

**UNITED STATES BANKRUPTCY COURT
For the Southern District of Iowa**

In re	:	Case No. 98-5353-CH
JEFFREY W. VOORHEES,	:	
	:	Chapter 7
Debtor.	:	
-----	:	
FIRST AMERICAN BANK,	:	Adv. No. 99-99044
WEBSTER CITY,	:	
	:	
Plaintiff,	:	
	:	
vs.	:	
	:	
JEFFREY W. VOORHEES,	:	
	:	
Defendant.	:	

ORDER—COMPLAINT TO DETERMINE DISCHARGEABILITY OF DEBT

On May 2, 2000, trial was held on the Plaintiff's Complaint to Determine Dischargeability of Debt. Plaintiff First American Bank, Webster City, was represented by its attorney James L. Kramer; Defendant Jeffrey W. Voorhees was represented by his attorney Mark C. Feldman. At the conclusion of the trial, the court took the matter under advisement upon a briefing schedule. Post-trial briefs have been filed, and the court now considers the matter fully submitted.

The court has jurisdiction of this matter pursuant to 28 U.S.C. § 157(b)(1) and § 1334 and order of the United States District Court for the Southern District of Iowa. This is a core proceeding. 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. Plaintiff/Creditor is First American Bank, Webster City. Plaintiff is the assignee of all rights and claims of First American Bank, Ames, formerly known as American State Bank. Plaintiff brings this action in its own right and as assignee of First Bank, Ames, for debts owed for loans guaranteed by Defendant/Debtor.

2. Defendant/Debtor is Jeffrey W. Voorhees (hereinafter Voorhees). On December 11, 1998, Voorhees filed a petition for relief under Chapter 7 of the Bankruptcy Code.

3. At the time of the bankruptcy filing, Voorhees was the sole shareholder and chief officer of Voorhees Development Group, Inc. (hereinafter VDG). Voorhees incorporated VDG to pursue real estate development, particularly in the area of low cost or affordable housing.

4. In order to commence an affordable housing project, Voorhees formed a development partnership. VDG served as the general partner and acquired the property and funding to begin the project. An investment syndicator would be approached to buy into the partnership as a limited partner. The syndicator would form a partnership with interested investors. The investment partnership then purchased a percentage of the development partnership as a limited partner. VDG used the funds from the syndicator to cover the expenses of development. Any funds remaining after the expenses were paid constituted development fees. The development fees were paid to VDG for development and management of the project.

5. At various times, VDG obtained loans to finance its operations.

Voorhees signed as president of VDG and also as a personal guarantor of these loans.

6. Robert Grathwohl (hereinafter Grathwohl), president of American State Bank of Ames, Iowa (hereinafter Ames bank), met Voorhees in 1986 and provided financing to VDG at various times on project-by-project basis. On October 11, 1994, Voorhees wrote to Grathwohl requesting a \$250,000 loan due no later than October 1, 1996. The letter stated that the funds were to be used as general working capital for several upcoming housing projects. The amount represented 70% of the last syndication payment to be made by First Sterling Capital Resources, Inc. (hereinafter Sterling) to Flagstaff Affordable Housing, Limited Partnership (hereinafter Flagstaff, LP).

7. On November 7, 1994, the Ames bank loaned VDG \$250,000. Voorhees signed the promissory note in his capacity as president of VDG and personally. Pursuant to the note, VDG granted the bank a security interest in “Additional Property: Described as follows: Assignment Of Rights To Receive Proceeds from Flagstaff Affordable Housing, Limited Partnership dated November 7, 1994.”

8. VDG and WESTCAP Investments, Inc. (hereinafter WESTCAP), as co-general partners of Flagstaff LP, entered into a Hypothecation Agreement dated November 7, 1994, with American State Bank of Ames. The Hypothecation Agreement provided that VDG could use the property belonging to Flagstaff, LP to secure the loan.

9. Voorhees provided the Ames bank with a document titled Assignment of Rights to Receive Proceeds. The document purported to convey all VDG’s right to receive all payments from Flagstaff, LP. VDG agreed to pay the last two scheduled payments from the limited partner to the Ames bank. The funds were to be paid into an

account in VDG's name, but controlled by the Ames bank.

10. Voorhees provided an additional document titled "Assignment of Rights to Receive Proceeds." This document stated that for valuable consideration received, VDG and WESTCAP, as co-general partners of Flagstaff, LP, transferred the right to receive the last syndication payment of \$362,125 from Sterling to the Ames bank.

11. Martin Soja, chairman of Sterling, sent two letters to the Ames bank acknowledging receipt of the Assignment of rights to Receive Proceeds.

12. On June 19, 1995, Voorhees sent a letter to the Ames bank notifying it of a renegotiated agreement with Sterling. The letter included copies of the renegotiated agreement showing an increased equity contribution by Sterling. The two final payments covered by the loan agreement increased to \$418,000.

13. On May 24, 1995, Voorhees wrote to Grathwohl requesting a \$156,000 loan for Flagstaff LP. The letter stated that the funds were to cover design, engineering, and pre-construction costs incurred in conjunction with a 30-unit apartment complex in Flagstaff, Arizona, identified as Mountainside Village Apts. - Phase II. The loan was to be secured by an assignment of the last syndication payment by Sterling on Phase II.

14. On July 7, 1995, Voorhees and VDG borrowed \$156,000 from the Ames bank. The arrangement was similar to that of the November 7, 1994 loan. Voorhees presented a Hypothecation Agreement and an Assignment of rights to Receive Proceeds document. The loan amount constituted 70% of the final syndication payment from Sterling.

15. Sometime in the summer of 1996, Voorhees received notice from a

general contractor on two projects in Boone and Sheldon that the contractor was insolvent and going out of business. At that time the projects were only half complete. Voorhees notified the bonding companies of the contractor's failure to perform. The bonding company responded that it had no record of the bonds being issued, and the bonds provided to Voorhees were forged. Voorhees contacted attorneys to pursue performance on the bonds, and subsequently, the bonding company failed.

16. Over the ensuing months, Voorhees worked to complete the projects. Voorhees testified that the failed general contractor had not paid subcontractors for work they had completed. Also, the general contractor did not subcontract all the work, so certain construction items were not completed. In contracting for completion of the projects, Voorhees determined that the general contractor might have initially underbid the projects, as bids he received to complete the projects escalated by a considerable amount. Finally, Voorhees incurred expenses for management fees and penalties for late work as the nine-month project extended to two years.

17. In addition to the problems with the Iowa projects, Voorhees testified that an Aurora, Illinois project faltered and \$1.5 million in equity was lost. Voorhees was unable to supply the \$300,000 to \$400,000 needed to sustain the townhomes in Burnsville, Minnesota, and the contractor took over the project. The equity in this project was forfeited.

18. Voorhees testified that the various real estate projects in which VDG was involved operated on a great deal of short-term debt. When the company defaulted on one loan, it was forfeited out of projects, thereby reducing equity and development fees

and in turn causing more defaults. VDG and consequently Voorhees' financing was subject to a "domino effect."

19. On December 6, 1996, Flagstaff, LP received a payment of \$175,000 from Sterling for Phase II. The funds were deposited in the Flagstaff, LP checking account at Earlham Savings Bank.

20. On December 21, 1996, Flagstaff, LP paid VDG \$25,000 from the checking account at Earlham Savings Bank.

21. Voorhees requested an extension of the due date of the \$250,000 loan. On December 31, 1996, the Ames bank, (now First American Bank, Ames,) extended the due date to June 1, 1997. Subsequently, Voorhees requested and received an extension on the \$156,000 loan due date to June 1, 1997.

22. Flagstaff, LP received \$617,514 from Sterling. These funds were deposited in the checking account at Community State Bank on March 21, 1997.

23. Voorhees testified that Sterling sent the payments directly to VDG 25-50% of the time. Sometimes the checks were made out to VDG and sent to the bank. Voorhees admitted that Sterling followed his instructions as to payments, and he did not consider the assignment agreements at the time he gave the instructions.

24. On March 21, 1997, Flagstaff, LP paid \$90,000 to WESTCAP from the checking account at Community State Bank. WESTCAP was paid from development fees that were pledged as collateral.

25. On March 24, 1997, Flagstaff, LP paid \$30,000 to WESTCAP and \$120,000 to VDG from the Community State Bank account. These funds constituted

development fees pledged as collateral.

26. VDG's general ledger shows receipts of \$257,853 and \$120,000 on March 24, 1997 and of \$74,362.58 and \$23,000 on March 27, 1997 for syndication payments for Flagstaff-Mountainside.

27. The March 1997 payments were the last funds received from Sterling. Voorhees testified that the developer fees were not paid to the bank as required by the assignment document, but were used to pay other expenses.

28. Voorhees attempted to totally refinance VDG by selling 50% of its stock to Western Funding. In a June 17, 1997, telephone call with Grathwohl, Voorhees outlined the details of the proposed deal. A meeting was scheduled to take place on June 25, with funding to be within 10 days after the meeting. The price was \$5 million for 50% ownership. Voorhees also told Grathwohl that the syndication payments for Flagstaff had been sent directly to Voorhees, and the money was used to solve several other problems. Voorhees indicated that he knew "he left [him] hanging." Voorhees admitted that this was the first time that he informed the bank that the collateral was received and spent.

29. On June 18, 1997, Voorhees sent a letter to First American Bank at Webster City requesting that certificates of deposits owned by VDG and held by the bank be transferred and the monies applied to the loans associated with Flagstaff, LP at the Ames bank. The Webster City bank complied with the request. The \$100,000 from the certificates of deposit was applied to the \$250,000 loan reducing it to \$150,000 plus interest.

20. Attorneys for First American Bank, Webster City, sent a letter to Voorhees dated June 23, 1997. In the letter, the attorneys stated that their firm represented First American Bank of Ames, Webster City, and Jewell. They gave information concerning the two promissory notes that Voorhees signed with the Ames Bank. Voorhees owed principal of \$156,000 on Note No. 6000094153 and \$150,000 on Note No. 6260088684. Both notes were due in full on June 1, 1997. The letter stated that both notes were secured with an assignment of rights to receive proceeds from VDG and the appropriate limited partnership, and that Voorhees and VDG had unlawfully converted the proceeds. The letter acknowledged receipts of drafts that satisfied the outstanding interest to June 1, 1997, and outlined a procedure for paying the debts owed to the banks.

31. VDG wrote two checks dated June 30, 1997 to First American Bank. The checks were drawn on the Earlham Savings Bank in the amounts of \$157,547 and \$152,182.85. The payments completely satisfied the promissory notes secured by Flagstaff, LP syndication payments. The bank received the default rate of interest on the promissory notes.

32. Voorhees testified that as of July 1, 1997, VDG was current on all of its loan payments and worth approximately \$250,000 in cash.

33. On February 24, 1998, Voorhees received a letter from First American Bank stating that Loan #456764 was paid off. The letter included the satisfied note and a check for \$1,942.12 constituting overpayment. The security for Promissory Note #456764 dated January 17, 1994, included the two certificates of deposit previously

transferred from the Webster City bank to the Ames bank.

34. First American Bank Group, Ltd. is the holding company of the banks located in Webster City, Iowa, Jewell, Iowa, and Ames, Iowa. First American Bank Group acquired the stock of those banks at an unknown date. Each of those banks operated as a separate entity under the parent company.

35. First American Bank, Webster City filed a proof of claim for \$494,474.03 in Voorhees' bankruptcy case. First American Bank, Ames filed a proof of claim for \$257,544.03.

DISCUSSION

First American Bank, Webster City, brings this adversary proceeding pursuant to 11 U.S.C. § 523(a)(6), and asks the court to except the \$257,544.03 claimed by the Ames bank from discharge. The bank argues that Voorhees willfully and maliciously converted security when he accepted syndication payments that were assigned to the Ames bank and used those payments to pay other expenses of VDG.

Voorhees argues that the debt should not be excepted from discharge because the Ames bank suffered no injury. Further, Voorhees argues that the conversion of the syndication payments does not meet the Eight Circuit's standard for willful and malicious conversion.

The court agrees with Voorhees. For the following reasons First American Bank's request to except the debt from discharge will be denied.

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) provides in

relevant part that a debtor is not discharged from any debt:

(6) 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).

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.

It is well settled that §523(a)(6) includes debts for injuries caused by willful and malicious conversion. In re Jacobs, 47 B.R. 526, 527 (Bankr. S.D. Fla. 1985). Conversion is generally defined as a wrongfully assumed "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).

Commencing in 1986, Voorhees established a business relationship with Grathwohl of the Ames bank. At various times he requested and received loans and lines of credit to finance his real estate development corporation, VDG. On November 7, 1994, at Voorhees' request, the Ames bank loaned VDG \$250,000. Voorhees signed Promissory Note No. 6260088684 in his capacity as president of VDG and also, individually. The note

was secured by an “Assignment of Rights to Receive Proceeds from Flagstaff Affordable Housing....” On July 7, 1995, at Voorhees' request, the Ames bank loaned VDG \$156,000. Voorhees signed Promissory Note No. 6000094153 in his capacity as president of VDG and individually. This note was secured by a similar assignment of rights to proceeds from Flagstaff Phase II, Mountainside Village Apartments. The proceeds envisioned by the “assignments” were syndication payments from the Sterling investment partnership. The final syndication payments would constitute development fees for VDG.

Sterling was to send the syndication payments securing the loans to the Ames Bank. The payments were to be placed in an account in VDG's name, but controlled by the Ames Bank. However, Sterling sent the payments directly to Voorhees. Voorhees testified that Sterling did so at his instruction. Voorhees then used these funds to pay other expenses of VDG. He did not apply the funds to the loans at the Ames bank.

Based on the foregoing facts, the court concludes that a technical conversion took place. The Ames bank had recognizable property rights that were created by the loan agreements and assignment documents. Security State Bank of Houston v. Nelson (In re Nelson), 67 B.R. 491, 497 (Bankr. D. Minn. 1985). Voorhees wrongly assumed dominion over the syndication payments to the exclusion of the Ames bank when he directed Sterling to make the payments directly to him and then used the funds to pay other expenses of VDG.

However, proving a technical conversion is insufficient to except a debt from discharge. Id. at 496. First American Bank must prove that the conversion was willful and malicious. Id. More importantly, First American Bank must show that it was injured by the

conversion. 11 U.S.C. § 523(a)(6). In this case, First American Bank has failed to prove that it sustained any injury from the conversion.

Upon Voorhees' request, the Ames bank extended the due dates of the loans until June 1, 1997. On June 18, 1997, Voorhees requested that First American Bank of Webster City transfer two certificates of deposit owned by VDG to the Ames bank. The Webster City bank held the certificates of deposit as security for Loan No. 456764. The Ames bank was then to apply the proceeds to VDG's loans at Ames. The certificates of deposit generated \$100,000 which was applied to Note No. 6260088684 reducing its principal to \$150,000.

In a letter dated June 23, 1997, counsel for First American Banks of Ames, Webster City, and Jewell, recited the discussions and agreements that had been reached at a meeting held the previous week between Voorhees, Grathwohl, and other bank officials. Counsel for the bank acknowledged that the proceeds from the certificates of deposit were applied to the loan at Ames. He further acknowledged that drafts were received that satisfied the outstanding interest on both loans up to June 1, 1997. He stated that agreement was reached whereby Voorhees would satisfy the balance due on the note with other funds on or before July 3, 1997.

Voorhees paid off Note No. 6260088684 and Note No. 6000094153 with checks dated June 30, 1997. The checks were drawn on VDG's account at Earlham Savings Bank and satisfied the principal and default rate interest on the two notes.

The court finds that the notes secured by the converted property were paid off in the entirety and at a default rate of interest. Consequently, American State Bank was not

injured by the conversion. Indeed, Grathwohl testified that the Ames bank was not injured by the conversion as it received full payment on the notes.

Plaintiff's argument that Voorhees' conversion deprived it of other collateral that could have been used to pay other loans due it is unpersuasive. Plaintiff's argument centers on the certificates of deposit that were released by the Webster City bank. However, the Webster City bank was under no obligation to release its security. Further, it was not harmed because the note, for which the certificates of deposit provided security, was paid. In a letter dated February 24, 1998, Voorhees received the note, an acknowledgment of payment, and a check for overpayment.

Even if the bank was injured by Voorhees' actions, the court concludes that it has not carried its burden in proving that the conversion was willful and malicious. Under § 523(a)(6), the court must separately analyze the elements of willfulness and malice. 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. The act must be done with the actual intent to cause injury to the creditor. Kawauhau v. Geiger, 523 U.S. 57, 61-64 (1998).

In this case, there is no question that Voorhees acted willfully in converting syndication funds. Voorhees is an experienced businessman and sophisticated in financing

real estate development projects. He requested the loans and offered the syndication payments as security. Voorhees knew that he could not use the syndication payments without the Ames bank permission. Voorhees testified that he knew and understood the terms of the loan and security agreements. He further testified that he intended to acquire the payments and use the funds to pay other expenses of VDG.

However, plaintiff's action must fail because the court finds that Voorhees did not act maliciously. The court is cognizant that a debtor who willfully breaks a security agreement is "testing the outer bounds of [his] right to a fresh start." In re Long, 774 F.2d at 882.

However, unless the debtor takes those actions with malice, fully intending or expecting to injure the economic interests of the creditor, the debt is not excepted from discharge. Id. Here, First American Bank has not sustained its burden in proving that Voorhees intended or expected to injure the Ames bank. To the contrary, Voorhees was constantly attempting to refinance VDG, and thereby repay all its creditors.

In the summer of 1996, Voorhees received notice from a contractor that it would not be able to complete two projects in Boone and Sheldon, Iowa. At that time, the projects were only half complete. Upon notifying the bonding company of the contractor's failure to perform, Voorhees was informed that the bonding company had no record of the bonds issuance, and the bonds provided to Voorhees were forged. After Voorhees initiated actions to collect on the bonds, the bonding company failed. Voorhees took actions to complete the projects. In so doing, he discovered that the contractor had failed to pay subcontractors for work that was completed. Further, the contractor did not subcontract all the work and

certain items were not completed. Voorhees incurred additional expenses to complete the work, for management fees, and for penalties for late completion. Voorhees also experienced losses on projects in Illinois and Minnesota.

Voorhees testified that VDG financed various projects with short-term debt. When the company defaulted on one loan, it was forfeited out of others in turn causing more defaults. Voorhees extended the due dates on the loans at Ames bank thereby avoiding default on the obligations. He used the syndication payments that collateralized those loans to pay other expenses in order to keep VDG operating until he totally refinanced the company. Voorhees testified that he was able to keep VDG afloat for several months and was able to continue paying creditors while he attempted the refinancing. The court finds that his intention throughout this time period was to return VDG to a solid financial condition.

There is no evidence in the record that Voorhees converted any of the syndication funds to his personal use. Any argument that he intended to harm the Ames bank is belied by fact that the loans secured by the converted funds were voluntarily paid in full at the default rate of interest. Without some evidence of personal enrichment and intent to harm the creditor, courts are reluctant to find the requisite malice and except the debt from discharge. See, In re Long, 774 F.2d at 882 (debt discharged where debtor diverted funds to corporate account instead of collateral account in attempt to keep business going and funds were not used for personal benefit); First Nat. Bank of Fayetteville, Ark. V. Phillips (In re Phillips), 882 F.2d 302 (8th Cir. 1989)(debt discharged where debtors deposited check for lease and used funds in an attempt to keep business operating); Mercantile Bank of

Arkansas, N.A., v. Speers (In re Speers), 244 B.R. 142 (Bankr. W.D. Ark. 2000)(debt not discharged where debtor sold security and used the money for his own personal use and for the use of the business). Accordingly, the court determines that First American Bank's claim is not excepted from discharge.

ORDER

IT IS THEREFORE ORDERED that the debt owed the plaintiff First American Bank, Webster City is not excepted from discharge, and the defendant Jeffrey W. Voorhees shall have judgment against the plaintiff dismissing the complaint.

Dated this _____ day of December, 2000.

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