

UNITED STATES BANKRUPTCY COURT
DISTRICT OF MINNESOTA

In re

John and Marcia Thomas
Debtors

Bky. No. 03-34351
Chapter 7 case

Lonsdale Feed Mill, Incorporated,
Plaintiff,

vs.

John and Marcia Thomas,
Defendants.

Adv. No. 03-3287

DEFENDANTS' PRETRIAL MEMORANDUM

This is a case involving an open credit account, in which the Plaintiff has alleged actual fraud under 11 U.S.C. § 523(a)(2)(A). Although the Plaintiff provided a scintilla of evidence sufficient to avoid summary judgment and raise a fact issue for trial, the evidence at trial will clearly negate (let alone fail to prove) any fraud.

FACTS

Overview

Defendants (Thomases) had an open account with Plaintiff (Lonsdale) for livestock feed. Lonsdale filed this adversary case alleging that, "Between 02/05/2002 and 08/31/2002, the Defendants accumulated in excess of \$41,201.89 charges toward this account." In fact, according to Lonsdale's own ledger the increase in the account balance during that interval, excluding service (interest) and three \$25.00 NSF charges, was only \$4,404.95, one tenth of the alleged amount. There were additional transactions and payments after August 31, 2002, and if

the calculation is extended through the June 19, 2003, petition date, the same calculation shows a net increase of only \$1,143.14, or 2.8 percent of the amount alleged in the complaint.

A chronological ledger and analysis are appended to this memorandum. The ledger is a chronological restatement of the ledger that Lonsdale attached to its proof of claim in the main case. The Thomases will ask the Court to admit both the original proof of claim ledger, and the restated chronological ledger, as trial exhibits.

Detail

As of February 5, 2002, the Thomas account had an outstanding balance of \$15,524.40. As of August 31, 2002, it had an outstanding balance of \$21,850.17. Immediately before the petition date, the balance was \$21,381.27. On and after February 5, 2002, with some exceptions, new purchases were handled on a “COD” (full payment at time of purchase) basis.

Total actual purchases and payments on and after February 5, 2002, to the petition date, net as follows:

| | | |
|--------------------------------|---------------|---|
| Total Sales | \$ 9,521.64 | on and after 2/5/02 |
| Total Misc. Debit ¹ | \$ 1,132.80 | on and after 2/5/02 |
| Total Payments | \$ (9,511.30) | excludes 3000 x 3 and 1193 x 1 (NSF items – see table below) |
| | <hr/> | |

Net of Purchases over Payments: \$ 1,143.14

The overall change in the account from February 5, 2002, to the petition date is summarized as follows:

¹ The Thomases do not contest Lonsdale’s assertion that “Misc debit” items on Lonsdale’s ledger are purchases.

| | | | |
|--------------------|---------------------|---------------|-----------|
| Beginning Balance | \$ 15,524.40 | | 2/5/2002 |
| Ending Balance | <u>\$ 21,381.27</u> | | 5/31/2003 |
| Change in acct bal | | \$ 5,856.87 | |
| Service Charges | | \$ (4,613.73) | |
| NSF Charges | | \$ (100.00) | |

Change not due to service or NSF charges \$ 1,143.14

Included on ledgers are NSF (returned check) debits and credits for payments that either became, or were intended replace, NSF checks, occurring after February 5, 2002, with \$25 service charges added to the NSF debits, as follows:

| Date | Debit | Credit | Net |
|---------------|-------------------|--------------------|-------------------|
| 2/5/2002 | \$3,025.00 | | |
| 2/23/2002 | | \$3,000.00 | (\$25.00) |
| 2/25/2002 | | \$3,000.00 | |
| 3/25/2002 | \$3,025.00 | | (\$25.00) |
| 4/16/2002 | | \$3,000.00 | |
| 4/26/2002 | \$3,025.00 | | (\$25.00) |
| 9/7/2002 | | \$1,193.00 | |
| 10/2/2002 | \$1,218.00 | | |
| 12/5/2002 | | \$1,193.00 | \$1,168.00 |
| Totals | \$9,075.00 | \$10,193.00 | \$1,093.00 |

The \$3000 / \$3025 transactions represent an unsuccessful effort to reduce the balance that existed before February 5, 2002. The \$1193 / \$1218 transactions represent payment for new purchases after February 5, 2002.

ARGUMENT

Lonsdale's assertion of law in its complaint, as to an implied representation of *ability* to repay, is contrary to recent case law in Minnesota and nationwide. *See, e.g., In re Stearns*, 241 B.R. 611, 622-23 (Bankr. D. Minn. 1999) (Kishel, J.), and cases discussed therein. By any standard, however, Lonsdale cannot prove fraud because the net of purchases over payments was

minimal. The actual fraud provisions of 11 U.S.C. § 523(a)(2)(a) apply only to “obtaining money, property, services, or an extension, renewal, or refinance of credit,” not to accrual of interest on a debt. Thus, the \$1143 net of purchases over payments represents the upper limit of the Thomases’ exposure in this case.

This Court has described a claim for actual fraud, in bankruptcy, as follows:

In accord with the congressional intent, the judicial construction of § 523(a)(2)(A) uses the generally-recognized elements of fraud under the "dominant consensus of common-law jurisdictions." *Field v. Mans*, 516 U.S. 59, 71 at n. 9, 116 S.Ct. 437, 133 L.Ed.2d 351 (1995). *See also In re Dallam*, 850 F.2d 446, 449 (8th Cir.(Mo.)1988) (§ 523(a)(2)(A) "has been construed to incorporate the elements of common law fraud ..."). In this Circuit, a creditor relying on § 523(a)(2)(A) must prove up the following fact elements:

1. The debtor made a false representation of fact;
2. The debtor knew the representation to be false at the time the debtor made it;
3. The debtor made the representation with the intent and purpose of deceiving the creditor;
4. The creditor justifiably relied on the debtor's representation; and
5. The creditor sustained the alleged injury as the proximate result of the making of the representation.

In re Stearns, *supra* at 620. The circumstances under which a court may infer a false representation and wrongful intention from conduct alone, in this context are extremely limited. For example, “when the cardholder lacked an intent to repay when making certain individual charges because he planned to shortly discharge them in bankruptcy, or when he engages in credit card kiting, using cash advances on one credit card to make the minimum payments on another credit card, without intention to pay for the money, property, or services received, the court may infer a concurrent intent not to pay, making the implied representation of that intent false.” *Id.* at 623 (citations and internal quotation marks omitted).

Stearns involved a debtor who ran up over \$8,700 in credit card debt in four months just before the bankruptcy filing. *Id.* at 625. The Thomases and Lonsdale engaged in a series of open account purchases and payments over 16 months, increasing the account balance by only \$1,143, when interest and \$100 in NSF charges are omitted from the calculation. The Bankruptcy Code “ensur[es] access to bankruptcy relief as a haven from insuperable debt burdens occasioned by inadvertence, simple negligence, outright irresponsibility, and even

recklessness.” *Id.* at 623. The minuscule increase in the Thomas – Lonsdale account balance does not rise above inadvertence.

In order to prevail in this case, Lonsdale must prove “an actual, consciously-conceived plan or scheme on the part of the [debtors], contemporaneous with the charges in question--the scheme being to knowingly abuse” the particular open-account relationship. *Id.* at 624 n. 21. Although the exact quantum and nature of proof may vary between a credit card case such as *Stearns* and a business open account case such as this one, the legal principle remains the same.

The Thomases will testify that they had no intention to defraud Lonsdale. The debt is an open account debt related to a failed livestock operation, with nothing to distinguish it from similar debts that are routinely discharged.

Renewed request for sanctions

Lonsdale clearly disregarded facts in its own possession in alleging fraudulent activity aggregating to over \$41,000. It is doubtful that Lonsdale would have brought this case over a paltry \$1,143. It also appears to be unfamiliar with the legal standards related to a § 523(a)(2)(a) claim.² The result of all of this has been to cause a great deal of expense and hardship for the Thomases.

A Rule 9011 sanction “is warranted if a party's pleading ‘was not grounded in fact nor by existing law or a good faith argument for an extension, modification, or reversal of the existing law.’ *In re Mahendra*, 131 F.3d 750, 759 (8th Cir.1997), *cert. denied*, 523 U.S. 1107, 118 S.Ct. 1678, 140 L.Ed.2d 815 (1998).” *In re Russ*, 187 F.3d 978, 981 (8th Cir. 1999). Because the Plaintiff’s own numbers show a close balance between payments and purchases, its wildly contrary allegations in the complaint fall outside of the realm of the well-founded, meriting

² While not directly relevant to the issue of sanctions, Lonsdale’s procedural problems in this case, such as non-service of the summons for over two months, indicate its lack of preparation and careful attention to the obligations falling on a plaintiff bringing this type of case. The incorrect statutory citations in paragraphs 1 and 9 of the complaint are additional indicators of lack of consideration of the law.

sanctions. It's utter lack of proof of wrongful intent, for the small actual account increase, further merits sanctions.

The full amount of fees incurred by the Defendants in this case will not be known until after trial. Whether Rule 9011 is viewed more as a deterrent to a wrongdoer or as compensation for the party wronged, the amount of fees is one consideration in determining the amount of sanctions. Therefore, the Court should defer its determination of the exact amount of sanctions until after trial.

CONCLUSION

For these reasons, the Court should deny all relief to the Plaintiff and award sanctions to the Defendants.

Respectfully submitted,

/e/ Kurt M. Anderson

Kurt M. Anderson # 2148

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ANALYSIS OF LONSDALE FEED MILL PROOF OF CLAIM LEDGER

| PROOF OF CLAIM LEDGER (re-sorted by date) | | | | |
|--|-------------|---------------------|---------------------|----------------|
| Description | Date | Debit | Credit | Balance |
| Beg Bal | 1/1/2002 | \$ 15,246.93 | | \$ 15,246.93 |
| Misc. Debit | 1/11/2002 | \$ 39.50 | | \$ 15,286.43 |
| Misc. Debit | 1/17/2002 | \$ 12.40 | | \$ 15,298.83 |
| Service Chg | 1/31/2002 | \$ 225.57 | | \$ 15,524.40 |
| Sale | 2/5/2002 | \$ 1,055.53 | | \$ 16,579.93 |
| NSF | 2/5/2002 | \$ 3,025.00 | | \$ 19,604.93 |
| Misc. Debit | 2/17/2002 | \$ 1,132.80 | | \$ 20,737.73 |
| Sale | 2/23/2002 | \$ 172.54 | | \$ 20,910.27 |
| Payment | 2/23/2002 | | \$ 3,000.00 | \$ 17,910.27 |
| Sale | 2/25/2002 | \$ 929.38 | | \$ 18,839.65 |
| Payment | 2/25/2002 | | \$ 3,000.00 | \$ 15,839.65 |
| Service Chg | 2/28/2002 | \$ 141.90 | | \$ 15,981.55 |
| Sale | 3/8/2002 | \$ 39.80 | | \$ 16,021.35 |
| Sale | 3/12/2002 | \$ 1,020.17 | | \$ 17,041.52 |
| NSF | 3/25/2002 | \$ 3,025.00 | | \$ 20,066.52 |
| Sale | 3/29/2002 | \$ 899.17 | | \$ 20,965.69 |
| Service Chg | 3/31/2002 | \$ 236.44 | | \$ 21,202.13 |
| Sale | 4/16/2002 | \$ 1,007.10 | | \$ 22,209.23 |
| Payment | 4/16/2002 | | \$ 3,000.00 | \$ 19,209.23 |
| Payment | 4/16/2002 | | \$ 1,007.10 | \$ 18,202.13 |
| Sale | 4/17/2002 | \$ 39.80 | | \$ 18,241.93 |
| Payment | 4/17/2002 | | \$ 938.97 | \$ 17,302.96 |
| NSF | 4/26/2002 | \$ 3,025.00 | | \$ 20,327.96 |
| Service Chg | 4/30/2002 | \$ 246.89 | | \$ 20,574.85 |
| Payment | 5/10/2002 | | \$ 1,229.02 | \$ 19,345.83 |
| Service Chg | 5/31/2002 | \$ 286.21 | | \$ 19,632.04 |
| Sale | 6/7/2002 | \$ 207.58 | | \$ 19,839.62 |
| Payment | 6/7/2002 | | \$ 207.58 | \$ 19,632.04 |
| Sale | 6/9/2002 | \$ 1,184.52 | | \$ 20,816.56 |
| Service Chg | 6/30/2002 | \$ 307.97 | | \$ 21,124.53 |
| Sale | 7/8/2002 | \$ 52.30 | | \$ 21,176.83 |
| Payment | 7/8/2002 | | \$ 1,193.00 | \$ 19,983.83 |
| Sale | 7/14/2002 | \$ 1,101.40 | | \$ 21,085.23 |
| Sale | 7/18/2002 | \$ 1,285.60 | | \$ 22,370.83 |
| Service Chg | 7/31/2002 | \$ 311.17 | | \$ 22,682.00 |
| Payment | 8/8/2002 | | \$ 1,285.60 | \$ 21,396.40 |
| Payment | 8/8/2002 | | \$ 88.35 | \$ 21,308.05 |
| Service Chg | 8/31/2002 | \$ 315.24 | | \$ 21,623.29 |
| Sale | 8/31/2002 | \$ 226.88 | | \$ 21,850.17 |
| Sale | 9/7/2002 | \$ 262.62 | | \$ 22,112.79 |
| Sale | 9/7/2002 | \$ 17.25 | | \$ 22,130.04 |
| Sale | 9/7/2002 | \$ 20.00 | | \$ 22,150.04 |
| Payment | 9/7/2002 | | \$ 1,193.00 | \$ 20,957.04 |
| Payment | 9/7/2002 | | \$ 262.62 | \$ 21,689.66 |
| Payment | 9/7/2002 | | \$ 17.25 | \$ 21,672.41 |
| Service Chg | 9/30/2002 | \$ 323.63 | | \$ 21,348.78 |
| NSF | 10/2/2002 | \$ 1,218.00 | | \$ 20,130.78 |
| Payment | 10/15/2002 | | \$ 576.33 | \$ 19,554.45 |
| Service Chg | 11/1/2002 | \$ 320.19 | | \$ 19,234.26 |
| Payment | 11/29/2002 | | \$ 226.88 | \$ 19,007.38 |
| Service Chg | 12/2/2002 | \$ 321.57 | | \$ 18,685.81 |
| Payment | 12/5/2002 | | \$ 1,193.00 | \$ 17,492.81 |
| Service Chg | 12/31/2002 | \$ 298.39 | | \$ 17,194.42 |
| Payment | 1/9/2003 | | \$ 1,285.60 | \$ 15,908.82 |
| Service Chg | 1/31/2003 | \$ 294.07 | | \$ 15,614.75 |
| Service Chg | 3/1/2003 | \$ 288.49 | | \$ 15,326.26 |
| Service Chg | 3/31/2003 | \$ 302.69 | | \$ 15,023.57 |
| Service Chg | 4/30/2003 | \$ 307.17 | | \$ 14,716.40 |
| Service Chg | 5/31/2003 | \$ 311.71 | | \$ 14,404.69 |
| Service Chg | 6/30/2003 | \$ 316.33 | | \$ 14,088.36 |
| Totals | | \$ 41,401.90 | \$ 19,704.30 | |
| Totals without beg bal | | \$ 26,154.97 | \$ 19,704.30 | |

| ANALYSIS thru petition date | | |
|--|---------------|-----------|
| Beginning Balance | \$ 15,524.40 | 2/5/2002 |
| Ending Balance | \$ 21,381.27 | 5/31/2003 |
| Change in acct bal | \$ 5,856.87 | |
| Service Charges | \$ (4,613.73) | |
| NSF Charges | \$ (100.00) | |
| Change not due to service or NSF charges | \$ 1,143.14 | |

| ANALYSIS thru 8/31/02 | | |
|--|---------------|-----------|
| Beginning Balance | \$ 15,524.40 | 2/5/2002 |
| Ending Balance | \$ 21,850.17 | 8/31/2002 |
| Change in acct bal | \$ 6,325.77 | |
| Service Charges | \$ (1,845.82) | |
| NSF Charges | \$ (75.00) | |
| Change not due to service or NSF charges | \$ 4,404.95 | |

DECLARATION OF SERVICE BY MAIL

Kurt Anderson declares under penalty of perjury that on September 1, 2004, he served the following:

Objection to Exhibits
Trial Memorandum
This Proof of Service

upon

Stephanie Onorato
Attorney at Law
102 5th Ave NW
PO Box 389
Lonsdale, MN 55046

By routing copies thereof pursuant to normal office procedure, for deposit in the United States Mail at Minneapolis, Minnesota, directed to each entity at the addresses indicated herein.

VERIFICATION

I hereby declare under penalty of perjury that I have read the foregoing Declaration of Service by U.S. Mail and that the facts stated therein are true and correct.

Executed on: September 1, 2004 /e/ Kurt M. Anderson