father, Heinrich Rosenzweig, $25,000.00. That debt was not disclosed on his bankruptcy schedules. The Debtor borrowed the money from his father to invest $25,000.00 in LMI.

On February 6, 1998, the Debtor filed his Chapter 13 plan. The plan listed LMI as a secured creditor in the amount of $18,500.00 and as an unsecured creditor in the sum of $31,500.00. Less than one month before the Debtor filed bankruptcy, LMI purchased 50 shares of stock for $2,500.00 or $50.00 per share. On April 30, 1998, after denial of confirmation of the plan, the Debtor converted the case to Chapter 7.

Until December 2, 1997, the Debtor was president and a director of LMI. On

December 11, 1997, the Debtor entered into a pledge agreement for the stock with LMI. On December 11, 1997, the Debtor also entered into a redemption buy-sell agreement concerning the stock. The Debtor's name does not appear as a shareholder of LMI in its corporate resolution approving the promissory note, pledge agreement and redemption buy-sell agreement. Prior to the promissory note, pledge agreement and redemption buy-sell agreement, the Debtor owned the stock free and clear of any liens, encumbrances and restrictions of record.

The Debtor was represented by attorney Tarick Loutfi ("Loutfi") on the date of the filing of his bankruptcy petition, schedules and on the date he filed his Chapter 13 plan. Loutfi's practice is concentrated in corporate matters and wills and trust. His familiarity with bankruptcy law is limited. Loutfi provided legal advice in the incorporation of LMI and was familiar with its corporate structure. The Debtor allegedly relied upon Loutfi in preparing his schedules and plan. In scheduling the Debtor's debt to LMI, Loutfi believed that the Bankruptcy Code required that he state the entire line of credit as a debt. Loutfi disclosed the nature of the debt to LMI in open court at a hearing attended by Reilly's counsel, including the fact that it was a line of credit, not all of which had been drawn down.

Reilly filed this adversary proceeding against the Debtor on August 27, 1998. Reilly's five-count complaint requests that the Debtor's discharge be denied under 11 U.S.C. §§ 727(a)(4)(A), (a)(4)(B) and (a)(2)(A) and that the debt owed by the Debtor to Reilly be found nondischargeable under 11 U.S.C. §§ 523(a)(4) and (a)(6). The Debtor denies Reilly is entitled to any of the relief sought. The matter has been set for trial scheduled to commence on July 20, 1999. On May 28, 1999, Reilly filed the instant motion for summary

judgment. The Debtor defends essentially on two grounds: (1) that he lacked the requisite fraudulent scienter under the § 727 counts or was in the requisite status or had the intent to harm for the § 523 counts; and (2) he properly relied on the advice and counsel of Loutfi. The Debtor concludes that it is premature to decide such critical issues at this stage in the absence of direct testimony and the opportunity for cross-examination to gauge witness credibility.

## III. APPLICABLE STANDARDS

### A. Motion for Summary Judgment

In order to prevail on a motion for summary judgment, the movant must meet the statutory criteria set forth in Rule 56 of the Federal Rules of Civil Procedure, made applicable to adversary proceedings by Federal Rule of Bankruptcy Procedure 7056. Rule 56(c) reads in part:

> [T]he judgment 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.

Fed. R. Civ. P. 56(c). See also Dugan v. Smerwick Sewerage Co., 142 F.3d 398, 402 (7th Cir. 1998). The primary purpose for granting a summary judgment motion is to avoid unnecessary trials when there is no genuine issue of material fact in dispute. Trautvetter v. Quick, 916 F.2d 1140, 1147 (7th Cir. 1990); Farries v. Stanadyne/Chicago Div., 832 F.2d 374, 378 (7th Cir. 1987) (quoting Wainwright Bank & Trust Co. v. Railroadmen's Federal Sav. & Loan Ass'n of Indianapolis, 806 F.2d 146, 149 (7th Cir. 1986)). Where the material

facts are not in dispute, the sole issue is whether the moving party is entitled to a judgment as a matter of law. ANR Advance Transp. Co. v. International Bhd. of Teamsters, Local 710, 153 F.3d 774, 777 (7th Cir. 1998).

In 1986, the United States Supreme Court decided a trilogy of cases which encourage the use of summary judgment as a means to dispose of factually unsupported claims. Anderson v. Liberty Lobby, Inc., 477 U.S. 242 (1986); Matsushita Electric Indus. Co., Ltd. v. Zenith Radio Corp., 475 U.S. 574 (1986); Celotex Corp. v. Catrett, 477 U.S. 317 (1986). The burden is on the moving party to show that no genuine issue of material fact is in dispute. Anderson, 477 U.S. at 248; Matsushita, 475 U.S. at 585-86; Celotex, 477 U.S. at 322.

All reasonable inferences drawn from the underlying facts must be viewed in a light most favorable to the party opposing the motion. Parkins v. Civil Constructors of Ill., Inc., 163 F.3d 1027, 1032 (7th Cir. 1998). The existence of a material factual dispute is sufficient only if the disputed fact is determinative of the outcome under applicable law. Anderson, 477 U.S. at 248; Frey v. Fraser Yachts, 29 F.3d 1153, 1156 (7th Cir. 1994). "Summary judgment is not an appropriate occasion for weighing the evidence; rather the inquiry is limited to determining if there is a genuine issue for trial." Lohorn v. Michal, 913 F.2d 327, 331 (7th Cir. 1990).

Rule 56(d) provides for the situation when judgment is not rendered upon the whole case, but only a portion thereof. The relief sought pursuant to subsection (d) is styled partial summary judgment. Particularly pertinent here is the point that partial summary judgment is available only to dispose of one or more counts of the complaint in their entirety.

Commonwealth Ins. Co. v. O. Henry Tent & Awning Co., 266 F.2d 200, 201 (7th Cir. 1959); Biggins v. Oltmer Iron Works, 154 F.2d 214, 216-17 (7th Cir. 1946); Quintana v. Byrd, 669 F. Supp. 849, 850 (N.D. Ill. 1987); Arado v. General Fire Extinguisher Corp., 626 F.Supp. 506, 509 (N.D. Ill. 1985); Capitol Records, Inc. v. Progress Record Distributing, Inc., 106 F.R.D. 25, 28 (N.D. Ill. 1985); In re Network 90°, Inc., 98 B.R. 821, 823 (Bankr. N.D. Ill. 1989); Strandell v. Jackson County, 648 F. Supp. 126, 136 (S.D. Ill. 1986). Rule 56(d) provides a method whereby a court can narrow issues and facts for trial after denying in whole or in part a Rule 56 motion. Capitol Records, 106 F.R.D. at 29.

Local Rule 402.M of the Bankruptcy Rules adopted for the Northern District of Illinois requires the party moving for summary judgment to file a detailed statement ("402.M statement") of material facts that the movant believes are uncontested. Local Bankr. R. 402.M. The 402.M statement "shall consist of short numbered paragraphs, including, within each paragraph specific references to the affidavits, parts of the record, and other supporting materials relied upon to support the facts set forth in that paragraph. Failure to submit such a statement constitutes grounds for denial of the motion." Id.

Reilly filed a 402.M statement that substantially complied with the requirements of Rule 402.M. It contained numbered paragraphs setting out assertedly uncontested facts with reference to parts of the record and other supporting materials relied upon to support the facts set forth in each paragraph.

The party opposing a summary judgment motion is required by Local Rule 402.N to respond ("402.N statement") to the movant's 402.M statement, paragraph by paragraph, and to set forth any material facts that would require denial of summary judgment, specifically

referring to the record for support of each denial of fact. Local Bankr. R. 402.N. The opposing party is required to respond "to each numbered paragraph in the moving party's statement" and make "specific references to the affidavits, parts of the record, and other supporting materials relied upon." Local Bankr. R. 402.N(3)(a).

The Debtor has complied with Local Bankr. R. 402.N. He responded to each numbered paragraph in the 402.M statement and made specific references to parts of the record. In addition, the Debtor filed a statement of additional facts pursuant to Local Bankr. R. 402.N(3)(b) accompanied by an affidavit from Loutfi. The Debtor asserts he relied entirely upon Loutfi in preparing the schedules and plan. In pertinent part, Loutfi states that his experience with bankruptcy is minimal and that he believed the entire line of credit offered by LMI had to be stated as a debt. See Affidavit of Tarick Loutfi, at ¶s 4-10. Further, he states that he prepared the Debtor's schedules with the aim of disclosing the maximum amount that LMI agreed to advance under the revolving line of credit, specifically $60,000.00.

**B. Exceptions to the Dischargeability of Debts**

The party seeking to establish an exception to the discharge of a debt bears the burden of proof. Selfreliance Fed. Credit Union v. Harasymiw (In re Harasymiw), 895 F.2d 1170, 1172 (7th Cir. 1990); Banner Oil Co. v. Bryson (In re Bryson), 187 B.R. 939, 961 (Bankr. N.D. Ill. 1995). The United States Supreme Court has held that the burden of proof required to establish an exception to discharge is a preponderance of the evidence. Grogan v. Garner, 498 U.S. 279, 291 (1991); In re McFarland, 84 F.3d 943, 946 (7th Cir.), cert. denied, 117 S. Ct. 302 (1996); In re Thirtyacre, 36 F.3d 697, 700 (7th Cir. 1994). To further the policy of

providing a debtor a fresh start in bankruptcy, "exceptions to discharge are to be construed strictly against a creditor and liberally in favor of a debtor." Goldberg Secs., Inc. v. Scarlata (In re Scarlata), 979 F.2d 521, 524 (7th Cir. 1992) (quoting In re Zarzynski, 771 F.2d 304, 306 (7th Cir. 1985)).

**C. Objections to Discharge**

The discharge provided by the Bankruptcy Code is to effectuate the "fresh start" goal of bankruptcy relief. In exchange for that fresh start, the Bankruptcy Code requires debtors to accurately and truthfully present themselves before the Court. A discharge is only for the honest debtor. In re Garman, 643 F.2d 1252, 1257 (7th Cir. 1980), cert. denied, 450 U.S. 910 (1981). Consequently, objections to discharge under 11 U.S.C. § 727 should be liberally construed in favor of debtors and strictly against objectors in order to grant debtors a fresh start. Soft Sheen Prods., Inc. v. Johnson (In re Johnson), 98 B.R. 359, 364 (Bankr. N.D. Ill. 1988) (citation omitted). Because denial of discharge is so drastic a remedy, courts may be more reluctant to impose it than to find a particular debt nondischargeable. See Johnson, 98 B.R. at 367 ("The denial of discharge is a harsh remedy to be reserved for a truly pernicious debtor."). Reilly has the burden of proving the objections. See Fed. R. Bankr. P. 4005; In re Martin, 698 F.2d 883, 887 (7th Cir. 1983) (the ultimate burden of proof in a proceeding objecting to a discharge lies with the plaintiff). The objector must establish all elements by a preponderance of the evidence. In re Scott, 172 F.3d 959, 966-67 (7th Cir. 1999).

## IV. DISCUSSION

**A. Count I–11 U.S.C. § 727(a)(4)(A)**

Reilly argues that the Debtor's discharge should be denied pursuant to § 727(a)(4)(A) because he made a false oath when he listed LMI as a secured creditor as a holder of a $60,000.00 claim in both his petition and plan. In addition, Reilly contends that the Debtor failed to list his father as a creditor even though he owed his father $25,000.00.

Section 727(a)(4) provides:

> (a) The court shall grant the debtor a discharge, unless--
> (4) the debtor knowingly and fraudulently, in or in connection with the case–
> (A) made a false oath or account.

11 U.S.C. § 727(a)(4)(A). The purpose of § 727(a)(4) is to enforce a debtor's duty of disclosure and to ensure that the debtor provides reliable information to those who have an interest in the administration of the estate. Brandt v. Carlson (In re Carlson), 231 B.R. 640, 655 (Bankr. N.D. Ill. 1999); Bensenville Community Center Union v. Bailey (In re Bailey), 147 B.R. 157, 163 (Bankr. N.D. Ill. 1992) (citations omitted).

In order to prevail, Reilly must establish five elements under § 727(a)(4)(A): (1) the Debtor made a statement under oath; (2) the statement was false; (3) the Debtor knew the statement was false; (4) the Debtor made the statement with the intent to deceive; and (5) the statement related materially to the bankruptcy case. Bailey, 147 B.R. at 162 (citations omitted). If made with the requisite fraudulent intent, a false statement, whether made in the schedules or orally at a § 341 creditors' meeting is sufficient grounds for denying a discharge provided it was knowingly made and is material. Armstrong v. Lunday (In re Lunday), 100 B.R. 502, 508 (Bankr. D. N.D. 1989). It is a debtor's role to consider the questions posed on the schedules and at the creditors' meeting carefully, and answer them accurately and

completely. Id. (citation omitted)

Turning to the matter at bar, Reilly must establish that the Debtor made a statement under oath. A debtor's petition and schedules constitute a statement under oath for purposes of a discharge objection under § 727(a)(4). See Nof v. Gannon (In re Gannon), 173 B.R. 313, 320 (Bankr. S.D. N.Y. 1994) (citations omitted). The petition and schedules filed by the Debtor constitute a statement under oath. That element has been established here.

Second, Reilly must show that such statements were false. Whether the Debtor made a false oath within the meaning of § 727(a)(4)(A) is a question of fact. Williamson v. Fireman's Fund Ins. Co., 828 F.2d 249, 251 (4th Cir. 1987); Continental Ill. Nat. Bank & Trust Co. of Chicago v. Bernard (In re Bernard), 99 B.R. 563, 570 (Bankr. S.D. N.Y. 1989) (citing Williamson). "Filing of false schedules with material omissions or misrepresentations with an intent to mislead creditors and the trustee as to a debtor's actual financial condition constitutes a false oath under section 727(a)(4)(A)." Britton Motor Serv., Inc. v. Krich (In re Krich), 97 B.R. 919, 923 (Bankr. N.D. Ill. 1988) (citation omitted). Subsequent voluntary disclosure through testimony or amendment to the schedules does not expunge the falsity of the oath. Bailey, 147 B.R. at 165 (citation omitted). This element has been satisfied because the filed schedules completely omitted any reference to the substantial debt owed the Debtor's father and grossly inflated the actual amount the Debtor owed LMI, which was really $8,000.00, not the $60,000.00 total principal amount of the LMI line of credit.

Third, Reilly must establish that the Debtor knew the statements were false. The Debtor contends that the schedules unintentionally mischaracterized his financial situation regarding LMI, and that mischaracterization was the result of Loutfi's lack of sophistication

about bankruptcy law. Thus, this element is disputed. Notwithstanding that point, there is no evidence on this limited record to show that the Debtor was somehow unaware of the fact that the substantial debt he owed his father was not listed.

Fourth, Reilly must prove that the Debtor made the statements with fraudulent intent. To find the requisite degree of fraudulent intent, the Court must find that the Debtor knowingly intended to defraud or engaged in behavior which displayed a reckless disregard for the truth. In re Yonikus, 974 F.2d 901, 905 (7th Cir. 1992); Bailey, 147 B.R. at 164-165 (citing Yonikus). If a debtor's bankruptcy schedules reflect a "reckless indifference to the truth" then the plaintiff seeking denial of the discharge need not offer any further evidence of fraud. Calisoff v. Calisoff (In re Calisoff), 92 B.R. 346, 355 (Bankr. N.D. Ill. 1988) (citation omitted). The requisite intent under § 727(a)(4)(A) may be inferred from circumstantial evidence. Yonikus, 974 F.2d at 905 (citations omitted). However, discharge should not be denied where the untruth was the result of mistake or inadvertence. Lanker v. Wheeler (In re Wheeler), 101 B.R. 39, 49 (Bankr. N.D. Ind. 1989). When a debtor is in doubt concerning disclosure, it is unquestioned that he is obligated to disclose. See Bank of India v. Sapru (In re Sapru), 127 B.R. 306, 315-16 (Bankr. E.D. N.Y. 1990) ("multitude" of false oaths and omissions were material and justified denial of discharge); Behrman Chiropractic Clinics Inc. v. Johnson (In re Johnson), 189 B.R. 985, 994-95 (Bankr. N.D. Ala. 1995) (failure to disclose transferred assets warranted denial of discharge). This element is hotly disputed between the parties as is the intent element as required in the other Counts of the complaint.

Finally, Reilly must show that the false statement related materially to the bankruptcy

case. The debtor's false oath must relate to a material matter before it will bar a discharge in bankruptcy. In re Agnew, 818 F.2d 1284, 1290 (7th Cir. 1987) (citation omitted). The test for materiality of the subject matter of false oath is whether it "bears a relationship to the bankrupt's business transactions or estate, or concerns the discovery of assets, business dealings, or the existence and disposition of his property." Bailey, 147 B.R. at 162 (citations omitted). A false oath may be material even though it does not result in any detriment or prejudice to the creditor. Scimeca v. Umanoff, 169 B.R. 536, 543 (D. N.J. 1993), aff'd, 30 F.3d 1488 (3d Cir. 1994); Congress Talcott Corp. v. Sicari (In re Sicari), 187 B.R. 861, 881 (Bankr. S.D. N.Y. 1994). This element is met. The unscheduled debt owed the Debtor's father and the variance between the actual amount the Debtor owed LMI, in contrast to the scheduled amount, are both "material" in the context of the case law applying § 727(a)(4)(A).

The Court denies the motion for summary judgment as to this Count of the complaint because material issues of fact exist regarding the Debtor's intent and his knowledge of the falsity of the original schedules given his alleged reliance on Loutfi.

**B. Count II–11 U.S.C. § 727(a)(4)(B)**

Section 727(a)(4)(B) provides that a discharge shall not be available if a debtor knowingly and fraudulently "presented or used a false claim." 11 U.S.C. § 727(a)(4)(B). The Bankruptcy Code defines a "claim" as a "right to payment" or a "right to an equitable remedy for breach of performance if such breach gives rise to a right to payment." 11 U.S.C. § 101(5).

Reilly argues that the Debtor's discharge should be denied for listing LMI's claim

falsely. Reilly maintains that the Debtor scheduled the inflated claim of LMI as a secured creditor in both his schedules and Chapter 13 plan. Further, Reilly contends that the Debtor's own testimony that $60,000.00 was never lent to him or on his behalf by LMI establishes that he knew the claim was false. No supporting case law has been cited for the proposition that a debtor who erroneously schedules the amount owed a creditor has "presented or used a false claim." As Collier aptly notes: "[v]ery few cases have ever arisen under this provision. . . ." 6 Collier on Bankruptcy, ¶ 727.05 at 727-44 (15th ed. rev. 1999).

The conduct complained of regarding the inflated scheduling of LMI's claim falls clearly within the text of § 727(a)(4)(A). There is no evidence at this stage that the Debtor filed a claim for LMI pursuant to Federal Rule of Bankruptcy Procedure 3004 that would trigger a potential cause of action under § 727(a)(4)(B).

The Court also denies the motion for summary judgment under this Count because a material issue of fact exists regarding the Debtor's intent. As discussed above regarding § 727(a)(4)(A), the affidavit of Loutfi raises the issue regarding the Debtor's intent. Loutfi stated that he listed the full amount of the line of credit because he thought that was what the Bankruptcy Code required him to do. Thus, a material issue exists which precludes the entry of summary judgment on this Count and Reilly has not shown that it is entitled to relief as a matter of law on this theory.

**C. Count III-11 U.S.C. § 727(a)(2)(A)**

Pursuant to this Count of the complaint, Reilly argues that the day before the Debtor filed the Chapter 13 petition, he transferred his interest in 450 shares of LMI by pledging the stock as collateral to LMI for the line of credit extended to him. In addition, he further

encumbered the stock by executing a redemption buy-sell agreement on that same date. Reilly argues that this transfer was done with the intent to hinder, delay or defraud the Debtor's creditors in violation of § 727(a)(2)(A).

Pursuant to 11 U.S.C. § 727(a)(2)(A), the Court will grant the Debtor a discharge unless Reilly can prove by a preponderance of the evidence that the Debtor:

> (2) with intent to hinder, delay, or defraud a creditor or an officer of the estate charged with custody of property under this title, has transferred, removed, destroyed, mutilated, or concealed, or has permitted to be transferred, removed, destroyed, mutilated, or concealed--
>
> (A) property of the debtor, within one year before the date of the filing of the petition

11 U.S.C. § 727(a)(2)(A).

The alleged improper transfer of the LMI stock is the gist of this Count, as opposed to removal, destruction, mutilation or concealment of property of the Debtor. Denial of discharge under this section requires proof of actual intent to hinder, delay or defraud a creditor. In re Snyder, 152 F.3d 596, 601 (7th Cir. 1998); In re Krehl, 86 F.3d 737, 743 (7th Cir. 1996); In re Smiley, 864 F.2d 562, 566 (7th Cir. 1989). "[P]roof of harm is not a required element of a cause of action under Section 727." Id. at 569. In determining whether a debtor has acted with intent to defraud under § 727, the Court should consider the debtor's "whole pattern of conduct." Bennett & Kahnweiler Assocs. v. Ratner (In re Ratner), 132 B.R. 728, 731 (N.D. Ill. 1991) (quoting In re Reed, 700 F.2d 986 (5th Cir. 1983)). The issue

of a debtor's intent is a question of fact to be determined by the bankruptcy judge. See Smiley, 864 F.2d at 566.

Actual fraudulent intent can be inferred from extrinsic evidence. Id.; Krehl, 86 F.3d at 743; Filmar, Inc. v. White (In re White), 63 B.R. 742, 744 (Bankr. N.D. Ill. 1986) ("a debtor is unlikely to directly testify that his intent was fraudulent, the court may deduce fraudulent intent from all the facts and circumstances of a case") (citation omitted). "Thus, where the evidence on the intent question is such that two permissible conclusions may rationally be drawn, the bankruptcy court's choice between them will not be viewed as clearly erroneous." Krehl, 86 F.3d at 744 (citation omitted). "Intent to defraud involves a material representation that you know to be false, or, what amounts to the same thing, an omission that you know will create an erroneous impression." In re Chavin, 150 F.3d 726, 728 (7th Cir. 1998) (citations omitted).

The Court denies the motion for summary judgment under this Count of the complaint because a material issue of fact exists regarding the Debtor's intent. The Debtor in his deposition states that the pledge of stock was done to fund the attorney's fees for the Debtor's bankruptcy case and to appeal from the judgment entered in the state court action. Hence, an issue regarding the Debtor's intent exists which precludes the entry of summary judgment.

**D. Count IV–11 U.S.C. § 523(a)(4)**

Next, Reilly contends that the debt is nondischargeable under § 523(a)(4) because the Debtor breached his fiduciary obligation of loyalty and honesty to Reilly when he started a competing business while in the employ of Reilly. Reilly maintains that the state court

previously determined that the Debtor breached a fiduciary duty he owed to Reilly. Reilly urges the Court to apply the doctrine of collateral estoppel and find the debt nondischargeable.

Collateral estoppel is an equitable doctrine. It applies when the following four requirements are met: (1) the issue sought to be precluded has been decided in a prior proceeding; (2) the issue was actually litigated in the prior proceeding; (3) the determination of the issue was essential to the final judgment in the prior proceeding; and (4) the party against whom the doctrine is asserted was fully represented in the prior proceeding. Chicago Truck Drivers, Helpers and Warehouse Union (Independent) Pension Fund v. Century Motor Freight, Inc., 125 F.3d 526, 530 (7th Cir. 1997) (citation omitted); Klingman v. Levinson, 831 F.2d 1292, 1295 (7th Cir. 1987). In the Seventh Circuit, the doctrine of collateral estoppel applies to dischargeability proceedings. Meyer v. Rigdon, 36 F.3d 1375, 1378-79 (7th Cir. 1994) (citing Klingman, 831 F.2d at 1294-95; Grogan v. Garner, 498 U.S. 279, 285 n.11 (1991) ("[C]ollateral estoppel principles do indeed apply in discharge exception proceedings pursuant to § 523(a)."). Hence, where a court of competent jurisdiction has previously ruled against a debtor upon specific issues of fact that independently comprise elements of a creditor's nondischargeability claim, the debtor may not seek to relitigate those underlying facts in bankruptcy court, provided that the issues involved had been "actually litigated." French, Kezelis & Kominiarek, P.C. v. Carlson (In re Carlson), 224 B.R. 659, 663 (Bankr. N.D. Ill. 1998) (citation omitted).

The Court is unable to apply the doctrine of collateral estoppel because Reilly has failed to demonstrate all of the necessary elements. Specifically, Reilly has not alleged, let

alone demonstrated, that the Debtor was fully represented in the state court proceeding. The Court assumes that this was an oversight by Reilly, given Loutfi's involvement in the state court litigation. See Loutfi's Affidavit at ¶ 5. In addition, Reilly has failed to allege or show that the issue–a fiduciary relationship within the narrow scope of § 523(a)(4)–was essential to the final judgment in the state court proceeding. Accordingly, the Court will not apply the doctrine of collateral estoppel to this matter.

Section 523(a)(4) provides that a discharge "does not discharge an individual debtor from any debt . . . for fraud or defalcation while acting in a fiduciary capacity. . . ." 11 U.S.C. § 523(a)(4). In the Seventh Circuit, the elements of a claim against a fiduciary under § 523(a)(4) are: (1) a fiduciary duty established either by the existence of an express trust or a relationship of special trust and substantial inequality of power or knowledge, In re Woldman, 92 F.3d 546, 547 (7th Cir. 1996); In re Marchiando, 13 F.3d 1111, 1116 (7th Cir. 1994); In re Volpert, 175 B.R. 247, 259 (Bankr. N.D. Ill. 1994), and (2) a debt caused by the debtor's fraud or defalcation while acting as a fiduciary. Klingman, 831 F.2d at 1295. Whether a debtor was acting in a fiduciary capacity for the purposes of § 523(a)(4) is a question of federal law. Davis v. Aetna Acceptance Co., 293 U.S. 328, 333 (1934). The first requirement for application of this provision is that a "fiduciary" relationship exist. O'Shea v. Frain (In re Frain), 222 B.R. 835, 837 (Bankr. N.D. Ill. 1998).

Under Illinois law, a number of relationships can constitute fiduciary relationships: attorney and client, Marchiando, 13 F.3d at 1115; joint venturers or partners, Woldman, 92 F.3d at 547; corporate directors and shareholders, Marchiando, 13 F.3d at 1115; and trustee and beneficiary under an express trust. Id. Under Illinois law, an express trust exists where

there is (1) intent to create a trust; (2) definite subject matter or trust property; (3) ascertainable beneficiaries; (4) a trustee; (5) specifications of a trust purpose; and (6) delivery of trust property to the trustee. Frain, 222 B.R. at 837 (quotation and citations omitted). Here it is undisputed that for a period of time in 1996 (and prior thereto) the Debtor was a former corporate office (vice president) and key employee of Reilly, who terminated his employment on April 18, 1996, and whom the state court found had violated his fiduciary duties to Reilly while still in its employ.

While fiduciary relationships may arise outside of express trusts, the mere existence of a state law fiduciary relationship may not be sufficient to deny discharge under § 523(a)(4). Woldman, 92 F.3d at 547. "[O]nly a subset of fiduciary obligations is encompassed by the word 'fiduciary' in section 523(a)(4)." Id. (citation omitted). The Seventh Circuit has made a distinction between a trust or other fiduciary relationship that has "an existence independent of the debtor's wrong and a trust or other fiduciary relation that has no existence before the wrong is committed. A lawyer's fiduciary duty to his client, or a director's duty to his corporation's shareholders, pre-exists any breach of that duty, while in the case of a constructive or resulting trust there is no fiduciary duty until a wrong is committed." Marchiando, 13 F.3d at 1115-16. Constructive, resulting, and implied trusts do not fall within the confines of § 523(a)(4). Id. at 1115. The real distinction is that fiduciary relations that impose actual duties in advance of the breach generally involve a difference in knowledge or power between the fiduciary and principal. As a result, the fiduciary holds a position of ascendancy over the principal. Id. at 1116 (citation omitted). This is the critical point of the Marchiando holding, which has not been answered by the

limited record at this stage.

The Court must deny the motion for summary judgment as to this Count of the complaint because Reilly has not established that the fiduciary duty owed by the Debtor to Reilly, while the former was an employee and vice president, was based on the existence of either an express trust or such a relationship of special trust and substantial inequality of power or knowledge that the Debtor had over Reilly that the debt was caused by the Debtor's fraud or defalcation while acting as such a fiduciary with ascendancy over Reilly.

**E. Count V–11 U.S.C. § 523(a)(6)**

Reilly contends that it is entitled to summary judgment on this Count of the complaint because the state court's findings in its judgment order show that the Debtor caused injury to Reilly by soliciting and obtaining its clients, violating the Illinois Trade Secrets Act and using Reilly's records to Reilly's "pecuniary and economic detriment."

Section 523(a)(6) provides:

> (a) A discharge under section 727 . . . of this title does not discharge an individual debtor from any debt–
>
> > (6) 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).

In order to be entitled to a determination of nondischargeability under § 523(a)(6), Reilly must prove three elements by a preponderance of the evidence: (1) that the Debtor caused an injury; (2) that the Debtor's actions were willful; and (3) that the Debtor's actions were malicious. Carlson, 224 B.R. at 662 (citation omitted). "Willful" means intent to cause injury, not merely the commission of an intentional act that leads to injury. Kawaauhau v.

Geiger, 523 U.S. 57, 118 S. Ct. 974, 977 (1998). Under Geiger, to satisfy the requirements of § 523(a)(6), a plaintiff must plead and prove that the debtor actually intended to harm him and not merely that the debtor acted intentionally and he was thus harmed. 118 S. Ct. at 977. The debtor must have intended the consequences of his act. Id. Injuries either negligently or recklessly inflicted do not come within the scope of § 523(a)(6). Whether an actor behaved willfully and maliciously is ultimately a question of fact reserved for the trier of fact. Thirtyacre, 36 F.3d at 700.

The Court is unable to grant summary judgment on this Count because a material issue of fact exists regarding whether the Debtor's actions were willful under the requirements of Geiger as to the Debtor's intent to harm Reilly. Consequently, summary judgment is not proper and must be denied pursuant to Count V of the complaint.

## V. CONCLUSION

For the foregoing reasons, the Court denies the motion for summary judgment.

This Opinion constitutes the Court's findings of fact and conclusions of law in accordance with Federal Rule of Bankruptcy Procedure 7052. A separate order shall be entered pursuant to Federal Rule of Bankruptcy Procedure 9021.

**ENTERED:**

**DATE:** _____

**John H. Squires**
**United States Bankruptcy Judge**

cc: See attached Service List

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

| | | |
|---|---|---|
| IN RE: | ) | |
| MICHAEL ROSENZWEIG, | ) | Chapter 7 |
| Debtor. | ) | Bankruptcy No. 97 B 38192 |
| | ) | Judge John H. Squires |
| | ) | |
| A.V. REILLY INTERNATIONAL, LTD., | ) | |
| | ) | |
| Plaintiff, | ) | |
| | ) | |
| v. | ) | Adversary No. 98 A 01434 |
| | ) | |
| MICHAEL ROSENZWEIG, | ) | |
| | ) | |
| Defendant. | ) | |

**O R D E R**

For the reasons set forth in a Memorandum Opinion dated the 12th day of July, 1999, the Court hereby denies the motion of A.V. Reilly International, Ltd. for summary judgment.

**ENTERED:**

**DATE:** _____

**John H. Squires**
**United States Bankruptcy Judge**

cc: See attached Service List