UNITED STATES BANKRUPTCY COURT
For the Southern District of Iowa

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<tr><td>In re:

MARC DAVID SHONKA and
MARGARET MARIE SHONKA,

Debtors.
- -
MAX ROSENBERG,

Plaintiff,

v.

MARC DAVID SHONKA and
MARGARET MARIE SHONKA,

Defendants.</td><td>:
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:</td><td>Case No. 00-01297-CH

Chapter 7

Adv. No. 00-20127</td></tr>
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ORDER—COMPLAINT TO DETERMINE DISCHARGEABILITY OF DEBT AND FOR PUNITIVE DAMAGES

On November 20, 2001, the court conducted a trial on Plaintiff's Complaint to Determine Dischargeability of Debt and for Punitive Damages. Michael P. Mallaney represented Plaintiff Max Rosenberg, and F. Montgomery Brown represented Defendant Marc David Shonka. At the conclusion of the hearing, the court took the matter under advisement. The court considers the matter fully submitted.

The court has jurisdiction of this matter pursuant to 28 U.S.C. §§ 157(b)(1) & 1334 and order of the United States District Court for the Southern District of Iowa. This is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(I). The court, upon review of the briefs, pleadings, evidence, and arguments of counsel, now enters its findings and conclusions pursuant to Fed. R. Bankr. P. 7052.

FINDINGS OF FACT

1. Marc David Shonka and Margaret Marie Shonka, filed a voluntary chapter 7 petition on April 12, 2000.

2. Max Rosenberg was scheduled as a creditor holding an unsecured nonpriority claim in the amount of $1,800.00. The consideration for this claim was scheduled as a loan made in August 1999. Rosenberg’s address was given as c/o Maxine's Gifts, 7144 University, Windsor Heights, Iowa 50311.

3. Both debtors received their discharge on July 25, 2000.

4. On July 19, 2000, Rosenberg (hereinafter Plaintiff) filed the instant complaint naming both debtors as defendants and objecting to discharge of a debt. Plaintiff appeared pro se and prayed that his claim be excepted from discharge pursuant to 11 U.S.C. § 523(a)(2)(A) as a debt procured by false pretenses, a false representation, or actual fraud.

5. Plaintiff amended the complaint on August 30, 2000, when he again appeared pro se, by adding Division II, wherein he prayed for punitive damages. Plaintiff alleged that the defendants’ actions violated public policy and punitive damages should be assessed to deter and punish such actions.

6. The defendants filed a motion for a more specific statement and on August 30, 2000, Plaintiff filed his Second Amendment to the complaint. Again, Plaintiff appeared pro se.

7. Counsel for Plaintiff appeared on December 15, 2000.

8. On December 5, 2000, Margaret Shonka filed a motion for summary judgment arguing in essence that she had no personal involvement with Plaintiff and did not participate in

the transactions of which he complains. The court entered an order on February 6, 2001, granting her summary judgment against Plaintiff and dismissing the complaint as to her.

9. On January 30, 2001, Plaintiff filed a motion for summary judgment arguing that the remaining defendant, Marc Shonka (hereinafter Defendant), had admitted in his answer to the complaint and in answers to requests for admissions that he had made fraudulent false representations to Plaintiff. On April 19, 2001, the court entered an order granting Plaintiff a partial summary judgment against Defendant. The court determined that it was undisputed that Defendant made false representations; he knew they were false when he made them; he made those representations with the intention of deceiving Plaintiff; and, Plaintiff justifiably relied upon those representations. However, the court reserved the issue of damages for trial.

10. Plaintiff met Defendant in the spring of 1999 at the 7 Flags Fitness Club. Plaintiff was a member, and Defendant was an employee of the club. The parties spoke frequently at the club.

11. On July 22, 1999, Plaintiff deposited $20,000.00 at Bankers Trust in an account designated "Max Rosenberg for R. Investments." The address given for the holder of the account was P.O. Box 1704, Des Moines, IA 50306.

12. In a separate matter, Defendant was convicted of false drawing and uttering of checks, and placed on probation on August 1, 1999.

13. On or about August 5, 1999, Plaintiff approached Defendant with a proposition for the purchase of McLeod USA Common Stock. Defendant would purchase the stock for Plaintiff with funds to be advanced by Plaintiff. Defendant would purchase, hold, and sell the

stock in his name. Defendant would report the sale of the stock on his personal income tax returns. Plaintiff would pay Defendant the amount of taxes incurred.

14. Defendant did not represent himself to Plaintiff as a stockbroker. His represented that he would find a broker and that he knew a broker.

15. On August 11, 1999, Plaintiff gave Defendant a check in the amount of $720.00 drawn on Plaintiff's account for the purchase of 65 shares of McLeod stock.

16. On August 12, 1999, August 17, 1999, and September 1, 1999, Plaintiff gave checks to Defendant, in the respective amounts of $2,520.00, $2,880.00, and $2,400.00, all drawn on the account of R. Investments over the signature of Plaintiff. These checks were given to Defendant for the purchase of McLeod stock.

17. Plaintiff and Defendant entered into an agreement titled "Stock Purchase Agreement" dated September 7, 1999. This agreement recited that Plaintiff purchased 385 shares of McLeod stock, which Defendant was to retain in his name. This stock, and any increased shares as a result of splits, etc., was to be sold at the end of the 1999 calendar year or in January 2000, and all proceeds were to be paid to Plaintiff at the time of sale. Plaintiff agreed to pay all state and federal income taxes, and any brokerage fees, incurred as a result of the sale. The agreement did not make any provision for compensation to be received by Defendant. Plaintiff prepared the agreement, and both parties signed on September 8, 1999.

18. On September 8, 1999, Plaintiff gave Defendant a check in the amount of $3,360.00, drawn on the R Investments account, over the signature of Plaintiff, for the purchase of 220 shares of McLeod stock.

19. On September 9, 1999, Plaintiff and Defendant signed the "Amendment to Stock Purchase Agreement Dated: September 7, 1999." This document provided that Plaintiff had purchased an additional 115 shares of McLeod Stock, which Defendant was to retain in his name. The amendment provided that the terms and conditions of the September 7, 1999 agreement remained the same. Plaintiff also prepared this amendment. The amendment did not provide for compensation to Defendant.

20. In sum, Plaintiff turned over $11,880.00 to Defendant for the intended purpose of acquiring 935 shares of McLeod USA common stock.

21. In January of 2000, Defendant revealed to Plaintiff that he had not purchased the stock and had kept the money for his own purposes. Plaintiff presented Defendant with a copy of The Des Moines Register, Business Section showing that on January 14, 2000, McLeodUSA stock had a value of $73.75 per share.

22. Plaintiff prepared a document titled "Restitution Agreement" dated January 18, 2000. This agreement provided that "as a result of Marc Shonka fraudulently selling McLeod USA stock to Plaintiff and collecting monies," Defendant agreed to make "restitution" to Plaintiff of $68,956.00 in payments of $10,000.00 by February 10, 2000 and $58,956.00 by March 10, 2000. The agreement further provided that "[a]mendments to agreement must be submitted and agreed in writing by both parties," and "[i]f all terms and conditions are adhered to Plaintiff agrees not to seek legal remedies." The agreement does not make any provision for any reduction of the amount for the payment of taxes.

23. Plaintiff threatened Defendant by stating that if Defendant did not sign the agreement Plaintiff would contact law enforcement and have him prosecuted for a criminal offense. Both parties signed this agreement on January 19, 2000.

24. Defendant paid $4,000.00 to Plaintiff on February 8, 2000.

25. On February 10, 2000, Plaintiff and Defendant entered into an agreement whereby defendant would pay Plaintiff $6,000.00 on or before February 21, 2000, to complete the first payment. Defendant prepared this agreement.

26. Defendant paid Plaintiff $3,300.00 on February 29, 2000. Defendant paid Plaintiff a total of $7,300.00

28. On May 3, 2000, Plaintiff reported these transactions to the Iowa Securities Bureau.

DISCUSSION

Plaintiff asks the court to except his claim against Defendant from discharge pursuant to 11 U.S.C. § 523(a)(2)(A). He claims that Defendant misrepresented an intention and ability to acquire shares of McLeod USA common stock and thereby fraudulently acquired funds from him. Defendant then converted the funds to his own use. Plaintiff argues that because of Defendant's fraud, he was damaged in the amount of $68,956.00. Said sum represents the value of the 935 shares of stock that Defendant represented that he would purchase. Plaintiff calculated the value as of January 14, 2000, the date he purportedly learned of Defendant's fraud, when McLeod USA stock traded at $73.75 per share. Plaintiff argues that under Iowa law, he is entitled to the benefit of his bargain. He also asks the court to impose punitive damages to deter

further fraudulent behavior by the defendant and send a message to the public that such investment fraud will not be tolerated.

The Bankruptcy Code provides that discharge under section 727 does not discharge an individual from certain debts. 11 U.S.C. § 523. Section 523(a)(2) provides in relevant part that a debtor is not discharged from any debt:

> (2) for money, property, services, or an extension, renewal, or other 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;

11 U.S.C. § 523(a)(2)(A).

The standard of proof under § 523 is a preponderance of the evidence. Grogan v. Garner, 498 U.S. 279, 286-287 (1991). It "is the evidence which, when weighed with that opposed to it, has more convincing force and is more probably true and accurate." Smith v. United States, 557 F. Supp. 42, 51 (W.D. Ark. 1982) aff'd, 726 F.2d 428 (8th Cir. 1984). The party with the burden of proof must provide evidence to prove his or her position is reasonably probable, not merely possible. Sherman v. Lawless, 298 F.2d 899, 902 (8th Cir. 1962). If the proven facts equally support each party's position, "the judgment must go against the party upon whom rests the burden of proof." Id.

The Eighth Circuit has adopted a five-part test to determine whether a debt will be excepted from discharge under § 523(a)(2)(A). The court asks whether: (1) the debtor made false representations; (2) the debtor knew these representations were false at the time they were made; (3) the debtor made these representations with the intention and purpose of deceiving the

creditor; (4) the creditor justifiably relied on the representations; and, (5) the creditor sustained the alleged injury as a proximate result of the representations having been made. Caspers v. Van Horne (In re Van Horne), 823 F.2d 1285, 1287 (8th Cir. 1987) as modified by Field v. Mans, 516 U.S. 59, 74-75 (1995).[1] The plaintiff must prove each element of his § 523 (a)(2)(A) claim or the debt is not excepted from discharge.

By order entered on April 19, 2001, the court granted Plaintiff partial summary judgment in this proceeding. The court found that that there was no question that Defendant made false representations to Plaintiff; he knew that the representations were false when he made them; he made the representations with the intent of deceiving Plaintiff; and Plaintiff justifiably relied on the representations. Accordingly, Plaintiff has carried his burden on the first four elements of the test, and the only issue remaining before the court is the question of injury to the Plaintiff. In other words, what is the appropriate measure of damages.

Iowa recognizes two measures of damages for fraud: the benefit-of-the-bargain plus consequential damages and out-of-pocket expenses. Midwest Home Distrib. v. Domco Industr., Ltd., 585 N.W.2d 735, 739 (Iowa 1998). "The underlying purpose of the benefit-of-the-bargain rule is to put the defrauded party in the same financial position as if the fraudulent representation had in fact been true." Id. The out-of-pocket-expenses rule is often used when the injured party returns the property, and then receives its expenses in accepting and rescinding the agreement. Id. The injured party "should be compensated for the amount that party lost by dealing with the

[1] In Van Horne, the Eighth Circuit originally held that the plaintiff must prove that his or her reliance was reasonable, however, the United States Supreme Court in Fields determined that the proper standard under 11 USC § 523(a)(2)(A) is "justifiable reliance." Additionally, Van Horne held that the plaintiff had the burden of proving the debtor's deceit by clear and convincing evidence. In Grogan, the United States Supreme Court held the proper standard to be by the preponderance of the evidence. The balance of Van Horne remains good law.

defrauding party, when it is apparent that no dealing would have occurred if the facts had been disclosed. Cornell v. Wunschel, 408 N.W.2d 369, 381 (Iowa 1987).

Defendant concedes to the facts and his own misdeeds. However, he contends that the damages requested by Plaintiff are too severe. He argues that Plaintiff is as culpable as he because the purchase agreement shows intent by Plaintiff to conceal assets and understate his income, thereby defrauding the United States through tax evasion. Accordingly, the court should not involve itself in an illegal matter between two wrongdoings. Defendant maintains that the court should leave the parties as it finds them.

Defendant correctly states the well-settled rule that courts will not enforce illegal contracts. Gibbs v. Sterrett Manuf's Co., 111 U.S. 597, 600 (1884). Nor will courts enforce contracts contrary to public policy. Rowen v. Le Mars Mut. Ins. Co of Iowa, 282 N.W.2d 639, 650 (Iowa 1979). Further, parties to fraudulent schemes may not look to either law or equity for protection. Kansas City Operating Corp. v. Durwood, 278 F.3d 354, 357 (8th Cir. 1960). In matters concerning fraud, the court will leave the parties where it finds them. Id.

In this case, Plaintiff offered evidence based on a benefit-of-the-bargain theory of damages. He also offered evidence of a "restitution" contract signed by both parties and calling for two payments totaling $68,956.00, along with an agreement extending the time for the first payment. Plaintiff did not provide evidence based on an out-of-pocket-expenses theory.

After reviewing the evidence and testimony, the court declines to award "damages" under either theory. Nonetheless, after weighing the equities, the court will require Defendant to return the funds he acquired from Plaintiff.

The material facts of this case are not in dispute, and after observing the witnesses' demeanors, assessing their credibility, and drawing logical inferences, the court concludes that it is confronted with two equally culpable parties. Neither particularly engenders sympathy in the court, and consequently, the court finds the testimony of each to be self-serving and incredible.

From the outset, the parties intended to engage in illegal conduct. At some point in their relationship, Plaintiff approached Defendant with a scheme to purchase McLeod stock. Whether Defendant intentionally planted the seeds of the plan with Plaintiff is not entirely clear from the record. However, it is clear that Plaintiff approached Defendant with the finances to carry out the intended stock purchase. Equally as clear was Plaintiff's intention that the stock be listed in Defendant's name. Consequently, the sale and profits would be reported on Defendant's tax returns and not Plaintiff's returns, thereby understating Plaintiff's income and assets, limiting his tax liability, and insulating himself from a suspicious transaction.

The court labels the transaction suspicious because it is undisputed that the purchase agreement was not for stock owned by Defendant. Plaintiff knew that Defendant was not a broker or dealer of securities, and he knew that Defendant was not connected with McLeod USA, yet he approached Defendant with a proposition to purchase the stock at a favorable price. Plaintiff believed, that by purchasing through Defendant, he would somehow receive additional stock at no cost. Adding to the suspicious nature of the transaction is the fact that nowhere in the record is there any indication of what Defendant was to receive for his efforts.

The court notes that Defendant was convicted of false drawing and uttering of checks, and placed on probation on August 1, 1999. The court finds that Plaintiff knew of Defendant's background and determined that this fact would provide him leverage in their dealings.

Taken as a whole, the court finds that the parties entered into an agreement, which had at its core an intent to evade taxes and conceal assets. However, Defendant never intended to purchase the stock. He planned to take Plaintiff's funds for his own use.

Based on the above facts and inferences, the court finds that it is inappropriate to award benefit-of-the-bargain or out-of-pocket damages based such an agreement. Nor does the court consider punitive damages appropriate. However, Defendant does not deserve the entire scope of the discharge. He is neither honest nor unfortunate, and the court will not allow Defendant to commit fraud and keep the ill-gotten gains.

Plaintiff offered evidence showing that he gave Defendant $11,880.00 to purchase the stock. Defendant offered evidence that he repaid $7,300.00. Defendant did not provide any evidence corroborating his assertion that he repaid additional funds to a third party for Plaintiff's benefit. Accordingly, the court discounts this assertion. Therefore, the court determines that Defendant should pay restitution to Plaintiff in the amount of $4,580.00. No prejudgment interest will be awarded on the restitution. Said amount will be excepted from discharge.

ORDER

IT IS THEREFORE ORDERED as follows:

1. Defendant Marc David Shonka shall pay Plaintiff Max Rosenberg restitution in the amount of $4,580.00, and Plaintiff shall have judgment accordingly.

2. The above restitution is excepted from discharge pursuant to 11 U.S.C. § 523(a)(2)(a).

RUSSELL J. HILL, JUDGE
U.S. BANKRUPTCY COURT