

UNITED STATES BANKRUPTCY COURT
For the Southern District of Iowa

In the Matter of :
: Case No. 89-2722-D H
DANIEL REINHART, :
: Chapter 7
Debtor. :
: :
- - - - - :
: :
STOTLER AND COMPANY & : Adv. No. 90-69
BATES COMMODITIES, :
: :
Plaintiffs, :
: :
v. :
: :
DANIEL REINHART, :
: :
Defendant. :
: :
- - - - -

ORDER ON DISCHARGE AND DISCHARGEABILITY

A trial on the Plaintiff's Complaint Objecting to Discharge and to Dischargeability of Debt was held on March 10 and 11, 1992. The Plaintiffs, Stotler and Company and Bates Commodities, were represented by Steven Hunter and the Defendant was represented by John Callas. At the conclusion of the trial the matter was taken under advisement. The parties have filed their post-trial briefs and the matter is now fully submitted.

The Court has jurisdiction of this matter pursuant to 28 U.S.C. § 157(b)(1) and § 1334. This is a core proceeding. 28 U.S.C. § 157(b)(2)(I) and (J). Upon review of the briefs, pleadings arguments of counsel and the evidence presented, findings and conclusions are now entered pursuant to

Fed.R.Bankr.P. 7052.

ISSUE

The only issue in this proceeding is whether the debt of the Defendant, Daniel Reinhart, to the Plaintiffs, Stotler and Company and Bates Commodities, should be excepted from discharge because of willful and malicious injury by Daniel Reinhart (hereinafter Reinhart) to Stotler and Company (hereinafter Stotler) and Bates Commodities (hereinafter Bates), or the property of said companies, as provided in 11 U.S.C. § 523(a)(6).

Plaintiffs had also asked for a denial of discharge under 11 U.S.C. § 727(a)(2)(A) but failed to pursue this relief at trial or in their briefs. Accordingly, the relief requested pursuant to § 727(a)(2)(A) will be denied.

FINDINGS OF FACT

1. On November 20, 1989, judgment was entered in favor of Stotler against Reinhart in the amount of \$197,329.89 in the Circuit Court of DuPage County, Illinois. Stotler assigned its interest in this judgment to Bates. The basis of this judgment was breach of contract for failure to pay debit balances incurred in accounts introduced by Reinhart to Stotler on October 19 and 20, 1987.

2. On December 4, 1989, Reinhart filed a Chapter 7 Petition and scheduled Stotler and Bates as creditors.

3. During the time in question Stotler was a futures commission merchant registered with the Commodity Futures Trading Commission (CFTC) and National Futures Association (NFA). As a clearing broker, Stotler was required to cover or pay to the clearing corporation all trading losses in a customer's account which exceeded the amount of funds on deposit. Reinhart knew that Stotler was required to pay all unpaid customer trading losses to the clearing house pursuant to Stotler's guarantee.

4. Bates was a sole proprietorship with its principal place of business located in Normal, Illinois and registered as an introducing broker for commodity transactions with the CFTC and NFA. Paul Bates was the owner of Bates. Bates' responsibilities included the solicitation of customers for the purpose of entering trades through the clearing broker Stotler.

5. Bates is an independent broker which at all times relevant herein maintained an independent broker contract with Stotler, the company with direct access to the exchange floor. Bates, pursuant to a contract with Stotler, agreed to pay all unpaid customer deficits to Stotler.

6. Bates had brokers working for it. These brokers, as well as Paul Bates, solicited new business, opened accounts

with clients, passed on market information to clients, suggested trades, entered orders, monitored clients' daily financial situation, and, if margins were needed, made the calls to secure those margins.

7. The Defendant, Daniel Reinhart, was one of the brokers supervised by Bates. Reinhart commenced employment with Bates in the spring of 1987.

8. Prior to employment with Bates, Reinhart owned and operated an investment company called Capital Express Company to which he had various and certain clients. During the time in question Reinhart was an employee of Bates and was registered as an Associated Person with the CFTC and NFA and as a Commodity Trading Advisor. There was no written contract of employment. Included in Reinhart's responsibilities as an employee of Bates was the requirement to enter orders for customer accounts, insure that accounts were properly margined and impliedly to adhere to and honor requests and instructions of his supervisor, Paul Bates.

9. Reinhart used a system of spread trading on commodities. This system involved trading on perceived misalignments in the market. Bates knew that Reinhart used this system of trading at the time he was employed and throughout the course of Reinhart's employment. Reinhart used this system in his trading on October 16 and 19, 1987.

10. Prior to and on October 19, 1987, Reinhart

maintained a personal commodity futures trading account with Stotler through the Bates introducing broker office.

11. Prior to and on October 19, 1987, Reinhart had discretionary authority over the Stotler customer accounts of William O'Neill, Brian and Susan Butler, Joe Franken, and Richard and Kathleen Opler, all of whom maintained their accounts at Stotler through Bates.

12. William O'Neill, Brian and Susan Butler, Joe Franken, and Richard and Kathleen Opler were neighbors, relatives and customers of Reinhart who wished to trade in the commodities market. Reinhart brought all four accounts with him when he started with Bates.

13. On October 16, 1987, Reinhart made several trades in his own and his customer's accounts which generated losses. Reinhart's personal account and two other accounts were placed in a debit balance, that is, the balance in each of these accounts fell below fifty percent of their original equity, on that date. However, on that date Reinhart did not receive any calls from the margin department.

14. On October 16, 1987, and October 19, 1987, Reinhart made trades in all of these accounts, including his own, in order to make profits for all concerned.

15. On October 19, 1987, Reinhart bought and sold three December 1987 Kansas City Value Line futures contracts and three December 1987 S&P 500 Index contracts in his own

personal Stotler account, account no. 9375P-16885. The net result of these trades was a loss of \$25,871.68.

16. On October 19, 1987, Reinhart entered orders for the purchase and sale of six December 1987 S&E 500 Index futures contracts and the purchase and sale of six September 1987 Kansas City Value Line futures contracts for the account of Richard and Kathleen Opler, Stotler account no. 9375D-17523. The net result of these trades was a loss of \$48,738.32.

17. On October 19, 1987, Reinhart entered orders for the purchase and sale of December 1987 Kansas City Value Line future contracts and the purchase and sale of three December 1987 S&P 500 Index futures contracts in the account of Joseph A. Franken, Stotler account no. 9375D-13336. The net result of these trades was a loss of \$25,001.68.

18. On October 19, 1987, Reinhart entered orders for the purchase and sale of three December 1987 Kansas City Value Line futures contracts and the purchase and sale of three December 1987 S&P 500 Index future contracts in the account of Brian and Susan Butler, Stotler account no. 9375D-10295. The net result of these trades was a loss of \$24,501.68.

19. On October 19, 1987, Reinhart entered orders for the purchase and sale of three December 1987 Kansas City Value Line future contracts and the purchase and sale of three December 1987 S&P 500 Index future contracts in the account of William J. O'Neill, Stotler account no. 9375D-15040. The net

result of these trades was a loss of \$24,501.68.

20. Reinhart placed the orders and liquidated all positions, thereby incurring all losses, on October 19, 1987.

21. Reinhart was aware, on October 19, 1987, that orders entered on stock index futures contracts on October 19, 1987, given prevailing market conditions, exposed Bates and Stotler to a substantial risk of loss.

22. The losses from stock index futures trades entered and liquidated on October 19, 1987, by Reinhart on behalf of himself and the accounts over which he exercised discretion totaled \$148,615.04.

23. Stotler paid the sum of \$148,615.04 to the clearing house on behalf of Reinhart and his customers as a result of the stock index futures contracts entered by Reinhart on October 19, 1987. Thereafter, pursuant to Bates' agreement with Stotler, Bates paid \$148,615.04 to Stotler pursuant to its agreement with Stotler.

24. Reinhart had a written agreement with his customers regarding the nature and extent of his trading authority in their accounts.

25. Bates contends that on October 16, 1987, he advised Reinhart and all brokers employed by him that because of the extreme volatility of the stock index futures market that no further stock index futures positions could be initiated. Bates also contends that he repeated this admonition on

October 19, 1987, and advised all brokers, including Reinhart, that existing positions could only be liquidated.

26. Reinhart contends that there was no general instruction prohibiting initiation of stock index futures positions on either date. He contends that Bates expressed concern about the deterioration of the stock market but there was no general prohibition given. Reinhart further contends that on the 19th of October, 1987, Bates was aware that Reinhart was trading, buying and selling, in his accounts in the stock index futures market.

27. The more credible evidence supports the conclusion that Bates did not specifically forbid the initiation of further stock index futures positions on either date and that on October 19, 1987, Bates knew that Reinhart was trading in the stock index futures market.

DISCUSSION

Plaintiffs, Stotler and Bates, have objected to the dischargeability of the debt they are owed by Reinhart. The burden of proof for the dischargeability exceptions in 11 U.S.C. § 523(a) is the preponderance of the evidence standard. Grogan v. Garner, 111 S.Ct. 654, 661 (1991). The creditor bears the burden of proving the nondischargeability of a debt. Caspers v. Van Horne (In re Van Horne), 823 F.2d 1285, 1287 (8th Cir. 1987). Any evidence presented in a dischargeability action must be viewed consistent with the congressional intent

that exceptions to discharge be narrowly construed against the creditor and liberally against the debtors, thus effectuating the fresh start provisions of the Code. Id.

Plaintiffs contend the \$197,329.89 judgment is nondischargeable pursuant to 11 U.S.C. § 523(a)(6). That statute provides: "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." Courts are required to separately analyze the elements of malice and willfulness. Barclays American/Business Credit v. Long (In re Long), 774 F.2d 875, 880 (8th Cir. 1985). "Willful" means intentional or deliberate. Id. "Malice" must apply to a heightened level of culpability that goes beyond recklessness if it is to have a meaning independent of willful. Johnson v. Miera (In re Miera), 926 F.2d 741, 743 (8th Cir. 1991). The Eighth Circuit Court of Appeals has defined willful as "headstrong and knowing" conduct and "malicious" as conduct "targeted at the creditor . . . at least in the sense that the conduct is certain or almost certain to cause harm." Id. at 743-44. An implicit state court finding of malice may suffice to estop relitigation of a matter in a § 523(a)(6) nondischargeability action. See id. at 744.

It is well settled that a debt arising out of a mere breach of contract absent any showing that the purpose of the

breach was to cause injury is still a dischargeable debt within the meaning of § 523(a)(6). Cadillac Vending v. Haynes (In re Haynes), 19 B.R. 849, 851 (Bankr. E.D. Mich. 1982). Section 523(a)(6) reflects a policy that debts created by reprehensible conduct should not be discharged. The vast majority of contracts are entered into for reasons of pecuniary gain, and the foreseeable consequences of the breach are also pecuniary. Thus, a party may intentionally breach a contract with the knowledge that an injury may result, but the nature of the injury is in large part foreseeable and assumed as a part of the risk of doing business. The injury is real, but it is not "malicious" in the sense that it deserves exception from discharge. Id. at 852.

Based on the standards stated above and the facts enumerated, the debt owed by Reinhart to Plaintiffs is dischargeable. While Reinhart's actions were deliberate and intentional, they were not malicious. Reinhart lost his own money in some of the transactions and the funds of his clients, some of whom were neighbors and relatives. The weight of the evidence indicates Paul Bates warned his brokers to be careful of the market's volatility on October 16 and 19; but did not prohibit trading. In fact, it appears Bates knew Reinhart was trading on those dates. Moreover, even if Reinhart did intentionally breach his contract, the debt arising therefrom would be dischargeable. Thus, while the

court finds that Reinhart's actions were intentional, they were not malicious.

ORDER

ACCORDINGLY IT IS ORDERED that the state court judgment entered against Defendant Daniel Reinhart in favor of Plaintiffs is dischargeable.

IT IS FURTHER ORDERED that Plaintiff's complaint under 11 U.S.C. § 727(a)(2)(A) for denial of discharge is dismissed.

Dated this 11th day of January, 1993.

RUSSELL J. HILL
U.S. BANKRUPTCY JUDGE