NOT FOR PUBLICATION

UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF NEW JERSEY

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In re:

Bernard W. Ozarowski,

Debtor.

Chapter 7
Case No. 02-52981(RTL)

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TULIO DIAZ,

Plaintiff,

v.

BERNARD W. OZAROWSKI,

Defendant.

Adversary Proceeding
No. 06-1245(RTL)

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OPINION

APPEARANCES:

TEICH GROH
Allen I. Gorski, Esq.
Counsel for Plaintiff

ALEXANDER W. BOOTH, Esq.
Counsel for Defendant

RAYMOND T. LYONS, U.S.B.J.

The Plaintiff contends that his claim against the Debtor for $84,000 in medical bills is nondischargeable under 11 U.S.C. § 523(a)(2), (3) or (4). Because: (1) the Plaintiff failed to establish a prima facie case for actual fraud under 11 U.S.C. § 523(a)(2); (2) no-asset, no bar date bankruptcy proceedings allow a debtor to gain a discharge despite a failure to list a creditor on the petition under 11 U.S.C. § 523(a)(3); and (3) officers of an insolvent company are not acting in a fiduciary capacity to the company's employees under 11 U.S.C. § 523(a)(4), the court

finds any claim held by the Plaintiff was discharged.

JURISDICTION

This court has jurisdiction under 28 U.S.C. § 1334(a) and (b), 28 U.S.C. § 157(a) and (b)(1), and the Order of Reference from the United States District Court for the District of New Jersey. Additionally, this is a core proceeding that may be heard and determined by a bankruptcy judge under 28 U.S.C. § 157(b)(2)(I) to determine the dischargeability of a particular debt.

FINDINGS OF FACT

Debtor/Defendant, Bernard Ozarowski, ("the Debtor") was the owner and President of FEM COM Business Systems, Inc. d/b/a Coastal Copy Systems ("Coastal"), that sold and serviced copy machines. Plaintiff, Tulio Diaz, ("the Plaintiff") was employed by Coastal as a technician servicing copiers. Coastal provided health benefits to all of its employees at its cost without contribution from the employees.

During his tenure at Coastal, the Plaintiff incurred medical bills while hospitalized totaling over $84,000.00. Plaintiff was rushed to the hospital on December 20, 1998 and was told he suffered a heart attack. He informed the hospital that he had medical insurance through his employer. He stayed in the hospital a few days and was discharged. Plaintiff suffered a second heart attack on December 27, 1998 and was again admitted to the hospital. A person in the hospital's accounting office informed the Plaintiff that the insurance carrier said his coverage had been cancelled. On December 29, 1998, Mr. Diaz's wife called Coastal and spoke to an administrative assistant to get confirmation that he was covered by health insurance. Mr. Ozarowski was not at Coastal when Mrs. Diaz called but returned shortly thereafter. He was

informed of Mr. Diaz's situation and called the hospital. In order to satisfy the hospital that Mr. Diaz's expenses would be paid, on December 29, 1998, Mr. Ozarowski sent a letter on Coastal's letterhead stating:

> Please accept this as authorization to bill Coastal Copy Systems for any medical expenses incurred by Tulio Diaz. Currently our medical insurance policy with Nylcare is on administrative hold.[1] Our insurance broker is in the process of resolving the problem. Any questions or concerns, please don't hesitate to call.

Mr. Diaz was discharged from the hospital and, after convalescing at home, returned to work at Coastal in February, 1999. Mr. Diaz presented his hospital bills to Mr. Ozarowski who said he would take care of them. Coastal paid $5,000 or $6,000 to the hospital but the balance remained unpaid. Mr. Diaz stayed at Coastal until June 1999 when he quit and went to work for another copier company. Since Coastal did not reinstate or replace its employee health insurance in 1999, Mr. Diaz obtained coverage through his wife's employer, although it was difficult considering his recent heart problems. Before December 1998, Mr. Diaz had no history of health problems and could have easily gotten coverage with his wife's employer.

Although Coastal had provided health insurance for its employees, the carrier had cancelled the coverage in September 1998, three months prior to Mr. Diaz's hospitalization. Mr. Diaz was not aware that his coverage had been cancelled. Had he been aware that Coastal was not providing coverage, Mr. Diaz could have immediately been covered under his wife's health insurance through her employer and his medical expenses for the two hospitalizations in December 1998 would have been paid. In other words, had he known the true state of facts in

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[1] The term "administrative hold" was made up by Mr. Ozarowski to induce the hospital to continue caring for Mr. Diaz. In fact, the medical insurance had been cancelled for non-payment of premiums.

September 1998 he would not have suffered any damage.

Mr. Ozarowski testified that he was, likewise, unaware that Coastal's employee health insurance had been cancelled in September 1998. Coastal had a history of paying its health insurance premiums late, but it had managed in the past to make a payment in time to avoid cancellation. According to Mr. Ozarowski, the first time he knew that Coastal's health insurance had been cancelled was on December 29, 1998, when he returned to the office after Mrs. Diaz had called. By that time, all of the employees in the office had heard about Mr. Diaz's situation. Mr. Ozarowski maintains he was about the last to know that the insurance was cancelled. No evidence was offered that Mr. Ozarowski knew of the cancellation at any earlier time.

Mr. Ozarowski joined Coastal as a salesman in 1985. The owner offered him 35% of the stock in the company as an inducement to stay in 1988. Mr. Ozarowski continued with his forté, sales, that kept him out of the office. The other owner ran the administration. At its peak, Coastal had 64 employees. In 1996, some problems developed between the owners. The majority owner left, leaving Mr. Ozarowski as the sole owner, director and president. This was followed in 1997 by the loss of Coastal's largest customer. To prop up the business, Mr. Ozarowski took out a mortgage on his residence, that had been free and clear, and another mortgage against a second home. Also, Mr. Ozarowski stopped drawing a salary. The business never recovered and Coastal filed a petition under chapter 11 of the Bankruptcy Code on September 22, 1999. The case was converted to chapter 7 on January 24, 2000 and the company liquidated. Mr. Ozaroski estimates that he lost between $1.5 and $2 million through Coastal's demise.

In October 2001, the Plaintiff filed suit against Mr. Ozarowski and the health insurance

company in United States District Court for payment on the $84,000 owed in medical bills. The insurance company settled for a nominal amount. It maintained it had terminated coverage properly. Mr. Diaz and his attorney agreed to drop the claim for a token payment. The Debtor was aware of the filed complaint, but failed to hire an attorney or provide an answer. Judgment by default was entered against him. In October 2003, the Debtor was served with an order for judgment entered by the United States District Court.[2] In October 2004, the Debtor was served with a United States District Court wage execution. The Debtor was eventually served with an arrest warrant.

Mr. Ozarowski has filed personal bankruptcy four times, all attributable to Coastal's problems. He filed two chapter 13 cases in 1999: one in July before Coastal's bankruptcy, the other in November while Coastal was a debtor in possession in its case. Neither of Mr. Ozarowski's chapter 13 cases succeeded; each was dismissed after a few months and he did not receive a discharge.

On March 14, 2002, Mr. Ozarowski filed a petition under chapter 7 of the Bankruptcy Code. By that time, he had lost his second home in foreclosure and his primary residence was encumbered by mortgages that exceeded its value. The chapter 7 trustee did not administer any assets, Mr. Ozarowski received a discharge, and his case was closed in April 2003. Mr. Diaz was not scheduled as a creditor and received no notice of the case. After the arrest warrant was issued in the District Court, on August 12, 2005, Mr. Ozarowski moved to reopen his 2002

[2] Although one might question Mr. Ozarowski's personal liability for a corporate obligation, that issue is foreclosed by the prepetition default judgment against Mr. Ozarowski in the United States District Court. He is liable to Mr. Diaz for the amount of the judgment. The question is whether the debt was discharged in this 2002 bankruptcy case or whether it is excepted from discharge as Plaintiff maintains.

chapter 7 case and add Mr. Diaz as a creditor. Plaintiff thereafter initiated this adversary proceeding to determine dischargeability.

The Debtor filed his fourth bankruptcy in chapter 11 on December 2, 2005 and the Plaintiff was listed on the petition as a creditor. The Debtor tried to refinance the mortgages on his residence but was unsuccessful. The mortgagees received relief from the automatic stay to continue foreclosure. The case was converted to chapter 7 but Mr. Ozarowski is not entitled to a discharge since he received one in the 2002 case. 11 U.S.C. § 727(a)(8).

DISCUSSION

Fraud

Mr. Diaz argues that Mr. Ozarowski's silence regarding the cancellation of Coastal's employee medical insurance constituted actual fraud and, therefore, his claim is excepted from discharge under Section 523(a)(2)(A) of the Bankruptcy Code. "The overriding purpose of the Bankruptcy Code 'is to relieve debtors from the weight of oppressive indebtedness and provide them with a fresh start.'" *Starr v. Reynolds (In re Reynolds),* 193 B.R. 195, 200 (D.N.J. 1996) quoting *Insurance Co. of N. Am. v. Cohn (In re Cohn),* 54 F.3d 1108, 1113 (3d Cir. 1995). Accordingly, exceptions to discharge are to be narrowly construed. A countervailing policy is that debts incurred through fraud should not be discharged. The discharge is reserved for the honest but unfortunate debtor. *Grogan v. Garner*, 498 U.S. 279, 286-287 (1991). "Where a debtor has committed fraud under the code, he is not entitled to the benefit of a policy of liberal construction against creditors." *Cohen v. De La Cruz (In re Cohen),* 106 F.3d 52, 59 (3d Cir. 1997), *aff'd* 523 U.S. 213 (1998). This countervailing policy is codified in § 523(a)(2)(A) of the Bankruptcy Code which provides:

> A discharge under section 727 . . . 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. . . .

Since Congress has not provided a separate definition, fraud has the same meaning in the Bankruptcy Code as in the common law of torts. *Field v. Mans*, 516 U.S. 59, 69-70 (1995).

> The operative terms in § 523(a)(2)(A), on the other hand, "false pretenses, a false representation, or actual fraud," carry the acquired meaning of terms of art. They are common-law terms, and, as we will shortly see in the case of "actual fraud," which concerns us here, they imply elements that the common law has defined them to include. . . .
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> It is . . . well established that "[w]here Congress uses terms that have accumulated settled meaning under . . . the common law, a court must infer, unless the statute otherwise dictates, that Congress means to incorporate the established meaning of these terms." . . .
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> [W]e will look to the concept of "actual fraud" as it was understood in 1978 when that language was added to § 523 (a)(2)(A). Then, as now, the most widely accepted distillation of the common law of torts was the Restatement (Second) of Torts (1976), published shortly before Congress passed the Act.
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> *Id.* (citations omitted).

Following the Court's guidance, one should look to the Restatement for the meaning of fraud. The Restatement (Second) of Torts, § 525, sets forth the law regarding liability for fraudulent misrepresentation.

> One who fraudulently makes a misrepresentation of fact, opinion, intention or law for the purpose of inducing another to act or to refrain from action in reliance upon it, is subject to liability to the other in deceit for pecuniary loss caused to him by his justifiable reliance upon the misrepresentation.

As the Supreme Court pointed out, "courts that have previously construed this statute, routinely

requir[e] intent, reliance, and materiality before applying § 523(a)(2)(A)." *Field v. Mans*, 516 U.S. at 68. Thus, for a debt to be nondischargeable under § 523(a)(2)(A) the creditor must prove that:

(1) the debtor represented a fact, opinion, intention or law;

(2) the representation was false;

(3) the representation was material;

(4) the debtor obtained money, property or services through the misrepresentation;

(5) the debtor knew at the time that the statement was false (or was made with reckless disregard for its truth);

(6) the debtor intended the creditor to rely on the statement;

(7) the creditor actually relied on the statement;

(8) the reliance was justified;

(9) the creditor sustained damage; and

(10) the damages were the proximate result of the false representation.

De La Cruz v. Cohen (In re Cohen), 191 B.R. 599, 604 (D.N.J. 1996), *aff'd sub nom.* 106 F.3d 52 (3d Cir. 1997), *aff'd* 523 U.S. 213 (1998). *AT&T Universal Card Servs. Corp. v. Wong (In re Wong)*, 207 B.R. 822, 826 (Bankr. E.D.Pa. 1997). Each element of the objection must be proved by a preponderance of the evidence. *Grogan v. Garner*, 498 U.S. at 287-88, *Starr v. Reynolds (In re Reynolds)*, 197 B.R. 204, 205 (Bankr. D.N.J. 1996).

The Plaintiff contends that the Debtor's silence regarding the lapse in medical coverage may serve as grounds for *prima facie* fraud. It has been held that silence as a representation can serve as a basis for *prima facie* fraud. *In re Tombadore*, 201 B.R. 710 (D. N.J. 1996) citing *In re*

Van Horne, 823 F.2d 1285, 1288 (8th Cir. 1987). Silence as to any material fact may constitute fraud in a section 523(a)(2) action. Creditors have the right to be informed of all facts related to the transaction and, in certain circumstances, a debtor's silence can rise to the level of fraud. *Id.* Still, silence alone will not necessarily satisfy the burden of proof required by the proponent. There needs to be a factual determination of the other elements of actual fraud. *Id.*

In this case, the Debtor's actions could constitute fraud where he had certain information and withheld it from the Plaintiff. The allegation is that Mr. Ozarowski knew that Coastal's health insurance was cancelled in September 1998 and failed to inform Mr. Diaz. By the time Mr. Diaz was hospitalized in December 1998, it was too late for him to obtain substitute health insurance coverage. Had he known earlier he could have easily obtained coverage through his wife's employer. Based on the evidence submitted, however, the Plaintiff has failed to establish that the Debtor had the requisite knowledge to commit fraud. Even if the Debtor's letter to the hospital in December 1998 serves to demonstrate that the Debtor knew that the Plaintiff had no coverage, the letter was written on December 29 after the time of the Plaintiff's injury. Plaintiff offered no evidence that Mr. Ozarowski knew that Coastal's employee health insurance had been cancelled. The only evidence was Mr. Ozarowski's testimony that he first learned of the insurance cancellation when he returned to the office on December 29 after Mrs. Diaz had called from the hospital. To prove fraud by silence, Plaintiff has to show that Defendant had knowledge and a duty to speak. Plaintiff produced no evidence that Defendant had such knowledge. Furthermore, it is insufficient to suggest that because the Debtor knew that Coastal was in financial trouble, he must have also known that medical coverage for Coastal's employees had been terminated. To deduce such facts, the court would have to reject Mr. Ozarowski's

testimony and infer knowledge of the insurance cancellation. It seems likely that if Mr. Ozarowski knew that the health insurance had been cancelled that there would have been direct evidence from the insurance carrier, the insurance broker, or other former employees of Coastal such as the office manager. None of this direct evidence was offered and the court declines to make such a deduction. Furthermore, the court finds no reason to doubt Mr. Ozarowski's testimony that he did not learn of the insurance cancellation until December 29 when Mr. Diaz had already been hospitalized for the second time. The Plaintiff needed to produce some support for the proposition that the Debtor specifically knew that employees of Coastal lacked medical coverage prior to the Plaintiff's hospitalization. The Plaintiff has failed in its burden to produce a *prima facie* case for fraud under 11 U.S.C. § 523(a)(2)(A).[3]

Not Scheduled

The second issue is whether the Plaintiff's claim is nondischargeable under 11 U.S.C. § 523(a)(3) because it was not listed on the Debtor's bankruptcy petition. Bankruptcy Code section 523(a)(3) excepts from discharge any debt:

> (3) neither listed nor scheduled under Section 521(1) of this title, with the name, if known to the debtor, of the creditor to whom such debt is owed, in time to permit -
>
> (A) if such debt is not of a kind specified in paragraph (2),(4), or (6) of this subsection, timely filing of a proof of claim,

[3] Plaintiff argued that two other frauds were committed by Mr. Ozarowski: the December 29, 1998 letter to the hospital promising that Coastal would pay the bills, and the February 1999 statement to Mr. Diaz that Mr. Ozarowski would "take care of" the bills. The first was a promise to do something in the future, breach of which is a contract claim, not fraud. *In re DeBaggis*, 247 B.R. 383 (Bankr. D.N.J. 1999). Also, most of Plaintiff's hospital bills had been incurred by December 29, 1998; there was no proof as to the expenses incurred after the letter. As to the February promise, no bills were incurred thereafter so none of the damages were proximately caused by this allegedly false promise. The court ruled at trial that neither of these other alleged frauds could form a basis for nondischargeability.

> unless such creditor had notice or actual knowledge of the case in time for such timely filing; or
>
> (B) If such debtor is of a kind specified in paragraph (2), (4), or (6) of this subsection, timely filing of a proof of claim and timely request for a determination of dischargeability of such debt under one of such paragraphs, unless such creditor has notice or actual knowledge of the case in time for such timely filing and request.

This chapter 7 case was reopened and the Debtor filed an Amended Schedule F listing Tulio Diaz as a creditor. An order was entered extending the date by which Mr. Diaz could file a complaint to determine dischargeability of his claim. He did so in a timely manner, so there is no question that the debt was not scheduled in time to request a determination of dischargeability under subsection 523(a)(3)(B). The only issue is whether the failure to schedule Mr. Diaz's debt before the time to file a proof of claim should bar discharge of that debt under subsection 523(a)(3)(A) or (B).

In "no-asset" chapter 7 bankruptcies, where no deadline for filing proofs of claim is established, a debt is discharged despite the debtor's failure to schedule the debt. *Judd v. Wolfe*, 78 F.3d 110 (3d Cir. 1996). The Bankruptcy Code views the right to file a proof of claim as a fundamental right of creditors. *Id.* at 114. In an effort to protect this right, section 523(a)(3)(A) excepts from discharge debts owed to creditors who did not know about the case in time to file a proof of claim. *Id.* at 115. In cases where the time for filing a claim has not, and never will, expire unless some assets are discovered, the right to file a proof of claim is futile and the application of section 523(a)(3)(A) is barred. *Id.* at 114.

In this case, the chapter 7 Trustee declared that he had found no property of the Debtor available for distribution from the estate over and above that exempted by law. As a result, the Debtor has presented the court with a "no-asset" bankruptcy case falling within the purview of

Judd v. Wolfe. Still, the Plaintiff argues that *Judd v. Wolfe* does not apply in situations where the Debtor intentionally fails to list a creditor on the petition. The Plaintiff has failed to provide adequate support for this proposition.

> The Bankruptcy Code does not impose a requirement of good faith for the discharge of an omitted debt in a no asset, no bar date case. No where in section 523(a)(3) is the reason why a debt was omitted from the bankruptcy schedules made relevant to the discharge of that debt...The plain language of section 523(a)(3) represents a congressional policy choice. Clearly, Congress could have exempted from the debtor's discharge, pursuant to sections 727(b) and 523, debts that were omitted intentionally, rather than merely inadvertently, from the debtor's schedules. Congress chose not to do so.

Judd v. Wolfe at 117, citations omitted.

As a creditor in a "no-asset" bankruptcy case without a bar date, the Plaintiff is prevented from having his claim deemed nondischargeable under bankruptcy code section 523(a)(3)(A) or (B) on account of the fact that the Debtor failed to list it on his petition.

Fiduciary Capacity

The third and final issue raised by the Plaintiff is whether the debt is nondischargeable under bankruptcy code section 523(a)(4) as a debt incurred for fraud or defalcation while acting in a fiduciary capacity. The Plaintiff contends that under the terms of employment with Coastal the Debtor would pay insurance premium for the benefit of its employees and that failure to do so amounts to a defalcation while acting in the fiduciary capacity of a corporate officer.[4] While the scope of "fiduciary capacity" under § 523(a)(4) is a question of federal law, the

[4] This is not a case where funds were withheld from employees wages then not remitted to the insurance carrier. Coastal undertook to provide health insurance without contribution from the employees.

determination of whether the requisite trust relationship exists between the parties requires an analysis of state law. *In re Casini,* 307 B.R. 800, 817 (Bankr. D.N.J. 2004) citing *In re Kaczynski,* 188 B.R. 770 (Bankr. D.N.J. 1995). Under New Jersey case law, directors of an insolvent corporation owe a fiduciary duty to creditors, sometimes characterized as a "quasi-trust" relationship. *Board of Trustees of Teamsters Local 863 Pension Fund v. Foodtown, Inc.*, 296 F.3d 164, 173 (3d Cir. 2002) citing *AYR Composition, Inc. v. Rosenberg*, 261 N.J. Super 495, 501, 619 A.2d 592 (App. Div. 1993). Under bankruptcy law, however, a corporate director is not the type of fiduciary whose debts should be excepted from discharge. *In re Casini,* 307 B.R. 800, 818 (Bankr. D.N.J. 2004). Numerous Supreme Court decisions have found that the meaning of "fiduciary" in section 523(a)(4) is limited to instances involving express or technical trusts. *Chapman v. Forsyth,* 43 U.S. 202, 207 (1844); *Davis v. Aetna,* 293 U.S. 328, 333 (1934); *Upshur v. Briscoe*, 138 U.S. 365, 378 (1891). While the Debtor acted as the officer of an insolvent company, this is not the type of fiduciary capacity within the meaning of Bankruptcy Code section 523(a)(4). For this reason, the Plaintiff is unable to prove the debt as nondischargeable under Bankruptcy Code section 523(a)(4).

CONCLUSION

For reasons discussed above, the court holds that the Plaintiff's claim against the Debtor is not excepted from discharge under bankruptcy code sections 523(a)(2), (3) or (4). The Plaintiff failed in his burden to establish a *prima facie* case for actual fraud under section 523(a)(2). Furthermore, because this is a no-asset bankruptcy case with no bar date, the debt is discharged despite the Debtor's failure to list it on the petition. Finally, bankruptcy law does not recognize officers of an insolvent company as acting in a fiduciary capacity with respect to

creditors under section 523(a)(4).

Dated: December 12, 2006

__/s/ Raymond T. Lyons_____
Raymond T. Lyons,
United States Bankruptcy Judge