

UNITED STATES BANKRUPTCY COURT
For the Southern District of Iowa

In the Matter of :
 :
STEPHEN D. SHUGER and :
JOANNE M. SHUGER, : Case No. 87-2184-D H
 :
 Debtors. : Chapter 7
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WILTON SAVINGS BANK, :
 : Adv. No. 87-0255
 Plaintiff, :
 :
v. :
 :
STEPHEN D. SHUGER and :
JOANNE M. SHUGER :
 :
 Defendants. :

FINDINGS AND CONCLUSIONS--
TRIAL ON COMPLAINT, DISCHARGEABILITY OF DEBT

On January 31, 1989, a trial was held on the amended complaint to determine dischargeability of debt by Debtors/Defendants, Stephen D. Shuger and Joanne M. Shuger, to Plaintiff, Wilton Savings Bank. The following attorneys appeared on behalf of their respective clients: H. Raymond Terpstra II for Plaintiff Bank, and David Scieszinski for Defendants. At the conclusion of said trial, the Court took the matter under advisement upon a briefing schedule. Briefs were timely filed and the Court considers the matter fully submitted.

This is a core proceeding pursuant to 28 U.S.C. §157(b)(2)(I). The Court, upon review of the pleadings, as amended, evidence presented, arguments of counsel, and briefs submitted, now enters its findings and conclusions pursuant to

Fed.R.Bankr.P. 7052.

FINDINGS

1. Stephen D. Shuger and Joanne M. Shuger filed their Chapter 7 Voluntary Petition on September 1, 1987.

2. Defendants were farmers and engaged in farming under the name of Shuger Farms. Their farming operation consisted of grain crops of corn and soybeans, and the raising of hogs. Defendants terminated their farming operation during the winter of 1986-87 and 1986 was their last crop year.

3. Wilton Savings Bank, (hereinafter "Wilton Bank") is a banking corporation which advanced loans to Defendants to enable them to operate their farming operation.

4. The debt of Defendants to Wilton Bank is evidenced by a Promissory Note which represented an FmHA guaranteed operating loan with a maximum line of credit of \$125,000.00. This note was executed in May 1986. It represented the consolidation of several previous promissory notes for operating and personal obligations in the approximate amount of \$53,600.00. Pursuant to said operating note, Wilton Bank advanced monies for various 1986 operating expenses, including advancement for rent, feed, chemicals, seed, fuel, and the repurchase of grain from Commodity Credit Corporation, (hereinafter C.C.C.).

5. Defendants/Debtors scheduled the debt to Wilton Bank as a secured debt of approximately \$167,600.00.

6. The indebtedness to Wilton Bank was secured, in part, by agricultural security agreements. The collateral was described as equipment, farm products, fixtures, accounts, documents, and general intangibles, now owned or thereafter acquired, and all products of, proceeds of, additions to, and replacements of said collateral.

7. The Shugers participated in the 1986 federal feed grain program. This participation was administered by the ASCS offices in Muscatine and Cedar Counties.

8. Stephen Shuger harvested the corn and bean crop during the fall of 1986. He secured C.C.C. loans on the 1986 corn and bean crops and sealed this grain, except grain raised on the Snyder Farm, which was not in the program.

9. On November 20, 1986, Wilton Bank executed and delivered to C.C.C. a "Lien Waiver" on Defendants' 1986 corn and bean crop.

10. The loan proceeds from the C.C.C. loans were paid jointly to Stephen Shuger and Wilton Bank. These proceeds were deposited with Wilton Bank and credited against the Shuger indebtedness to said Bank under the operating loan.

11. Stephen signed up for the 1987 feed grain program before he decided to quit farming. He received an advance program payment, approximately \$10,000.00, which was paid to Wilton Bank.

12. Stephen Shuger commenced liquidating his farm

operation during December 1986, and early winter of 1987. Wilton Bank was not aware of this until on or about February 3, 1987. All of the hogs had been sold by February 17, 1987.

13. On December 19, 1986, Wilton Bank advanced \$26,500.00 to the Shugers for payment of rent and farm operating expenses incurred during the 1986 crop year.

14. On December 23, 1986, and December 30, 1986, Wilton Bank advanced a total of \$11,075.00 to Stephen Shuger. Stephen used some of this advancement of funds to purchase PIK Certificates and redeem grain with these certificates.

15. In January and February of 1987, Stephen sold hogs and the proceeds were deposited with Wilton Bank on the operating loan. Stephen used grain raised on the farm as feed for the hogs prior to the time that they were sold.

16. On January 14, 1987, Wilton Bank advanced \$5,000.00 to the Shugers for living expenses.

17. In January and February of 1987, Stephen was thinking that he might file a petition under the Bankruptcy Code.

18. During the first few months of 1987 Stephen did not know where he was going to get the financing to redeem the sealed grain. Wilton Bank would not finance this transaction as the price of corn was at or below the amount of the C.C.C. loan.

19. Stephen suggested to Wilton Bank that he assign all

of his interest in the sealed grain to the bank. Warm weather was approaching and there was concern that the grain would spoil.

20. Wilton Bank declined Stephen's offer and advised Stephen that he should handle the grain. Wilton Bank did not request an accounting.

21. Stephen borrowed money from his father, received an advance from a grain dealer, and took some money from a joint account to fund the PIK certificates which were used to fund the redemption of the grain.

22. Upon redemption of the sealed grain, Stephen sold the grain and used the proceeds to repay the grain dealer and his father for their advances and repay the government for the advance payment on the 1987 feed grain program.

23. On or about January 27, 1987, the Shugers closed out their checking account at Wilton Bank.

24. Stephen opened a checking account at Liberty Trust and Savings Bank, Durant, Iowa (hereinafter "Liberty Bank"), during the very early part of February 1987. This account was still open on September 1, 1987, when the Shugers filed their Chapter 7 petition.

25. The Shugers did not reveal the Liberty Bank account in their Statement of Financial Affairs. On September 2, 1988, Stephen Shuger swore under oath as follows: "that I made no deposits of any farm income in 1987 in any bank other than

the Wilton Savings Bank."

26. Defendants received the following 1986 Federal Feed Grain entitlements in March 1987, from the Cedar and Muscatine County ASCS offices:

- a. Cash from the Cedar county office in the amount of \$1,290.21.
- b. PIK Certificates from the Cedar County office in the amount of \$1,273.90.
- c. Cash from the Muscatine County Office in the amount of \$364.65.
- d. PIK certificates from the Muscatine County office in the amount of \$413.31.

27. Defendants redeemed 1986 corn, previously sealed, from the C.C.C. on the following dates and amounts:

- a. 2,880 bushels on 4/6/87 at \$1.82 per bushel for \$5,241.60.
- b. 10,008 bushels on 4/6/87 at \$1.82 per bushel for \$18,214.56.

28. Defendants redeemed 1986 beans, previously sealed, from the C.C.C. on the following dates and amounts:

- a. 1,882 bushels on 5/4/87 at \$4.56 per bushel for \$8,581.92.
- b. 1,180 bushels on 5/4/87 at \$4.56 per bushel for \$5,380.80.

29. Defendants had an overage of corn when they redeemed the C.C.C. sealed corn on April 6, 1987, of 2,874 bushels.

During April and May, 1987, corn sold for approximately \$1.50 to \$1.60 per bushel. Using an average of \$1.55 per bushel, the fair market value of this corn was \$4,454.82.

30. Defendants had an overage of beans when they redeemed the C.C.C. sealed beans on May 4, 1987, of 33 bushels. During April and May, 1987, beans sold for approximately \$5.20 to \$5.75 per bushel. Using an average of \$5.57 per bushel, the fair market value of these beans is \$183.81.

31. On or about January 30, 1987, Defendants sold beans to Treimer Grain & Storage, Durant, Iowa. These beans were produced by Defendants and payment for the beans, \$2,220.88, was made payable to Benjamin Shuger, Defendants' 9-year-old son.

32. Except for payments from the Chapter 12 trustee in October 1987, Wilton Bank did not receive any of the federal feed grain payments, proceeds from the redeemed grain, and proceeds from grain sales during 1987.

33. Defendants sold their grain and some of the proceeds therefrom were deposited in their account at Liberty Bank during 1987.

34. When questioned about the unaccounted for funds, Stephen first testified that they were paid to Wilton Bank. When doubt was cast upon this disposition, Stephen then testified that the funds were used for living expenses. When

doubt was cast upon this disposition, Stephen testified that the funds were used for operating expenses. When doubt was cast upon this disposition, Stephen testified that the money was actually paid to his son and father to repay them for loans made to Stephen. Neither Stephen's son nor father are secured creditors. Stephen did not keep records of his financial dealings with his father and son.

DISCUSSION

This matter came before this Court on complaint filed by Wilton Savings Bank, Wilton, Iowa, alleging that Debtors had violated 11 U.S.C. §523(a)(2) and (4) in their pre-petition dealings with the Bank. Trial was held and at the close of the evidence, Plaintiffs moved to amend the complaint to comply with the evidence. The motion to amend was granted. The amended complaint, as filed, alleges that Debtors violated 11 U.S.C. §523(a)(2), (4), and (6) in their dealings with the Bank.

The evidence submitted at trial does not support a finding of fraud pursuant to §523(a)(2) nor a finding of theft under §523(a)(4). There has been a failure of proof to show that Defendants had an intent and purpose of deceiving Wilton Bank or intent to fraudulently misappropriate the funds at the time they received the advances. The evidence does, however, support a finding that Debtors violated §523(a)(6) and that discharge should, therefore, be denied as provided herein.

I. Nondischargeability Under 11 U.S.C. §523(a)(6)

Section 523(a) provides, in pertinent part:

A discharge under §727, 1141, 1228(a), 1228(b), or 1328(b) 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.

It is well settled that this provision includes debts for "willful and malicious" conversion of property. In re Jacobs, 47 B.R. 526, 527 (Bankr. S.D. Fla. 1985). The elements of a willful and malicious conversion under this section must be proven by clear and convincing evidence. See American Honda Finance Corp. v. Loder, 77 B.R. 213, 214 (N.D. Iowa 1987).

Conversion is generally defined as the wrongful assumption of "dominion over personal property by one person to the exclusion of possession by the owner and in repudiation of the owner's rights." In re Hicks, 100 B.R. 576, 577 (Bankr. M.D. Fla. 1989); In re Pommerer, 10 B.R. 935 (Bankr. D. Minn. 1981).

In a ruling on a transfer in breach of a security agreement, the Eighth Circuit established the definition of willful and malicious. In re Long, 774 F.2d 875, 881 (8th Cir. 1985). According to the Eighth Circuit, willful means headstrong and knowing, and malicious means targeted at the creditor, at least in the sense that the conduct is certain or

almost certain to cause financial harm. Id. These terms must be separately analyzed and both found to apply to the circumstances of the case.

In proceeding with its analysis, the Court keeps well in mind that statutory exceptions to discharge are to be narrowly construed and that 523(a)(6) requires that a "heightened level of culpability" must be found for this exception to discharge to apply. Long, supra. The Court must find that Debtors acted both willfully and maliciously in converting proceeds from collateral away from Bank.

In December 1986, Debtors borrowed \$26,500.00 from Wilton Bank for payment of rent and farm operating expenses and \$11,075.00 for redemption of sealed grain; in January 1987, they borrowed \$5,000.00 for living expenses. During the next several months, Shugers received farm program payments on the 1986 crop in which they knew Wilton Bank held a security interest; Shugers redeemed sealed bushels of corn and beans from the 1986 crop and liquidated them; and Shugers liquidated 1986 crops which had not been sealed, but stored. None of the proceeds from these activities were turned over to Wilton Bank.

The Court finds that these acts of Debtors in converting proceeds of collateral of Wilton Bank were willful. This finding is based on several facts that emerged in testimony at trial. Though Shuger obtained funds on loan from the Bank in

order to redeem stored grain from the C.C.C. in late December 1986, none of the proceeds from sale of the grain redeemed during 1987 was applied to the indebtedness with the Bank.

In addition, the fact that Debtors opened a bank account at Liberty Trust and Savings Bank, Durant, Iowa, in early February 1987, was not revealed in Debtors' Statement of Financial Affairs. In fact, Mr. Shuger stated on affidavit in these proceedings that he "made no deposits of any farm income in 1987 in any bank other than the Wilton Savings Bank". Some of the proceeds from sale of the sealed grain were, in fact, deposited at the Liberty Bank during 1987. The evidence showed that Stephen Shuger was contemplating filing bankruptcy in January and February 1987. Further, when Debtor sold beans in January 1987, the check for the proceeds was made payable to his 9-year-old son.

These facts show with clear and convincing evidence that Debtors actions were headstrong and knowing. There can be little, if any, doubt Debtors opened the account at Liberty Bank for the purpose of depositing funds therein without knowledge of Wilton Savings Bank. There also can be little, if any, doubt that Debtors knew Wilton Bank held a security interest in the proceeds from the redeemed grain, particularly in light of the fact that Debtors borrowed from Wilton Bank for the purpose of redeeming the grain. The evidence also shows clearly and convincingly that Debtors actions were

malicious. By opening the account at Liberty Bank in early February 1987, and opening an account at First National Bank, Muscatine, Iowa, on or about January 20, 1987, on or about the time Debtors closed their account at Wilton Bank, Debtors show that their actions were targeted at Wilton Bank. Debtors clearly wished to be able to deposit funds without the knowledge of Wilton Bank. These actions by Debtors, having been found to be willful and malicious, render the debt to Wilton Savings Bank nondischargeable pursuant to 11 U.S.C. §523(a)(6). The Court must now determine the amount of the indebtedness to which this ruling will apply.

The complaint prays for an order denying discharge of Debtor's indebtedness to Wilton Savings Bank in the amount of \$47,281.67. This is not the full amount of the debt to Bank, but rather is the amount the Bank claims Debtors wrongfully obtained by liquidation of 1986 crops in violation of its security agreement with the Bank. The amount of the debt which should be held to be nondischargeable raises sub-issues as to (1) whether Debtors' interest in PIK payments could be assigned to the Bank as security for loans, and (2) how the lien waiver granted by Bank to C.C.C. is properly interpreted as affecting the security interests of Bank in Debtors' 1986 crops.

II. PIK Certificates as Collateral

There are two lines of cases regarding the availability

of PIK certificates as collateral for loans. One line of cases has held that PIK certificates are assignable as security. See, e.g., Security Bank and Trust Co. v. Case (In Re George), 85 B.R. 133 (Bankr. D. Kan. 1988). The other line of cases has held that language in the Code of Federal Regulations does not allow PIK certificates to be assigned as collateral for loans. One of these cases was decided by Judge Jackwig and affirmed by the Federal District Court for the Southern District of Iowa. In Re Hunerdosse, 85 B.R. 595 (Bankr. S.D. Iowa 1988), aff'd. sub nom. United States of America v. Hunerdosse, No. 88-364-B (S.D.Iowa, filed Nov. 28, 1988).

The chronology of this case is virtually the same as that in Hunerdosse. That is, the security agreement was entered into in spring 1986, the regulations controlling assignability which were controlling in Hunerdosse were promulgated first in June 1986, and the PIK certificates in question were issued after the promulgation of the regulations. Therefore, this Court, being bound by the District Court decision therein, holds consistently with Hunerdosse that the PIK certificates were nonassignable.

III. Effect of Lien Waiver

On November 20, 1986, Wilton Bank executed and delivered to C.C.C. a document entitled "Lien Waiver". This document concerned Debtors' 1986 corn and bean crops. The effect of

the lien waiver was to allow C.C.C. to have a first lien on the grain as required by regulations governing C.C.C. 7 C.F.R. §1421.10.

Two employees of A.S.C.S. testified that they understood the lien waiver document to operate as a subordination agreement issued for the limited purpose of allowing the farmer to comply with C.C.C. regulations which require C.C.C. to obtain a first lien on grain which the farmer wished to seal. The document itself states, at (2) in the box checked by Wilton Savings Bank, that the Bank "[a]uthorize[s] the loan proceeds to be disbursed jointly to the producer and the undersigned lienholder". [Emphasis added.]

However, the language in the body of the document states "The undersigned holder of a lien on the above described commodity does hereby waive, relinquish and surrender all right, title and interest in said commodity in order that the producer may obtain a loan upon the security thereof. . ." [Emphasis added]. The plain and generally accepted meaning of a waiver, relinquishment or surrender of all right, title and interest is that absolutely no right, title or interest remain. In Re Bar C Cross Farms & Ranches, Inc., 48 B.R. 976 (D.Colo. 1985). The Court will not resort to rules of construction where intent of the parties is expressed in clear and unambiguous terms. Gendler Stone Products Co. v. Laub, 178 N.W.2d 628 (Iowa 1970).

In addition, the Bank did realize some return on the 1986 crops which were subsequently sealed, as they were named on the checks issued by C.C.C. at the time the grain was sealed.

Therefore, after fully considering the plain language of the lien waiver, the testimony at trial, and the purposes of the lien waiver, the Court concludes that the Bank did waive their security interest in the 1986 crops under loan to C.C.C.

IV. Calculation of the Nondischargeable Debt

Based on the above analyses that the Bank could not hold a security interest in the PIK certificates and that the "Lien Waiver" document did not affect the security interest of the Bank, the Court finds that the Bank had a valid security interest in the following property at the following values which were converted by Debtors:

\$ 1,209.22	Cash received from Federal Feed Grain Program from Cedar County 3-19-87
381.03	Cash received from Federal Feed Grain program from Muscatine County 3-19-87
4,454.82	Fair market value of overage of corn received 4-6-87.
177.87	Fair market value of overage of beans received 5-4-87.
2,220.88	Amount received for beans sold to
Treimer	Grain & Storage 1-30-87

\$ 8,443.82	

CONCLUSION AND ORDER

Debtors acted willfully and maliciously in liquidating their 1986 crop and converting the proceeds to the detriment of Wilton Saving Bank, who Debtors knew to hold a valid security interest in said crops. The value of the PIK certificates received for those crops as part of the 1986 Federal Feed Grain Program were not eligible as security under

the Bank's security agreement with Debtors; therefore, that amount cannot be included in the calculation of the nondischargeable debt. The "Lien Waiver" executed by Bank did waive their security interest in the crops under loan to C.C.C.

It is THEREFORE ORDERED that the Shugers' indebtedness to Wilton Savings Bank is nondischargeable in the amount of \$8,443.82.

Dated this 15th day of June, 1990.

/s/ _____
Russell J. Hill
U.S. Bankruptcy Judge