

In the United States Bankruptcy Court
for the
Southern District of Georgia
Savannah Division

In the matter of:)	
)	Adversary Proceeding
KENT C. POTTER)	
(Chapter 7 Case <u>95-20049</u>))	Number <u>95-2014</u>
)	
<i>Debtor</i>)	
)	
)	
SOUTHEASTERN BANK)	
)	
<i>Plaintiff</i>)	
)	
)	
v.)	
)	
KENT C. POTTER)	
)	
<i>Defendant</i>)	

MEMORANDUM AND ORDER

This action is a complaint to determine dischargeability of a debt pursuant to Title 11 U.S.C. Section 523(a)(2) and (6). Plaintiff, Southeastern Bank, claims that it is owed approximately \$31,428.00 as the balance due under a note signed by Defendant/Debtor before filing for bankruptcy protection and asserts that this obligation is nondischargeable.

By virtue of 28 U.S.C. Section 157(b)(2)(I), this matter is a core proceeding. After a trial on December 7, 1995, I make the following findings of fact and conclusions of law.

FINDINGS OF FACT

On January 20, 1994, Debtor individually and as president of Precision Restaurant Services, Inc., a food service and restaurant equipment supplier, executed a Promissory Note for \$35,000.00 together with a security agreement and a UCC-1 financing statement pledging certain restaurant equipment owned and to be acquired with the loan proceeds (Exhibits P-1, P-2, and P-3).

Debtor had attached to his written loan request a list of his existing equipment which cost \$17,778.00. Testimony revealed that Debtor in fact possessed all of the listed equipment except a \$4,300.00 washer which had recently been sold.¹ Debtor also provided a specific list of equipment which he intended to purchase totaling \$33,562.00 (Exhibit P-6).

On that same day, Debtor signed a commercial loan sheet which specified the purpose of the loan as "purchase equipment" (Exhibit P-5). Debtor's loan request also revealed the purpose to include certain renovations to his business premises (Exhibit P-4).

Southeastern Bank filed the appropriate financing statement evidencing its security

¹ This Court finds that the failure to list the washer was an oversight. During the loan negotiations, Southeastern Bank's loan officer required a list of equipment to complete the transaction. Debtor went to his place of business where he recalled from the computer a list of equipment which had not been updated since November of 1993. Because Debtor had sold the washer in December of 1993 it was omitted from the list of equipment when Debtor returned to the bank.

agreement which granted a security interest in all present and future equipment of Debtor. All parties understood that Debtor leased his business premises and that the lease required all fixtures or improvements to remain with the property.

On January 20, 1995, Debtor withdrew all of the loan proceeds and transferred the money into his operating business checking account. However, Debtor did not purchase all of the listed equipment. A series of unforeseen economic and personal hardships caused Debtor to use the proceeds other than for their intended purpose. These include business failures of some of his customers, embezzlement by an employee, and Debtor's divorce.

During the first half of 1994, Debtor began a portion of the showroom renovations and purchased some of the required inventory and equipment. However, for the most part, instead of applying the loan proceeds towards the purchase of equipment, Debtor used the money to sustain the business' day to day operations. Specifically, Debtor applied the money towards employees' salaries, taxes owed, and the monthly payments of the loan with Southeastern Bank.

The parties closed an additional loan in October of 1994 in which Debtor pledged two automobiles as collateral and received \$6,200. Although the exact date of the closing of Debtor's business is unknown, it is clear that Southeastern Bank eventually accelerated its loan and repossessed some of Debtor's equipment. Thereafter, Debtor filed for bankruptcy on January 23, 1995.

Plaintiff alleges that (1) Debtor provided a false list of existing equipment when procuring the loan, (2) Debtor failed to purchase specific items of equipment as required in the loan agreement, and (3) Debtor used the loan proceeds for purposes beyond the scope of the loan agreement. Debtor contends that the loan agreement actually permitted an extended time within which to purchase the required equipment and make the specified improvements. Moreover, Debtor asserts that his actions although intentional were not malicious.

CONCLUSIONS OF LAW

In pertinent part, 11 U.S.C. Section 523(a)(2) and (6) provides,

(a) A discharge under section 727 . . . of this title 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 or an insider's financial condition;

(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)(2) and (6). Plaintiff requests that this debt be excepted from discharge pursuant to Sections 523(a)(2) and (6). The burden of proof in non-dischargeability actions is upon the plaintiff excepting a discharge to show by a preponderance of the evidence that a discharge is not warranted. Grogan v. Garner, 498 U.S. 279, 111 S.Ct. 654, 112 L.Ed. 2d

755 (1991).

In order to except a particular debt from discharge because of fraud, a creditor must prove the following:

- (1) the debtor made a false representation with the purpose and intention of deceiving the creditor;
- (2) the creditor relied upon such representation;
- (3) such reliance by the creditor was justifiable;
- (4) the creditor suffered a loss as a result of that reliance.

In re Hunter, 780 F.2d 1577, 1579 (11th Cir. 1986); In re Phillips, 804 F.2d 930 (6th Cir. 1986); In re Lacey, 85 B.R. 908 (Bankr.S.D.Fla. 1988). *See also* In re Vann, 67 F.3d 277 (11th Cir.1995)(reliance must be justifiable); In re Kimzey, 761 F.2d 421, 423 (7th Cir. 1985) (plaintiff must demonstrate reliance on the debtor's representations); In re Dobbs, 115 B.R. 258, 265 (Bankr.D.Idaho 1990); Matter of Carpenter, 53 B.R. 724, 729 (Bankr.N.D.Ga. 1985)(actual fraud).

In order to be non-dischargeable the objecting creditor must show that property was obtained by fraud in the inception. In re Marazino, 67 B.R. 394 (Bankr.D.Kan. 1986). In other words, the original debt must have been incurred through fraudulent conduct. *See* In re Barney, 186 B.R. 105 (Bankr.N.D.Ohio 1987). The intent to deceive

must be present at the time the goods and services are obtained not later. In re Pitt, 121 B.R. 493, 495 (Bankr.E.D.Va. 1990).

In regard to the Section 523(a)(2) contention, I conclude that Plaintiff has not met its burden in this case. Although Plaintiff did prove that Debtor supplied an erroneous list of equipment when procuring the loan, Plaintiff has not carried its burden demonstrating Debtor's intent to deceive. Debtor testified that the inclusion of the washer was an innocent oversight because it had been recently sold and I find this testimony credible. Plaintiff offered no evidence to refute this testimony. Accordingly, Plaintiff's Section 523(a)(2) action to except the debt from discharge is denied.

However, in regard to the Section 523(a)(6) motion, I conclude that Plaintiff has met its burden. In order to except a debt from discharge under Section 523(a)(6), the creditor must prove three elements by a preponderance of the evidence: (1) that the debtor injured another entity or property of another entity; (2) that the debtor's actions were deliberate and intentional; and (3) that the debtor's actions were malicious.

The Eleventh Circuit in Chrysler Credit Corp. v. Rebhan, 842 F.2d 1257 (11th Cir.1988), approved and adopted the approach set forth in United Bank of Southgate v. Nelson, 35 B.R. 766 (Bankr.N.D.Ill. 1983) in construing the "willful and malicious" elements of 11 U.S.C. Section 523(a)(6). Under Southgate, "willful means deliberate or intentional" and "malice for purposes of Section 523(a)(6) can be established by a finding of implied or constructive malice." Rebhan, 842 F.2d at 1263. "No showing of personal

hatred, spite, or ill will is required to prove an injury malicious; it is enough that it was 'wrongful and without just cause or excuse.'" In re Lindberg, 49 B.R. 228, 230 (Bankr.D.Mass. 1985) [quoting In re Askew, 22 B.R. 641, 643 (Bankr.M.D.Ga. 1982) aff'd 705 F.2d 469 (11th Cir.1983).] Hence, an injury is considered "willful" if it is intentional and "malicious", if it results from an intentional or conscious disregard of one's duties. Id. at 643. A conversion of property of another can amount to a willful and malicious injury. Id. at 643.

To meet the wilful and malicious standard of Section 523(a)(6) the Debtor must be aware that the act violates the property rights of another. Matter of Brinsfield, 78 B.R. 364, 370 (Bankr.M.D.Ga. 1987). In assessing the intent of the debtor, a business person will be held to a higher standard than an ordinary individual where it is clear that the business person would be more knowledgeable of the natural consequences of his act. Matter of Ricketts, 16 B.R. 833, 834-35 (Bankr.N.D.Ga. 1982).

It is often difficult to prove that one holds a purposeful intent to harm another. However, when one acts with the knowledge that his acts are in contravention of the rights of another yet proceeds deliberately and intentionally in the face of that knowledge, without justification or excuse, this Court will infer malice and render such debt non-dischargeable under Section 523(a)(6).

Considering the above, it was established that Debtor is a sophisticated businessman and that Debtor understood the terms of the agreement. Debtor borrowed

approximately \$33,500.00 for the express purpose of making \$4500.00 of improvements and purchasing \$29,000.00 of restaurant equipment. In actuality, Debtor spent approximately \$8,000.00 of the loan proceeds towards the purchase of new equipment. Debtor intentionally used the remainder of the loan proceeds to support the day to day operations of his business although he knew that these actions were contrary to the loan agreement and that his failure to purchase the required collateral deprived creditor, Southeastern Bank, of a valuable remedy in case of default. As a result, I find his actions to be both willful and malicious.

Because a portion of the proceeds were properly utilized, however, the debt excluded from discharge is not the balance on the account. Rather, the loan proceeds not applied towards the purchase of restaurant equipment or renovations shall be excepted from discharge. I conclude that an obligation of \$20,362.50 from Debtor, Kent C. Potter, to Plaintiff, Southeastern Bank, is excepted from discharge in this bankruptcy proceeding.² While there was testimony that the liquidation value of the items would have been less than the original cost, the measure of damages in this case is the actual dollar amount converted to some use other than that for which the funds were advanced. Certainly it is this Court's

² The cost of the following items of restaurant supply equipment which were listed on Debtor's "Expected Application of Loan" (Exhibit P-6) and never purchased comprise the total amount excepted from discharge:

1. Walk in Refrigerator: \$3,030.00
2. Walk in Freezer: \$3,987.00
3. Pallet Racks: \$4,640.00
4. Pallets: \$800.00
5. Straddle Stacker: \$3,400.00
6. Shelving for Reefer: \$1,673.00
7. Shelving for Freezer: \$1,936.00
8. Pallet Truck: \$521.00
9. (2) Black Belts: \$59.50
10. Safety Step Steel Ladder: \$316.00
11. Computer Printer: unknown

experience that the amount recovered by Southeastern, had Debtor purchased all these items, would be far less than the cost of acquisition, but Debtor made the decision to misapply the loan proceeds and deprive Southeastern of its collateral and of its opportunity to liquidate it on favorable terms. It would be inappropriate to give Debtor the benefit of any reduction in the loss sustained based upon mere speculation as to the liquidation value of those very goods which, by Debtor's conversion of funds, were never purchased.

ORDER

Pursuant to the foregoing Findings of Fact and Conclusions of Law, IT IS THE ORDER OF THIS COURT that the obligation of Debtor, Kent C. Potter, to Plaintiff, Southeastern Bank, in the amount of \$20,362.50 is excepted from discharge.

Lamar W. Davis, Jr.
United States Bankruptcy Judge

Dated at Savannah, Georgia

This ____ day of February, 1996.