

UNITED STATES BANKRUPTCY COURT
For the Southern District of Iowa

In the Matter of :
:
Bernhard G. WILTFANG and : Case No. 86-146-C H
B. BERNADINE WILTFANG, f/d/b/a :
WILTFANG FARMS, : Chapter 7
:
Debtors, :
----- :
ROBERT KLINE, BARBARA KLINE, :
and WINIFRED KLINE, :
:
Plaintiffs, :
:
v. : Adv. No. 86-0112
:
Bernhard G. WILTFANG and :
B. BERNADINE WILTFANG, f/d/b/a :
WILTFANG FARMS, :
:
Defendants. :

FINDINGS OF FACT AND CONCLUSIONS OF LAW--
COMPLAINT TO DETERMINE DISCHARGEABILITY OF DEBT
AND COUNTERCLAIM FOR DAMAGES

On May 10, 1993, a trial was commenced on the Complaint to Determine Dischargeability of Debt and the Counterclaim for Damages. Evidence in this adversary proceeding was received along with the evidence in the adversary proceeding with the caption of Harlan E. Iske, et. al., Plaintiffs, vs. Bernhard G. Wiltfang, et. al., Defendants, Adversary No. 86-0113. Lawrence L. Marcucci, of counsel, and Julia L. Stevenson, Shearer, Templer, Pingel and Kaplan, P.C., appeared for the

Plaintiffs. Wade R. Hauser III, Ahlers, Cooney, Dorweiler, Haynie, Smith and Allbee, P.C., appeared for the Defendants.

The trial proceeded through May 13, 1993, and at the conclusion of the trial the Court took the matter under advisement upon a briefing deadline. The briefing deadline was continued and the briefs and arguments have now been filed. The Court considers the matter fully submitted.

PLEADINGS

Plaintiffs bring this action requesting judgment be entered finding that an alleged debt owed by the Defendants to Plaintiffs be declared non-dischargeable. Plaintiffs allege that they owned a farm and entered into a transaction with Defendants whereby Defendants would provide financing to Plaintiffs enabling Plaintiffs to continue farming. They allege that Defendants perpetrated a fraud on them and that Defendants' acts and omissions constituted willful and malicious injury to Plaintiffs and their property.

Defendants deny these allegations. Bernhard G. Wiltfang counterclaims alleging that Plaintiffs converted property, breached a contract, and perpetrated fraud upon him.

Plaintiffs deny the allegations of the counterclaim and assert affirmative defenses.

For the reasons set forth below, Plaintiffs' complaint will be dismissed and judgment awarded to the Defendant Bernhard G. Wiltfang on the counterclaim.

JURISDICTION

This Court has jurisdiction pursuant to 28 U.S.C. § 1334. This is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(I).

FINDINGS OF FACT

1. Robert and Barbara Kline are husband and wife and residents of Poweshiek County, Iowa. Winifred Kline is the mother of Robert Kline and is also a resident of Poweshiek County.

2. At all times material herein Bernhard G. Wiltfang and Bernadine Wiltfang were husband and wife and residents of Jasper County, Iowa. Bernhard Wiltfang is a medical doctor practicing in Grinnell, Iowa.

3. The Klimes were livestock and grain farmers on a farm which had been in the Kline family for over a 100 years. The Klimes terminated their farming operation in 1984.

4. The Kline farm operation accumulated debt throughout the 1970s and increased in the 1980s. This debt was caused by operating losses, high interest costs, and taxes.

5. In 1982 Robert Kline contacted John F. Range to assist in locating financing for the farm operation. Robert Kline entered into a contract with J.F. Range Co. whereby Range was to procure financing and the Klines would pay Range a fee of 2 percent of the amount of any loan.

6. The Kline farm real estate had been previously mortgaged to secure prior financing.

7. Range could not obtain a total debt consolidation loan. He did obtain a \$146,000.00 loan from Thorpe Credit Corp. in 1982.

8. In 1983 Grinnell State Bank was applying pressure on the Klines for payment of overdue notes. Said bank threatened to commence legal proceedings to collect this debt.

9. The Kline farm operation suffered substantial losses from 1978 through 1982 and conventional financial was unavailable.

10. Robert Kline contacted John Range again in 1983 and advised Range of his continued troubled financing.

11. Range could not find a loan for the Klines. The value of farmland and machinery fell drastically in 1983, and the farm credit market was very demanding and tight.

12. By May 1983, the Klines had retained William D. Olson (Olson), attorney at law, as their attorney to assist them in fending off pressing creditors. On May 20, 1983, Olson wrote a letter to the Grinnell State Bank advising said bank that the Klines were attempting to refinance and needed additional time (Exh. 9).

13. Conventional financing was unavailable in May 1983.

14. In May and June 1983, counsel for the Klines and counsel for Bernhard Wiltfang commenced discussions concerning a sale/ lease-back type of transaction.

15. The first meeting between Kline and Wiltfang was arranged by Olson. At that time Kline knew that any type of financing by Wiltfang would be a sale/lease-back type of transaction and that there would be a fee for providing the financing.

16. The Klines knew by the middle of July 1983 that they would have to incorporate their operation and sell the stock to the financier with a right of repurchase in the Klines (Exh. K-14). The Klines knew at this time that Dr. Wiltfang was going to charge a fee and that it would be around 10%.

17. During July and August 1983, Olson was in regular contact with the Klines (Exh. K-63). At this time Klines' farm operation was insolvent and the only way they could realize any equity was to liquidate all of their farm assets. The Klines refused to do this even though their attorney counseled them to do so.

18. The Klines incorporated their farm operation on August 10, 1983 under the name of Ralbed Farms, Inc. The directors were Robert, Winifred, and Barbara Kline, and William D. Olson was designated as the registered agent. Olson drafted the documents creating Ralbed Farms.

19. On August 4, 1983, the real estate owned by the Klines had a fair market value of \$564,000.00 (Exh. K-24). The mortgages against the Kline Farms were in excess of \$487,000. This mortgage debt is distinct from other debt owed by the Klines.

20. On October 5, 1983, a Stock Purchase Agreement was entered into between Robert and Barbara Kline, sellers, and Beef Barons, Inc., an Iowa corporation with Defendants as sole stockholders, directors, and officers, as the buyer (Exh. K-29). The Klines sold their stock in Ralbed Farms to Beef Barons with a lease back. The lease payments and due dates

were clearly stated on the lease. The Klines understood that they had to make the lease payments as they came due.

21. In addition, the Klines and Beef Barons entered into an option agreement whereby the Klines could repurchase the capital stock of Ralbed Farms (Exh. K-33).

22. Olson counseled the Klines on the significance of these documents and that the transaction involved a sale of stock. The tax problems caused by the transaction were a concern of Olson and the Klines. The Klines also understood that if they did not make the lease payments they would lose the lease and also the option to repurchase the stock.

23. The purchase of the Ralbed stock by Beef Barons was financed by a loan with Douglas County Bank & Trust Co., Omaha, Nebraska, in the principal amount of \$650,000. This note (Exh. 37) was due and payable on March 5, 1985.

24. Bernhard Wiltfang and Bernadine Wiltfang, personally, (Exh. 36) and Beef Barons, Inc., corporately, (Exh. 35) guaranteed the debt to Douglas County Bank.

25. After the sale of the Ralbed stock, the Klines retained the 1983 crop and the proceeds from the milk production from October through December 1983.

26. Robert Kline purchased over 20 head of new dairy cows from the loan proceeds and put them into his milking operation.

27. The Klins received \$7,300 from the sale of Ralbed Farms cows late in 1983 and did not deposit the proceeds into the Ralbed Farms account as required.

28. In 1984 Robert Kline sold \$13,285.78 worth of Ralbed Farms livestock but did not deposit this amount in the account of Ralbed Farms as required.

29. Prior to the time of closing of the sale of the Ralbed stock, Robert Kline and his attorney knew that the 10% Beef Barons fee was to be paid from the proceeds of the loan at the time of closing.

30. Robert Kline also knew at the time of closing that Mr. Rogers' fee was 2% and that it was also to be paid at the time of closing.

31. Robert Kline and his attorney also knew prior to the closing that the bank charges were also to be paid from the loan proceeds on the date of closing. The exact amount of these charges could not be determined at the time of closing but the fact that they had to be paid from the loan proceeds was known.

32. Robert Kline knew before the time of closing that the amount of Ralbed Farms loan from Douglas County Bank was \$650,000. He, with his attorney, also knew that Beef Barons fee was \$58,000 and that the attorneys fees for Ralbed Farms, Inc. were to be paid up front.

33. Bernhard Wiltfang did not promise additional money beyond the stock purchase price.

34. At the time of the closing, Kline, with his attorney, knew that the transaction was being financed by a loan from Douglas County Bank; that income from the farm operation was needed to service the debt on the farm; the fees and costs that were to be paid up front from the loan proceeds; he, Kline, could lose the farm if the lease payments and debt were not paid; Beef Barons and the Wiltfangs were at risk in the transaction; he, Kline, would be able to increase the size of his dairy herd from the proceeds of the transaction; and, he, Kline, was a tenant on the farm and he could regain the farm by exercising the option to repurchase Ralbed Farms, Inc. stock.

35. Bernadine Wiltfang never talked with the clients or their counsel about the transaction; she never made any kind of representation to any of the Klines or their attorney related to the transaction; the first time the Klines ever saw

or met Bernadine was at the night of closing; she did not participate at any of the decisions to finance the Klines, except to express her disapproval of the transaction; she did not receive a salary from Beef Barons; she did not receive any money from the Kline transaction; and she did not negotiate or participate in any way in the financing of the transaction. She did sign a personal guaranty of the debt and signed other transactions of the documents upon the advice of counsel for Beef Barons. Bernadine did not really understand the transaction.

DISCUSSION

I. Corporate Veil

The Court must first determine if it should disregard the corporate entity of Beef Barons. The Eighth Circuit, in interpreting the doctrine of piercing the corporate veil under Iowa law, found the following determinative factors:

[A] corporation's existence is presumed to be separate, but can be disregarded if (1) the corporation is undercapitalized, (2) without separate books, (3) its finances are not kept separate from individual finances, individual obligations are paid by the corporation, (4) the corporation is used to promote fraud or illegality, (5) corporate formalities are not followed or (6) the corporation is merely a sham.

Lakota Girl Scout Council, Inc. v. Harvey Fund-Raising Management, Inc., 519 F.2d 634, 638 (8th Cir. 1975) (citations omitted).

After consideration of these factors, the Court must find that the Plaintiffs have not presented sufficient evidence to demonstrate that the corporate entity of Beef Barons should be disregarded. The Court, therefore, refuses to pierce the corporate veil in this case. However, assuming arguendo that the corporate entity of Beef Barons should be disregarded, the Court shall address the Plaintiffs' arguments as follows.

II. 11 U.S.C. § 523(a)(2)(A)

The Plaintiff argues that this debt is nondischargeable pursuant to § 523(a)(2)(A) which provides in relevant part:

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

To succeed in a § 523(a)(2)(A) claim, a creditor must prove the following elements:

- (1) The debtor made false representations;
- (2) At the time made, the debtor knew them to be false;
- (3) The representations were made with the intention and purpose of deceiving the creditor;
- (4) The creditor relied on the representations; and
- (5) The creditor sustained the alleged injury as a proximate result of the representations having been made.

Matter of Van Horne, 823 F.2d 1285, 1287 (8th Cir. 1987). The standard of proof required under the § 523(a) exceptions to dischargeability is the ordinary preponderance of the evidence standard. Grogan v. Garner, 498 U.S. 279, 111 S.Ct. 654, 112 L.Ed.2d 755 (1991). To prevent discharge because of fraud under § 523(a)(2)(A), a plaintiff must prove actual fraud, not fraud implied in fact. In re Simpson, 29 B.R. 202, 209 (Bankr. N.D. Iowa 1983).

Because a defendant's state of mind is almost impossible to prove, the plaintiff is allowed to present evidence of the surrounding circumstances from which intent may be inferred. Van Horne, 823 F.2d at 1287 (citations omitted).

A plaintiff must prove that it relied on the representation. However, a plaintiff need not prove that its reliance on the fraudulent misrepresentation was reasonable. In re Ophaug, 827 F.2d 340, 343 (8th Cir. 1987).

The proximate cause element requires a finding that the conduct of the defendant was the act, without which the plaintiff would not have suffered the alleged injury. Van Horne, 823 F.2d at 1288-89 (citing In re Maier, 38 B.R. 231, 233 (Bankr. D. Minn. 1984)).

A. Bernadine Wiltfang

The Klines claim that Bernadine Wiltfang was active in and cognizant of the formulation and implementation of each transaction and, therefore, a participant in the alleged fraud. Based on the weight of the evidence presented, the Court finds that Bernadine Wiltfang did not make a knowingly false representation with the intent to deceive Plaintiffs. Mr. Kline testified that Bernadine did not talk with them or make any representations regarding the transaction, nor did they meet her until the time of the closing. She did not participate in any of the decisions nor in the financing of the transactions except to sign a personal guaranty of the debt upon advice of counsel.

Additionally, the Klines presented no evidence which would indicate that Bernadine Wiltfang received anything of value from the transaction. She did not receive a salary from Beef Barons. Bernadine Wiltfang testified that she followed

the instructions of Dr. Wiltfang or Mr. Oltrogge in this matter and the Court has found that she did not clearly comprehend the transaction. Therefore, the Court holds that the Plaintiffs have failed to prove by the preponderance of the evidence the elements of § 523(a)(2)(A) in regards to Bernadine Wiltfang.

B. Bernhard Wiltfang

The Klines allege that Wiltfang knowingly made false representations intending to deceive them regarding the financial transaction entered into between the parties. Specifically, the Klines allege that Wiltfang's undisclosed intention was to acquire the real estate without consideration. The Klines argue that they never intended to transfer ownership of the farm and that the transaction should be viewed as a financing arrangement. They charge that Wiltfang failed to disclose that no purchase price was paid and that Beef Barons was at no risk as it was not financially interested in the transaction. The Klines allege that they were not given the money promised to operate the farm and that Wiltfang deliberately took control of the farm in order to sabotage its operation and prevent the Klines from exercising their option to repurchase the property. Lastly, the Klines

claim that Wiltfang misrepresented the amount of Beef Baron's fee and did not tell them it was to be paid up-front.

At the time of the transaction, it is clear that conventional financing was not available to the Klines. The farm operation at this time was insolvent, but the Klines did not wish to liquidate their farm assets despite the advice of their attorney. The Klines were then introduced to Wiltfang and presented with an alternative. The Klines were represented by counsel throughout the discussions with Wiltfang and the transaction itself. They were advised as to the significance of the documents presented to them and the concerns of their attorney.

Mr. Kline testified that he was told at the first meeting with Wiltfang that this was to be a sale lease-back transaction.

The Klines incorporated their operation in preparation for the sale of stock. They then entered into a Stock Purchase Agreement wherein the Klines sold their stock in Ralbed Farms to Beef Barons with a lease back. In exchange for the stock, Beef Barons made available \$568,500 to pay debts of the Klines. The assets of Ralbed Farms, along with the Wiltfangs personal guaranty, were used to secure this loan which would

not have been extended to the Klines on their own. The Court finds this to be sufficient consideration for the transaction.

The parties also entered into an agreement wherein they had the right to repurchase the stock. The lease terms of the agreement were clearly stated and the Court finds that the Klines understood that if they defaulted on the lease payments they would lose the lease, as well as their option to repurchase the stock. Therefore, the Court finds that the weight of the evidence in this case supports a finding that the Plaintiffs understood that the transaction they were entering into was a sale/lease-back type of transaction as opposed to a loan.

The evidence presented in this case reveals that the Klines kept the 1983 crop and used the proceeds for their own purposes. In this case they chose to use the proceeds to make a lease payment. They also kept all proceeds from the milk operation for the months of October, November, and December 1983. It was not until the Klines defaulted on the lease agreement that Wiltfang took control over the operation of the farm. Additionally, Wiltfang testified, and was corroborated by Oltrogge and Range, that no additional money was promised by Wiltfang at the closing. Money was available to purchase over twenty cows.

Although there is no clear written documentation of the fee charged for the transaction, the parties acknowledge that it was discussed prior to closing. The Court finds that the weight of the evidence supports a finding that prior to the closing of the sale the Klines understood that a fee to Beef Barons, legal fees and bank charges would be charged for the transaction. Moreover, the Court finds that prior to the closing the Klines knew that these fees and costs were to be paid from the proceeds of the loan at the time of closing. The evidence shows that the fees charged were commensurate with the discussions of the parties. Therefore, the Court finds no misrepresentation with regards to the fees.

After consideration of all of the evidence presented including testimony, documents, and the surrounding circumstances of this case, the Court is not persuaded that Wiltfang entered into this transaction with the undisclosed motive of acquiring the property. Clearly, Wiltfang did not do this out of purely altruistic motives. This was a business deal and the Court is convinced that Wiltfang intended to make a profit and collect fees for his role in the transaction. However, the Plaintiffs have failed to prove that Wiltfang knowingly made any misrepresentations to them with an intent

to deceive. Therefore, the Court must find that the Plaintiffs have failed to prove the elements of § 523(a)(2)(A).

III. 11 U.S.C. § 523(a)(6)

Additionally, Plaintiff contends that the debt is non-dischargeable under § 523(a)(6), which provides in relevant part:

(a) 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.

The Eighth Circuit has held that the requirement of willful and malicious injury requires a two-prong analysis. In re Long, 774 F.2d 875, 881 (1985). Nondischargeability 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 to cause financial harm. Id.; see also In re Miera, 926 F.2d 741, 744 (8th Cir. 1991). Culpability must go beyond recklessness or beyond the intentional violation of a security interest to make a finding of malice. Long, 774 F.2d at 881.

The Court finds that Plaintiffs have failed to prove by a preponderance of the evidence that either Bernhard Wiltfang or

Bernadine Wiltfang intended to cause them financial harm. In this case, the parties entered into a business transaction which proved to be financially disastrous for the parties. However, this Court is convinced that the Wiltfangs did not willfully and maliciously intend for the Klines to suffer harm, but instead intended to make a profit from the business deal. In fact, the Wiltfangs, themselves, have shared in the resulting financial ruin.

IV. Counterclaim

Ralbed Farms has assigned all causes of action against Robert Kline to Bernhard Wiltfang. Wiltfang alleges that Robert Kline wrongfully converted chattels belonging to Ralbed Farms, breached his obligations under the Stock Purchase Agreement entered into with Beef Barons, and falsely represented that he intended to perform in good faith pursuant to the terms of the contract. Wiltfang argues that because Kline failed to answer, he is entitled to default judgment on the counterclaim. The Court finds that Wiltfang failed to move for default prior to the trial in this case. As such, evidence was presented regarding the counterclaim and Wiltfang may not at this time argue that he is entitled to a default judgment.

Therefore, the Court shall consider the merits of the counterclaim.

A. Conversion

Wiltfang argues that Robert Kline converted chattels belonging to Ralbed Farms. To prove the elements of conversion under Iowa law, Wiltfang must show that Robert Kline asserted control over the personal property of Ralbed Farms in a manner inconsistent with the possessory property rights. Kendall/Hunt Publishing Co. v. Rowe, 424 N.W.2d 235, 247 (Iowa 1988); Welke v. City of Davenport, 309 N.W.2d 450, 451 (Iowa 1981); Jensma v. Allen, 81 N.W.2d 476, 480 (Iowa 1957); Trowe Farms, Inc. v. Central Iowa Production Credit Association, 528 F.Supp. 500 (S.D. Iowa 1981). The converter's good faith, ignorance of the owner's rights, mistake, or the owner's negligence are irrelevant in this determination. Trowe Farms, 528 F.Supp. at 506. Interference with the possessory right to the property may be so serious as to entitle the owner to receive as damages the full value of the property converted. Rowe, 424 N.W.2d at 247.

In late 1983, the evidence shows that the Klines received \$7300.00 from the sale of Ralbed Farms cows. This money was not deposited in the Ralbed Farms account as required pursuant

to the Stock Purchase Agreement. Additionally, in 1984, Robert Kline sold Ralbed Farms livestock valued at \$13,285.78. The proceeds were not placed in the Ralbed Farms account. Therefore, the Court finds that Robert Kline wrongfully converted livestock belonging to Ralbed Farms. Robert Kline's argument that this money was put back into the operation is unsupported by evidence. Accordingly, the Court holds that judgment should be entered against Robert Kline in the amount of \$20,585.78, the value of the converted property.

B. Breach of Contract

Wiltfang claims that Robert Kline failed to perform certain contractual obligations pursuant to the Stock Purchase Agreement executed with Beef Barons. Generally, non-performance of a duty owed under a contract constitutes a breach unless performance is excused. Metropolitan Transfer v. Design Structures, 328 N.W.2d 532, 537-38 (Iowa App. 1982). Fraud may excuse performance of a contract if there is a material misrepresentation which is relied upon by the other party to that party's detriment. Midwest Management Corp. v. Stephens, 291 N.W.2d 896, 906 (Iowa 1980).

In this case, the Court has found that Robert Kline sold livestock belonging to Ralbed Farms and failed to turn over

the proceeds as required pursuant to the Stock Purchase Agreement. These actions clearly constitute a breach of that agreement. The Court has found no misrepresentations on the part of Wiltfang in the making of this contract. Therefore, the Court finds that performance is not excused on the grounds of fraud or any other grounds.

Generally, damages for breach of contract include placing the innocent party in the position that would have been occupied had there been performance. Lakota Girl Scout Council v. Havey Fund-Raising Management, 519 F.2d 634 (Eighth Cir. 1975). The Court finds that had Kline performed under the contract as obligated, Beef Barons would have received the proceeds from the livestock. Therefore, the measure of damages is the same as that already awarded for wrongful conversion and no further damages shall be given.

C. Deceit

Lastly, Wiltfang alleges deceit by Robert Kline arguing that he falsely represented he would perform in good faith with no intention of doing so. The Court finds that Wiltfang has failed to sustain his burden of proving that Kline intended to deceive Wiltfang at the time of the agreement. Therefore, Wiltfang's claim for deceit shall be denied.

ORDER

IT IS THEREFORE ORDERED that Defendants shall have judgment against Plaintiffs dismissing the Complaint.

IT IS FURTHER ORDERED that Defendant/Counterclaimant, Bernhard G. Wiltfang, shall have judgment against the Plaintiff, Robert Kline, on the counterclaim in the amount of \$ 20,585.78.

Dated this 21st day of June, 1994.

RUSSELL J. HILL
U.S. BANKRUPTCY JUDGE