

**United States Bankruptcy Court
District of New Mexico**

Document Verification

Case Title: Scott Graff Company v. Rene Camille Loranger
Case Number: 00-01257
Nature of Suit:
Judge Code: S
Reference Number: 00-01257 - S

Document Information			
Number:	14		
Description:	Memorandum Opinion re: [8-1] Motion For Summary Judgment by Rene Camille Loranger		
Size:	9 pages (21k)		
Date Received:	10/12/2001 10:20:32 AM	Date Filed:	10/12/2001
		Date Entered On Docket: 10/15/2001	
Court Digital Signature			View History
3d 35 9a d2 fc 97 92 dd 93 91 82 dd 1c 44 64 88 16 5c 2d d2 5c 25 18 90 a1 84 29 29 07 d9 b4 1e e9 fd 8a 39 ca f7 d7 2c 9b 5a 3a 93 45 40 d4 d9 d8 3d 29 ac 83 bf 31 4e a6 52 c0 7b 3e 6d c3 57 e7 99 9c 85 61 a3 d7 81 1f 85 21 bb 34 4e c8 52 46 a6 22 c2 d9 da cb 2c f1 3c cf 11 78 e0 cf 46 fd d8 1b 64 6c db 33 02 fb 5d 4b 35 94 2c dc c3 1d 12 93 fa 97 af e1 13 6e f0 a5 7c 9d e5 a3 75			
Filer Information			
Submitted By:			
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UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF NEW MEXICO

In re:

RENE CAMILLE LORANGER and
LILLIAN C. LORANGER,
Debtors.

No. 7-00-14869 SA

SCOTT GRAFF CO.,
Plaintiff,
v.

Adv. No. 00-1257 S

RENE CAMILLE LORANGER,
Defendant.

**MEMORANDUM OPINION ON DEFENDANT'S
MOTION FOR SUMMARY JUDGMENT**

This matter is before the Court on the Motion for Summary Judgment (docket 8) and supporting brief (docket 9) filed by the Defendant, through his attorney Michael K. Daniels. Plaintiff, through its attorney Calvert & Menicucci, P.C. (Sean R. Calvert) filed a response (docket 12), to which Defendant replied (docket 13). This is a core proceeding. 28 U.S.C. § 157(b)(2)(I).

Plaintiff's complaint objects to discharge under §§ 523 (a)(2) and (a)(4). Those sections provide:

A discharge under section 727 ... does not discharge an individual debtor from any debt -

...

(2) for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by -

(A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's ... financial condition; [or]

(B) use of a statement in writing-

- (i) that is materially false;
 - (ii) respecting the debtor's ... financial condition;
 - (iii) on which the creditor ... reasonably relied; and
 - (iv) that the debtor caused to be made or published with intent to deceive;
- ... [or]
- (4) for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny,

Plaintiff's complaint alleges that on or about January 3, 1996 Loranger obtained an extension of credit from Plaintiff for the purchase of materials and supplies to be incorporated into construction projects¹; plaintiff provided goods to Loranger on open account pursuant to a credit application attached to the complaint as Exhibit A; despite demand, Loranger has failed to pay the amount due. Defendant admitted these allegations. Plaintiff also alleges, but defendant denies, that Loranger had a fiduciary duty pursuant to New Mexico law², that he received funds in trust for the payment

¹ Loranger is, or was at the relevant times, a licensed New Mexico contractor. Affidavit of Rene Loranger. Docket 10, ¶ 1.

² Paragraph 11 of the Loranger affidavit asserts that "[t]here was no special trust or confidence reposed in me by Plaintiff, to the best of my knowledge, information and belief." Affidavit of Rene Loranger. Docket 10. Because the affidavit contains no foundation for this conclusory statement, the Court has relied solely on the New Mexico statute as incorporated into the case law cited in this decision. The Court is not deciding whether such a recitation, even if fully supported, could override the duty

of labor and materials, that he has defrauded Plaintiff, and that he obtained the trust funds under false pretenses by indicating monies would be held in trust for the payment of labor and materials.

DEFENDANT'S MOTION FOR SUMMARY JUDGMENT

The first argument in Defendant's Motion for Summary Judgment is that Plaintiff has failed to allege any representations by Defendant that would lead to finding actual fraud. Rather, Defendant claims that the adversary complaint merely alleges an ordinary course of business transaction and his inability to pay.

Plaintiff's 523(a)(2) complaint fails to allege the requisite elements. If the complaint is based on § 523(a)(2)(A), the only allegation is that on several occasions Plaintiff provided goods to Loranger on open account pursuant to a credit application. Plaintiff does not allege that the application was false, that it reasonably relied on the application, or that the application was published with the intent to deceive. If the claim is based on § 523(a)(2)(B), Plaintiff must allege that the debtor made a false

imposed on Loranger by the New Mexico statutory scheme for licensing contractors. See Allen v. Romero (In re Romero), 535 F.2d 618, 621-22 (10th Cir. 1976) (fiduciary capacity "imposed by law").

representation; the representation was made with the intent to deceive the creditor; the creditor relied on the representation; the reliance was reasonable; and the debtor's representation caused the creditor to sustain a loss. Fowler Brothers v. Young (In re Young), 91 F.3d 1367, 1373 (10th Cir. 1996). Paragraphs 17 and 18 of the complaint use the terms "defrauded" and "false pretenses", but the complaint does not plead fraud with particularity. See Fed.R.Civ.P. 9(b). That is, Plaintiff does not allege what statement was made, when, or how it was false. Plaintiff does not allege that it relied on any representation made by Loranger, or that its reliance was reasonable. Plaintiff also does not allege how any representation caused it to sustain a loss. Plaintiff's complaint is essentially a strict liability argument that Loranger received money for a project and failed to pay plaintiff.

Defendant's second argument is that Plaintiff cannot demonstrate fraud or defalcation while acting in a fiduciary capacity. Plaintiff's 523(a)(4) complaint is based on Allen v. Romero (In re Romero), 535 F.2d 618 (10th Cir. 1976), a Bankruptcy Act case. Bankruptcy Act § 17(a)(4) provided:

A discharge in bankruptcy shall release a bankrupt from all of his provable debts, whether allowable in full or in part, except such as ... (4) were created by his fraud, embezzlement, misappropriation or

defalcation while acting as an officer or in any fiduciary capacity.

In Romero, Allen advanced moneys to Romero to construct three four-plexes; Romero did not maintain separate bank accounts for each of his jobs, and it was impossible for him to determine if moneys advanced by Allen were disbursed to materialmen, laborers, and sub-contractors. 535 F.2d at 620. Romero also falsified lists of disbursements to obtain additional advances from Allen. Id. The Court of Appeals first discussed the concept of "fiduciary capacity" and noted that this connoted the idea of trust or confidence which arises whenever one's property is placed in another's custody. Id. at 621. The Court noted, however, that the exception under § 17(a)(4) only applied to "technical trusts" and not those that arose from contract. Id. Furthermore, the fiduciary relationship must have existed prior to the creation of the debt. Id. The Court of Appeals reviewed § 67-35-26(G) NMSA 1953³, which provided for the revocation of a license on

³Section 67-35-26(G) 1953 provided for revocation or suspension of a license on the grounds of:
diversion of funds or property received for prosecution or completion of a specific contract, or for a specified purpose in the prosecution or completion of any contract, obligation or purpose. The current wording of the statute, Section 60-13-23(F) NMSA 1978 (1997 Repl.), changes the word "diversion" to "conversion" and adds "as determined by a court of competent jurisdiction" to the end. For the purposes of this Memorandum

the grounds of "diversion" of funds or property received for a specific contract. Id. at 621-22.

The Supreme Court of New Mexico has stated that the purpose of the Act is to provide "a comprehensive method for the licensing and control of contractors in order to protect the public from either irresponsible or incompetent contractors." Peck v. Ives, 84 N.M. 62, 499 P.2d 684 (1972). In our view, § 67-35-26, supra, clearly imposes a fiduciary duty upon contractors who have been advanced money pursuant to construction contracts.

Id. at 621. The Court found that Romero was acting in a fiduciary capacity "imposed by law". Id. at 621-22. And, the fiduciary duties were binding upon Romero prior to his contracting with Romero by virtue of his obtaining a license. Id. The Court of Appeals, finding the requisite fiduciary capacity, then reviewed the record to determine whether the debt was created by "fraud, embezzlement, misappropriation or defalcation" as required by § 17(a)(4).

Under Defendant's reading of Romero, a fiduciary relationship is only owed to the customer advancing funds to the contractor.⁴ The Court disagrees. Romero makes the

Opinion the Court sees no distinction in the language.

⁴ Loranger appealingly argues that Romero in effect makes a fiduciary relationship out of every commercial transaction in the construction industry, Brief in Support of Defendant's Motion for Summary Judgment, at 4-5 (docket 9). However, Romero is still the law in this circuit, binding upon this Court where applicable, and thus this Court has no occasion to question whether the New Mexico contractor licensing scheme

contractor a trustee for the funds advanced. Under common law, a trustee has a duty to the beneficiaries to follow the instructions of the grantor with regard to execution of the trust. G. Bogert, *The Law of Trusts and Trustees* § 42 (2d ed. rev.). Therefore, a contractor has duties toward the subcontractors and suppliers. E.g., Antlers Roof-Truss & Builders Supply v. Storie (In re Storie), 216 B.R. 283 (10th Cir. B.A.P. 1997) (§523(a)(4) action brought by suppliers and subcontractors). This ruling comports with general bankruptcy policies. Creating a debt by breaching a fiduciary duty is a "bad act" that invokes section 523(a)(4). Id., at 289 (quoting Carlisle Cashway, Inc. v. Johnson (In re Johnson), 691 F.2d 249, 256 (6th Cir. 1982).) The Court does not see how this "bad act" would be any less depending on the identity of the plaintiff. To the extent that Defendant's Motion for Summary Judgment is a request that the complaint be dismissed on legal grounds, it will be denied.

Finding Loranger to be a fiduciary, however, does not resolve the question of his liability to Plaintiff. Defalcation is a failure to account for funds entrusted to a fiduciary. Storie, 216 B.R. at 287. Defalcation under section 523(a)(4) is a fiduciary-debtor's failure to account

creates a fiduciary relationship.

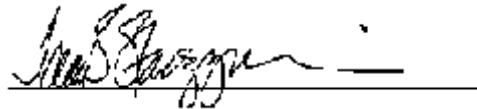
for funds due to any breach, whether intentional, wilful, reckless, or negligent. Id. at 288. The complaint, arguably, alleges that Loranger received trust funds which he misapplied. Loranger's affidavit does not discuss the application of funds he received from owners. If no funds were misapplied, and Loranger simply ran out of money due to unforeseen circumstances or negligence, that would be a very different situation from one where Loranger used the funds for personal or other purposes. Reading Romero, 535 F.2d at 621-22 together with Storie, 216 B.R. at 290 ("failing to fully account for funds entrusted to them and paying themselves a salary prior to paying Antlers"), it appears that all suppliers and subcontractors need to be paid as a condition to the funds being used for any other purpose, such as compensation to the contractor.⁵ But if the contractor were able to show that all the funds paid over to the contractor were completely and solely disbursed to suppliers and subcontractors, then presumably there would have been no defalcation. Since the factual record on this issue is

⁵ This statement is not intended to be taken as a chronological measurement; that is, if the suppliers and subcontractors are being paid current during a project, and there are sufficient funds to pay the contractor some portion of the funds during the course of the project, the contractor is not precluded from doing so.

insufficient at this time, the motion for summary judgment will be denied as to the Section 523(a)(4) claims.

SUMMARY

Defendant's Motion for Summary Judgment is granted in part. The Court will dismiss the claims under Section 523(a)(2). The Court will deny the Motion for Summary Judgment with respect to the Section 523(a)(4) claims.



Honorable James S. Starzynski
United States Bankruptcy Judge

I hereby certify that on October 12, 2001, a true and correct copy of the foregoing was either electronically transmitted, faxed, delivered, or mailed to the listed counsel and parties.

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