

UNITED STATES BANKRUPTCY COURT
For the Southern District of Iowa

In the Matter of :
 :
ROBERT C. BRUNS and : Case No. 89-1524-D H
JULIA D. BRUNS, :
 :
Debtor. : Chapter 7
- - - - - :
CHAMPION HOME BUILDERS CO., :
 :
Plaintiff, : Adv. No. 90-0038
v. :
 :
ROBERT C. BRUNS and :
JULIA D. BRUNS, :
 :
Defendants. :
- - - - -

ORDER--COMPLAINT TO DETERMINE DISCHARGEABILITY OF DEBT

On March 14, 1991, trial was held on the complaint to determine dischargeability of debt. The following attorneys appeared on behalf of their respective clients: Steven T. Hunter and Kelli R. Grubbs, Stanley, Rehling, Lande & Van Der Kamp, for the Plaintiff, Champion Home Builders Co.; and Stephen C. Gerard II and Lisa Patrick, Bartley Law Offices for the Debtor-Defendants, Robert C. and Julia D. Bruns. At the conclusion of the trial the Court took the matter under advisement upon a briefing deadline. 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, arguments of counsel, and submitted briefs, now enters its

findings and conclusions pursuant to Fed.R.Bankr.P. 7052.

FINDINGS OF FACT

1. Robert C. Bruns and Julia D. Bruns filed a joint petition for protection under Chapter 13 of the Bankruptcy Code on July 11, 1989. By order entered on November 22, 1989, this case was converted to a case under Chapter 7 of the Code.

2. Champion Home Builders Co. (hereinafter "Champion") is a manufacturer of mobile homes.

3. Robert and Julia, husband and wife, were in their thirties at the time of the trial. Both are high school graduates. Robert was president and majority shareholder of Family Homes, Inc. Julia was vice president, secretary and treasurer of Family Homes. Prior to owning and operating Family Homes, Robert had engaged in mobile home sales for over two years as the general manager of Modern Manor, the predecessor to Family Homes.

4. Robert was responsible for making the business decisions on a day-to-day basis. Julia's primary job in the business was cleaning and decorating the mobile homes on the sales lot. She ran errands and signed papers in the business and at the bank as directed by Robert. She wrote checks to pay bills as instructed by Robert and made deposits at the bank.

5. Family Homes had a floor plan arrangement with Hills

Bank, Hills, Iowa, for the purchase and financing of its mobile home inventory. In late 1987 and early 1988, Family Homes was selling mobile homes which were financed by Hills Bank and failing to remit the proceeds to this bank as required by its security agreement. In other words, Family Homes was "out of trust" with Hills Bank.

6. In April 1988, Family Homes applied for credit through Champion Credit Corp. (Champion Credit) a financing company affiliated with Champion Homes. Neither Robert nor Julia advised Champion Credit that Family Homes was out of trust with Hills Bank.

7. Family Homes was approved by Champion Credit for floor plan financing in June 1988 for its inventory purchased from Champion Homes on a recourse basis. Family Homes granted a security interest to Champion Credit in the inventory purchased from Champion Homes. Robert and Julia executed individual guaranties in favor of Champion Credit on June 4, 1988.

8. Family Homes continued to be out of trust with Hills Bank.

9. From July 1988 through August 1988, Family Homes sold three mobile homes financed by Champion Credit. No portion of the sale proceeds was remitted to either Champion Credit or Champion Homes.

10. Family Homes used those sale proceeds to pay other

obligations, including the out of trust account with Hills Bank.

11. Julia knew Family Homes was experiencing severe financial problems and had failed to pay Champion Credit pursuant to the floor plan, but Robert made the business decisions for the corporation. These decisions included what bills were to be paid as Family Homes received invoices.

12. Champion Credit contacted Robert Bruns regarding the inventory and sales referred to above. In an attempt to deceive Champion Credit as to the status of its collateral, Robert Bruns advised Champion Credit that the sales had not been closed, and when he admitted the sales had closed he falsely misrepresented that the sales proceeds had been transmitted to Champion Credit.

13. Champion Credit assigned the Family Homes debt to Champion Homes on October 4, 1988.

14. On February 24, 1989, a default judgment was entered against Family Homes, Inc., Robert C. Bruns and Julia D. Bruns in the Iowa District Court for Johnson County in the amount of \$51,852.91, plus interest at the rate of 10 percent per annum from December 14, 1988, and court costs.

CONCLUSIONS

Plaintiff contends Defendants converted the proceeds from the sales of secured property and the debt Defendants owe it

is nondischargeable pursuant to 11 U.S.C. § 523(a)(6). A discharge under section 727 does not discharge an individual debtor from any debt "for willful and malicious injury by the debtor to another entity or to the property of another entity." 11 U.S.C. § 523(a)(6). Defendants do not dispute there was a conversion of secured property.¹ Instead, Defendants argue they cannot be held personally liable for corporate obligations and even if they can be held liable, their conduct in this case does not rise to the level of willful and malicious injury.

I. Individual Liability for Corporate Obligations

Defendants devote a considerable portion of their trial and post-trial briefs to the contention that the court should not pierce the corporate veil to hold them personally responsible for the obligations resulting from the breached security agreement. The premise behind piercing a corporate veil is that the fiction that a corporation is an entity separate from the persons comprising the corporation will be ignored where to do otherwise would produce injustices and inequitable consequences. Fazio v. Brotman, 371 N.W. 2d 842, 846-47 (Iowa App. 1985). Piercing the corporate veil deprives

¹The Defendants' concession that conversion occurred makes it unnecessary for this court to analyze underlying state law to ascertain if a technical conversion did in fact occur. See In re Long, 774 F.2d 875, 882 n.9 (8th Cir. 1985).

owners of the insulation they generally have from corporate liabilities. Briggs Transp. Co. v. Starr Sales Co., 262 N.W. 2d 805, 809-10 (Iowa 1978).

In this case the Defendants signed personal guaranties unconditionally guaranteeing the indebtedness of Family Homes, Inc. They listed their liability for the corporate debt on schedule A-3 of their bankruptcy schedules. A guaranty is defined as a promise to answer for the debt of another. See Ted Spangenberg Co. v. Peoples Natural Gas, 305 F. Supp. 1129, 1135 (S.D. Iowa 1969), aff'd, 439 F. 2d 1260 (8th Cir. 1971).

The Defendants assumed liability for the corporation's obligations when they executed the personal guaranties rendering unnecessary any application of the doctrine of piercing the corporate veil.

II. Section 523(a)(6) - Willful and Malicious Injury

Statutory exceptions to discharge are to be narrowly construed. In re Long, 774 F.2d 875, 879 (8th Cir. 1985). The standard of proof for the dischargeability exceptions of § 523(a) is the preponderance-of-the-evidence standard. Grogan v. Garner, ____ U.S. ____, 111 S. Ct. 654, 661 112 L. Ed. 2d 755 (1991).

"It has long been held that the breach of a security agreement may be sufficient to render a secured debt nondischargeable under section 523(a)(6)." In re Phillips,

882 F.2d 302, 305 (8th Cir. 1989). Courts are required to separately analyze the elements of malice and willfulness. Long, 774 F.2d at 880. "Willful" means intentional or deliberate. Id. "Malice," to have any meaning independent of "willful," "must apply only to conduct more culpable than that which is in reckless disregard of creditors' economic interests and expectancies, as distinguished from more legal rights." Id. at 881.

"Malice" requires a heightened level of culpability going beyond recklessness and beyond intentional violation of a security interest. Id. Circumstantial evidence of a debtor's state of mind may be used to ascertain whether malice existed. In re Miera, 926 F.2d 741, 744 (8th Cir. 1991).

"Malice" encompasses a degree of intentional harm. See Long, 774 F.2d at 881. A person acts "intentionally" if he or she knows the consequences certain or substantially certain to result from his or her act. See Miera, 926 F.2d at 744. While intentional harm may be very difficult to establish, the likelihood of harm in an objective sense may be considered in evaluating intent. Long, 774 F.2d at 881.

A finding of malice is essential to a nondischargeability determination in the context of a breached security agreement.

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.

Id. at 882.

The United States Court of Appeals for the Eighth Circuit has set forth the following standards to be applied when transfers in breach of security agreements are in issue:

[N]ondischargeability turns on whether the conduct is (1) headstrong and knowing ("willful") and, (2) targeted at the creditor ("malicious"), at least in the sense that the conduct is certain or almost certain to cause financial harm.

Id. at 881.

It is clear from the record in this case that the Defendants were aware of the floor plan arrangement and intentionally sold mobile homes in which Champion Credit held a security interest without remitting the sales proceeds to it. The sales out-of-trust and the breach of the security agreement were "willful" actions under § 523(a)(6).

The Court also concludes the conduct of Robert Bruns in this case was malicious. Prior to operating Family Homes Robert had engaged in mobile home sales for over two years as an employee of Modern Manor. He was well-versed in the financing arrangements of a mobile home retailer in terms of floor planning and payments to inventory financiers, suppliers and creditors. Robert Bruns was fully aware of his obligation to remit sales proceeds to the Plaintiff and that failing to

do so would deprive Champion Credit of sales proceeds to which it was legally entitled.

Robert Bruns' conduct did not stop with selling the mobile homes out-of-trust and improperly retaining the proceeds. When Champion Credit inquired as to Defendants' missing inventory, Robert Bruns misled it regarding the status of the sales and the remission of the sales proceeds. Such misrepresentations delayed Champion Credit's discovery of the out-of-trust sales, compounding the injury it sustained from the conversion of the collateral. The pattern of deceitful conduct in this case reflects a deliberate and intentional disregard of Champion Credit's economic interests and expectancies. This was conduct targeted at Champion Credit and certain, or almost certain, to cause it financial harm.

Robert Bruns' deceptive conduct subsequent to the conversion of the sales proceeds renders this case distinguishable from In re Phillips, 882 F.2d 302 (8th Cir. 1989), and In re Long, 774 F.2d 875 (8th Cir. 1985). The debtors in those decisions breached security agreements in an attempt to keep their struggling businesses from failing. At no point did their conduct rise to more than a reckless disregard of their creditors' economic interests. This Court concludes Robert Bruns' deception in attempting to conceal the status of the sales and the disposition of the proceeds constitutes the additional "aggravated circumstances," Long,

774 F.2d at 881, which give rise to the level of culpability which will render this obligation nondischargeable. See In re Holtz, 62 B.R. 782, 786 (Bankr. N.D. Iowa 1986) (debtor's omissions and misrepresentations regarding conversion of secured property rendered debt nondischargeable); In re Lindberg, 49 B.R. 228, 230 (Bankr. D. Mass. 1985) (concealment of sale of secured property contributed to finding debt nondischargeable). The debt owed Plaintiff due to the breached security agreement is nondischargeable with regard to Defendant Robert Bruns.

Defendant Julia Bruns, while aware of the out-of-trust sales, did not engage in additional deceptive and egregious conduct similar to that of her husband. The record does not support a finding that her conduct was anything more culpable than that of a reckless disregard of Champion Credit's economic interests and expectancies. Her obligation to Plaintiff is discharged.

IT IS HEREBY ORDERED:

(1) The Plaintiff has sustained its burden of proof with regard to the nondischargeability of the debt owed by Robert Bruns and judgment in the amount of \$47,774 shall be entered in favor of Plaintiff; and (2) the Plaintiff has not sustained its burden of proof with regard to the nondischargeability of the obligation owed by Julia Bruns and that obligation is discharged.

Judgment shall enter accordingly.

Dated this 30th day of July, 1991.

RUSSELL J. HILL
U.S. BANKRUPTCY JUDGE