

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF NEBRASKA

IN THE MATTER OF:)	BK01-42947
)	A02-4008
MARVIN A. EVERT and BONNIE EVERT,)	
)	CHAPTER 7
Debtors.)	
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PINNACLE BANK,)	FILING NO. 1
)	
Plaintiff,)	
)	
vs.)	
)	
MARVIN A. EVERT and BONNIE EVERT,)	
)	
Defendants.)	

MEMORANDUM

Trial on the adversary complaint was held on May 28, 2003, in Lincoln, Nebraska. Joel G. Lonowski appeared for the plaintiff, and Douglas D. DeLair appeared for the defendants. This memorandum contains findings of fact and conclusions of law required by Federal Rule of Bankruptcy Procedure 7052 and Federal Rule of Civil Procedure 52. This is a core proceeding as defined by 28 U.S.C. § 157(b)(2)(I).

BACKGROUND

Pinnacle Bank brought this action in the Chapter 7 case of the debtors/defendants to obtain a judgment of non-dischargeability under 11 U.S.C. §§ 523(a)(2)(A) & 523(a)(6). The bank alleges that the debtors presented a check to the bank in the amount of \$15,000 for deposit into the checking account of Mr. Evert, that the bank gave immediate credit, that the debtors wrote checks on the account against the \$15,000 deposit, and then the \$15,000 deposited check was dishonored, leaving an overdraft of \$9,734.48. It is the position of the bank that the presentation of the check, which was later dishonored, and the act of writing checks against the dishonored amount, enabled the debtors to obtain money under false pretenses, a false representation, or actual fraud and therefore the obligation represented by the overdraft should not be discharged.

Separately from and in addition to the claim concerning the dishonored check, the debtors borrowed \$100,000 from the bank and gave the bank a security interest in an assignment of an investment account with Linsco Private Ledger, which contained stocks, bonds, mutual funds, money market funds

and other investments. The agreement between the bank and the debtors with regard to the Linsco Private Ledger account required the debtors to refrain from taking distributions from the account if such receipt of distributions would reduce the asset value of the account to less than \$100,000. In other words, the debtors agreed to secure the \$100,000 note from the bank with \$100,000 in asset value in the Linsco Private Ledger account. The value of the Linsco Private Ledger account did decline to less than \$100,000 in September of 2001, resulting in part from a \$15,000 distribution taken by the debtors at that time.

It is the position of the bank that, by allowing the asset value in the Linsco Private Ledger account to decline to less than \$100,000, and specifically by withdrawing funds to cause such decline, the debtors willfully and maliciously injured the collateral interest of the bank and, therefore, the difference between the \$100,000 minimum required asset value and the actual balance of approximately \$58,000 on the bankruptcy petition date should be deemed non-dischargeable.

DECISION

Judgment shall be entered in favor of the defendants and against the plaintiff on each claim for relief. The debts owed to Pinnacle Bank are discharged.

FACTS

For several years prior to May of 2000, the debtors owned an investment account with Linsco Private Ledger and had an outstanding loan of approximately \$100,000 secured by the account. Originally the loan was with National Bank of Commerce in Lincoln, Nebraska. In May of 2000, the debtors, following their loan officer from National Bank of Commerce to Pinnacle Bank, borrowed \$100,000 from Pinnacle Bank and used the funds to pay off the National Bank of Commerce obligation. They secured the obligation to Pinnacle Bank by the assignment and grant of a security interest in the Linsco Private Ledger account to Pinnacle Bank. At that time, there was more than \$400,000 in the account.

In May of 2001, the loan was renewed and the Linsco Private Ledger account continued as security for the loan. The debtors had, both before May of 2000 and after, used the Linsco Private Ledger account as an active investment vehicle. They purchased shares of stock on "margin." That means that they were able to purchase stock by borrowing against the value of the assets in the Linsco Private Ledger account. The original source of the funds for the Linsco Private Ledger was the proceeds of sale of a business owned by the Everts. After the sale of the business, the Everts did not have regular monthly income from employment and withdrew funds from the account, regularly in the approximate amount of \$15,000 per month, to cover living expenses.

In August of 2001, the stock market apparently declined in value, and management of the Linsco Private Ledger account made a margin call. This means that the value of the stock in the Linsco Private Ledger account which had been pledged to permit margin purchases of stock was not valued at a sufficient level to protect the interest of the margin lender. Therefore the margin lender requested a pay-down and took more than \$200,000 to cover the margin debt. At approximately the same time, the Everts took a

withdrawal of \$15,000. The combination of the decline in the value of the stock market generally, the margin call withdrawal, and the \$15,000 distribution to the Everts resulted in the asset value of the Linsco Private Ledger investment account being reduced to approximately \$58,000.

Upon learning that the value in the account had declined to less than \$100,000, Mr. Evert contacted the loan officer at Pinnacle Bank and informed him of the status of the account. Such information caused the bank to request full payment of the loan or a replenishment of the asset value in the Linsco Private Ledger account. Mr. Evert attempted to refinance the mortgage on his home to obtain approximately \$60,000 of equity to be deposited in the account to protect the interest of the bank. That refinancing did not occur because Pinnacle Bank had a second mortgage on the house which impaired the equity that Mr. Evert believed he had.

With regard to the claim of the bank concerning the \$15,000 check which was dishonored, that check was one provided to Mrs. Evert on a credit card account that she held. She received a cover letter and several blank checks from the credit card company. The letter informed her that she could use the checks for any purpose in an amount up to \$15,000. Mr. Evert had informed her that his checking account was overdrawn at Pinnacle Bank and, to cover the overdraft, she wrote him a check in the amount of \$15,000. He endorsed the check and deposited it into his Pinnacle Bank account. Apparently because of the business relationship that he had with Pinnacle Bank, Pinnacle Bank gave immediate credit for the \$15,000 deposit. At the time the deposit was made, the account was overdrawn by approximately \$3,300. After the deposit of the \$15,000 check, and before it was dishonored approximately a week later, other checks drawn on the account were paid by the bank, increasing the eventual overdraft to approximately \$6,800. Then, the bank received notice of the dishonor of the \$15,000 deposited check. Even after receiving such notice, the bank continued to pay checks in the approximate amount of \$3,000, thereby increasing the overdraft to the amount claimed in the complaint of approximately \$9,800.

The \$15,000 check was dishonored because, although the cover letter to Mrs. Evert from the credit card company informed her that she could write checks up to the amount of \$15,000, she apparently had a balance on the credit card account which, when added to the \$15,000 check that was eventually drawn, put her account over its maximum credit limit. As a result, the credit card company would not honor the \$15,000 check. Her testimony, and it is credible testimony, is that she was not aware that she had a balance on the account prior to the time she wrote the check. In addition, she was not aware that there were any strings attached to the check, such as a maximum account limit which would preclude her use of the check. In other words, her use of the check was entirely innocent and solely for the purpose of covering overdrafts in her husband's checking account. When the check was dishonored and she was informed of its dishonor, she contacted the credit card company to find out what the problem was. She was informed about the maximum credit limit at that time.

Mr. Evert had endorsed the check and deposited it to the account in the innocent belief that it was a valid check which would be honored and which would cover the overdraft in his checking account.

For a debt to be declared non-dischargeable under § 523(a)(2)(A) for fraud, the creditor must

show, by a preponderance of the evidence, that: (1) the debtor made a representation; (2) the representation was made at a time when the debtor knew the representation was false; (3) the debtor made the representation deliberately and intentionally with the intention and purpose of deceiving the creditor; (4) the creditor justifiably relied on such representation; and (5) the creditor sustained a loss as the proximate result of the representation having been made. Universal Bank, N.A. v. Grause (In re Grause), 245 B.R. 95, 99 (B.A.P. 8th Cir. 2000) (citing Thul v. Ophaug (In re Ophaug), 827 F.2d 340, 342 n.1 (8th Cir. 1987), as supplemented by Field v. Mans, 516 U.S. 59 (1995)).

The focus of a § 523(a)(2)(A) determination is whether the debtor ever intended to pay the obligation.

To qualify as a false representation or false pretense under § 523(a)(2)(A), the statement must relate to a present or past fact. Shea v. Shea (In re Shea), 221 B.R. 491, 496 (Bankr. D. Minn. 1998). "[A debtor's] promise . . . related to [a] future action [which does] not purport to depict current or past fact . . . therefore cannot be defined as a false representation or a false pretense." Id. (quoting Bank of Louisiana v. Bercier (In re Bercier), 934 F.2d 689, 692 (5th Cir. 1991)). A debtor's promise related to a future act can constitute actionable fraud, however, where the debtor possesses no intent to perform the act at the time the debtor's promise is made. Universal Pontiac-Buick-GMC Truck, Inc. v. Routson (In re Routson), 160 B.R. 595, 609 (Bankr. D. Minn. 1993).

Gadtke v. Bren (In re Bren), 284 B.R. 681, 690 (Bankr. D. Minn. 2002).

"The intent element of § 523(a)(2)(A) does not require a finding of malevolence or personal ill-will; all it requires is a showing of an intent to induce the creditor to rely and act on the misrepresentations in question." Merchants Nat'l Bank v. Moen (In re Moen), 238 B.R. 785, 791 (B.A.P. 8th Cir. 1999) (quoting Moodie-Yannotti v. Swan (In re Swan), 156 B.R. 618, 623 n.6 (Bankr. D. Minn. 1993)). "Because direct proof of intent (i.e., the debtor's state of mind) is nearly impossible to obtain, the creditor may present evidence of the surrounding circumstances from which intent may be inferred." Id. (quoting Caspers v. Van Horne (In re Van Horne), 823 F.2d 1285, 1287 (8th Cir. 1987)). The intent to deceive will be inferred when the debtor makes a false representation and knows or should know that the statement will induce another to act. Id. (quoting Federal Trade Comm'n v. Duggan (In re Duggan), 169 B.R. 318, 324 (Bankr. E.D.N.Y. 1994)).

The applicable law in this circuit regarding non-dischargeability under § 523(a)(6) has been explained as follows:

Under section 523(a)(6), a debtor is not discharged from any debt for "willful and malicious injury" to another. For purposes of this section, the term willful means deliberate or intentional. See Kawaauhau v. Geiger, 523 U.S. 57, 61, 118 S. Ct. 974, 140 L. Ed. 2d 90 (1998) (§ 523(a)(6) requires deliberate or intentional injury); In re Long, 774 F.2d 875, 881 (8th Cir. 1985) (to meet willfulness component of § 523(a)(6), debtor's actions

creating liability must have been "headstrong and knowing"). To qualify as "malicious," the debtor's actions must be "targeted at the creditor . . . at least in the sense that the conduct is certain or almost certain to cause financial harm." In re Long, 774 F.2d at 881.

Hobson Mould Works, Inc. v. Madsen (In re Madsen), 195 F.3d 988, 989 (8th Cir. 1999).

The Bankruptcy Appellate Panel of the Eighth Circuit recently discussed the necessary elements for a finding of "malice" in Johnson v. Logue (In re Logue), 294 B.R. 59 (B.A.P. 8th Cir. 2003):

Malice requires conduct more culpable than that which is in reckless disregard of the creditor's economic interests and expectancies. Long, 774 F.2d at 881. The debtor's knowledge that he or she is violating the creditor's legal rights is insufficient to establish malice absent some additional aggravated circumstances. Conduct which is certain or almost certain to cause financial harm to the creditor is required. While intentional harm may be difficult to establish, the likelihood of harm in an objective sense may be considered in evaluating intent. Id.

In the context of the breach of a security agreement, a willful breach is not enough to establish malice. Phillips, 882 F.2d at 305; Long, 774 F.2d at 882. As the Eighth Circuit Court of Appeals stated:

Debtors who willfully break security agreements are testing the outer bounds of their right to a fresh start, but unless they act with malice by intending or fully expecting to harm the economic interests of the creditor, such a breach of contract does not, in and of itself, preclude a discharge.

Long, 774 F.2d at 882.

Johnson v. Logue, 294 B.R. at 63.

CONCLUSION

In this case there is no evidence that the debtors intended to deceive the bank or cause it to rely on knowingly false representations. Likewise, there is no evidence that the debtors willfully and maliciously caused harm to the bank. The debtors diligently tried to cover the shortfall in the investment account and the overdrawn checking account. The fact that they were unable to do so does not rise to the level of intentional fraud or willful and malicious injury.

Separate judgment will be entered.

DATED this 28th day of July, 2003.

BY THE COURT:

/s/Timothy J. Mahoney
Chief Judge

Notice given by the court to:

*Joel G. Lonowski
Douglas D. DeLair
Joseph H. Badami
U.S. Trustee

Movant (*) is responsible for giving notice of this memorandum to all other parties not listed if required by rule or statute.

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MARVIN A. EVERT and)
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JUDGMENT

Trial on the adversary complaint was held on May 28, 2003, in Lincoln, Nebraska. Joel G. Lonowski appeared for the plaintiff, and Douglas D. DeLair appeared for the defendants.

IT IS ORDERED: Judgment is hereby entered in favor of the defendants and against the plaintiff on each claim for relief. The debts owed to Pinnacle Bank are discharged.

See Memorandum filed this date.

DATED this 28th day of July, 2003.

BY THE COURT:

/s/Timothy J. Mahoney
Chief Judge

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Douglas D. DeLair U.S. Trustee

Movant (*) is responsible for giving notice of this judgment to all other parties not listed if required by rule or statute.