UNITED STATES BANKRUPTCY COURT
DISTRICT OF MINNESOTA

In re: BKY 00-41194

EUGENE M. WALES,

Debtor.

ASSOCIATED BANK MINNESOTA, ADV 00-4130

Plaintiff,

-v.-

EUGENE M. WALES,

Defendant.

FINDINGS OF FACT, CONCLUSIONS OF LAW AND ORDER FOR JUDGMENT

At Minneapolis, Minnesota, January 3, 2001.

This matter came on for trial on November 7, 2000, and December 19, 2000. S. Steven Prince and Andre Hanson appeared on behalf of the Plaintiff. Barbara J. May appeared on behalf of the Defendant.

Based upon the testimony of witnesses, arguments of counsel, the proceedings, and upon all of the files and records herein, the Court makes the following:

FINDINGS OF FACT[1]

1. On March 6, 2000, Debtor Eugene M. Wales ("Debtor") filed both the above-captioned Chapter 7 case and a Chapter 7

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[1] The parties' Stipulation of Undisputed Facts is incorporated into these Findings by reference.

case for a company he wholly owned and controlled, Wales Transportation Services, Inc. ("Wales Transportation").

2. Plaintiff Associated Bank Minnesota ("the Bank") commenced this adversary proceeding pursuant to Federal Rule of Bankruptcy Procedure 7001, 11 U.S.C. § 523(a)(6), and 11 U.S.C. § 727(a)(2), (4), and (7).

3. The Bank's claim arises out of a business loan made to Wales Transportation on April 13, 1999 ("the loan") pursuant to which Wales Transportation borrowed $175,000 from the Bank (actually from its predecessor), and executed a business loan agreement, promissory note, security agreement, assignment of loan documents and commercial pledge agreement. Debtor signed a personal guaranty of the loan. The Bank perfected its security interest in its collateral, which included virtually all of the assets of Wales Transportation, including specifically its accounts receivable.[2]

4. The loan documents specified that the proceeds of the loan were to be used for business purposes only unless specifically consented to the contrary by the Bank. Specifically, they recited the proceeds were to be used 1) to fund Debtor's buyout of his brother, Mark, who was also a

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[2]Through error on the Bank's part, the Bank's security interest in certain vehicles was not perfected.

shareholder, and 2) for working capital. Debtor knew and understood that this is how the proceeds were to be used.

5. Further, the "Borrower's Certification" executed by Debtor and on behalf of Wales Transportation explicitly provided:

> . . . borrower will not, without Lender's prior written consent: Make any distribution of company assets that will adversely affect the financial condition of the Borrower . . . [or] otherwise dispose of any of Borrower's property or assets, except in the ordinary course of business.

Debtor knew that the loan was to be used only for these purposes and that he was responsible for making sure the proceeds were not disbursed in a wrongful manner.

6. At the closing, the Bank disbursed $77,019.00 to Mark, to fund Debtor's buyout of his brother's 50% interest in the company. From that point forward, Debtor was in sole and complete control of Wales Transportation. The remaining $97,981.00 in loan proceeds was deposited in the Wales Transportation checking account.

7. From the beginning, Wales Transportation was under-capitalized. By the summer or fall of 1999, it was in a serious financial situation, so cash-strapped that Debtor had to hold checks to make sure cash was available to cover them. The company was in unmitigated financial distress and Debtor knew it. This caused Wales Transportation to default on the

loan. On December 27, 1999, the Bank notified Wales Transportation that it was terminating authority to use cash collateral and demanded a turnover of collateral and all proceeds thereof subject to the Bank's security interest, including the company's accounts receivable.

8. As it turned out, however, both before and after this notice, Debtor had engaged in a practice of siphoning off money from the corporate checking accounts for his own personal benefit, thus stripping the Bank of its collateral.

9. On April 13, 1999, the very day the loan closed, Debtor had Wales Transportation issue checks from its corporate account to pay his personal federal and state income taxes, $36,048.00 to the Internal Revenue Service and $14,052.00 to the Minnesota Department of Revenue. Debtor knew that it was never contemplated that loan proceeds would be used to pay Debtor's personal income taxes. Debtor's explanation, that he believed it was appropriate to pay his personal taxes from corporate sources because the loan documents required the *corporation* to stay current on its tax obligations, is utterly unbelievable.

10. Between April of 1999 and January of 2000, Debtor withdrew approximately $150,000 from the corporate checking accounts, which sums were payable to himself, to his spouse,

to his real estate agent, or to various government agencies for his child support obligations. This sum includes the foregoing tax payments and, inter alia: $14,000.00 to himself on April 19, 1999; $1,865.00 to his wife on November 16, 1999; $5,132.77 to his wife on December 8, 1999; $26,940.00 to himself on December 8, 1999; $11,543.00 to himself on December 30, 1999; $1,000.00 to the real estate agent to purchase a new home on January 6, 2000; and $13,253.15 to himself on January 19, 2000. In addition, usually on a bi-weekly basis, he paid himself what he says was salary in the sum of $595.57, $140.74 of which was sent directly to various government agencies to pay his child support. Between April and December, he apparently paid himself sporadic smaller lump sum payments totaling about $5,500. All in all, Debtor knew that these withdrawals were wrongful and in direct contravention of the contract with the Bank. I discredit his testimony to the contrary and the rather feeble and unbelievable explanations he provided for these activities. Debtor has claimed that the regular monthly withdrawals were salary and the more sporadic lump sum payments were year-end draws. Yet, he had never before taken salary draws from the business he owned or managed, relying instead on distributions of profits to shareholders. If these payments were actually salary, the practice was a radical departure from his prior practices. There is inadequate (or no) documentary evidence to support his testimony that the payments to his wife were supported by consideration and not gifts. The more far-fetched argument that some of the payments were for a loan he made to the company or on a loan a third person took out from him that was run through Wales Transportation are, again, either not supported by documentary evidence or, in fact, belied by it. To the contrary, I find that he knew the company was failing and he knew that paying himself or others on his behalf was wrong and would jeopardize the Bank's collateral position. While Debtor may have been entitled to pay himself a modest salary from the corporate revenue (even this may be doubtful based on his testimony that he really only expected to get paid out of profits), he was not entitled to raid the corporate treasury for his own benefit.

11. The evidence amply supports my finding that Debtor deliberately converted Wales Transportation's assets; that he knew the conversions would have, and did in fact have, an adverse effect on the financial condition of Wales Transportation; that the withdrawals violated covenants made in the loan documents; and that his actions were both willful

(he intended to do the act) and malicious (he intended to cause financial harm to the Bank).

12. This is especially demonstrated by the fact that in December of 1999 and January of 2000, Debtor siphoned a number of very large draws out of the company, which exceeded $50,000. This was at a time when Wales Trasnsportation was seriously in default on its loans to the Bank. Much of the money was withdrawn <u>after</u> the Bank had given its notice of default and demanded protection of the accounts receivable. The evidence shows that after the Bank's notice was received, Debtor escalated his attempts to have account debtors pay quickly, even if he had to discount the accounts to get immediate payment.

13. Bankruptcy was on Debtor's mind. Since the Bank held a mortgage on his home, Debtor knew that he could not protect that home from the Bank's foreclosure in pursuit of its guaranty. Therefore, Debtor took over $50,000, subject to the security interest of the Bank, from Wales Transportation to make a downpayment toward the purchase of a new home at 9799 Lancaster Lane North, Maple Grove, Minnesota. He left the Bank to foreclose on the first house, a foreclosure which to date has yielded it nothing. Thus, Debtor wrongfully took fraudulently obtained assets converted from the bank accounts

of Wales Transportation and used them to buy a new home in which he immediately had $50,000 in exempt equity.

14. The petition filed by Wales Transportation and signed by Debtor as its officer failed to disclose any of the foregoing insider transactions. There are no payments to creditors or insiders listed in answer to Question Number 3 of the Statement of Financial Affairs. None of the insider payments were listed in answer to Question 10, regarding other transfers out of the ordinary course. And the corporation responded "None" in answer to Question 21 regarding withdrawals or distributions credited or given to insiders, including compensation in any form during the one year immediately preceding the commencement of the case. Debtor offered no credible excuse for not disclosing information regarding the more than $200,000 withdrawn from the corporation and paid to him, child support agencies on his behalf, his wife, his brother, his banks, the taxing authorities on his behalf, and his real estate broker. These nondisclosures can only be determined to have been done with fraudulent intent in order to keep them from being discovered by the corporation’s bankruptcy trustee.

CONCLUSIONS OF LAW

I. DENIAL OF DISCHARGE UNDER § 727(a)(7)

The Bank seeks a denial of the Debtor’s discharge on two grounds under section 727(a)(7). Generally speaking, denying the debtor a discharge is a “harsh and drastic penalty.” American Bank v. Ireland (In re Ireland), 49 B.R. 269, 271 n.1 (Bankr. W.D. Mo. 1985); see also Peoples State Bank v. Drenckhahn (In re Drenckhahn), 77 B.R. 697, 705 (Bankr. D. Minn. 1987) (recognizing that denial of discharge is a “harsh sanction”); McDonough v. Erdman (In re Erdman), 96 B.R. 978, 984 (Bankr. D.N.D. 1988) (“Denying a discharge to a debtor is a serious matter not to be taken lightly by a court.”). Accordingly, the denial of discharge provisions of section 727 "are strictly construed in favor of the debtor." Fox v. Schmit (In re Schmit), 71 B.R. 587, 589-90 (Bankr. D. Minn. 1987). Importantly, however, section 727 was also included to prevent the debtor's abuse of the Bankruptcy Code. See id. at 590.

The burden of proof in a denial of discharge case is on the objecting party. See Fed. R. Bankr. P. 4005; Ramsay v. Jones (In re Jones), 175 B.R. 994, 997 (Bankr. E.D. Ark. 1994). The objecting party, the Bank in this case, must prove each element by a preponderance of the evidence. See, e.g., Grogan v. Garner, 498 U.S. 279 (1991); Kirchner v. Kirchner (In re Kirchner), 206 B.R. 965, 973 (Bankr. W.D. Mo. 1997) (citing Barclays/American Bus. Credit v. Adams (In re Adams), 31 F.3d 389 (6th Cir. 1994)); Kaler v. Craig (In re Craig), 195 B.R. 443, 448-49 (Bankr. D.N.D. 1996)(citing, inter alia, Farouki v. Emirates Bank Int'l, Ltd., 14 F.3d 244 (4th Cir. 1994); First Nat’l Bank v. Serafini (In re Serafini), 938 F.2d 1156 (10th Cir. 1991)).

Section 727(a)(7) specifically provides:

> The court shall grant the debtor a discharge, unless-
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> (7) the debtor has committed any act specified in paragraph (2), (3), (4), (5), or (6) of this subsection, on or within one year before the date of the filing of the petition, or during the case, in connection with another case, under this title or under the Bankruptcy Act, concerning an insider.

11 U.S.C. § 727(a)(7) (1994). In other words, under this provision, a bankruptcy court may deny a debtor a discharge if: on or within one year before the date of the filing of the petition, or at any time during the debtor’s own case, the debtor commits any of the objectionable acts specified in § 727(a)(2), (3), (4), (5), or (6), in connection with another case concerning an insider. See Collier on Bankruptcy ¶ 727.10 (Lawrence P. King ed., 15th revised ed. 2000).

As discussed below, the Bank has satisfied all three of the requisite elements to deny the Debtor his discharge. First, it is undisputed that Debtor was the director and officer in sole control of Wales Transportation during the one-year period prior to the filing of both his personal bankruptcy and the Wales Transportation corporate bankruptcy. Second, all transfers made from Wales Transportation between March 6, 1999 and March 6, 2000 to either the Debtor himself, his brother, or his wife fall within the definition of insider transactions under 11 U.S.C. § 101(31)(B). The remaining issue, then, is whether the Debtor committed any of the objectionable acts specified in the other subsections of § 727 in connection with his corporate bankruptcy case. See Collier on Bankruptcy ¶ 727.11[1] ("Section 727(a)(7) extends the basis for denial of discharge to the debtor's misconduct in a substantially contemporaneous related bankruptcy case. Thus if the debtor engages in objectionable conduct in a case involving ... a corporation of which the debtor is an officer, director or controlling person, the debtor may be denied a discharge in the debtor's own case."); see also In re Jones, 175 B.R. at 997 (denying debtor his discharge for failure to schedule bank accounts and other transfers accurately in both his personal and professional association cases). Citing the catch-all language of § 727(a)(7), the Bank claims the Debtor violated § 727(a)(4) when he failed to disclose certain assets and transfers on his corporate bankruptcy schedules and § 727(a)(2) when he converted the Bank's collateral to bankroll his purchase of exempt assets just prior to the petition filings in his personal and corporate bankruptcy cases.

A. Debtor Failed to Disclose Insider Transfers on His Corporate Bankruptcy Petition Under § 727(a)(4)[3]

Section 727(a)(4)(A) "provides a harsh penalty for the debtor who deliberately secretes information from the court, the trustee, and other parties in interest in his case." Cepelak v. Sears (In re Sears), 246 B.R. 341, 347 (B.A.P. 8th Cir. 2000). That sub-section, read together with § 727(a)(7), entitles a debtor to a discharge unless the debtor knowingly and fraudulently made a false oath or account in connection with another bankruptcy case. See 11 U.S.C. section 727(a)(4)(A) (1994); 11 U.S.C. § 727(a)(7) (1994). For such a false oath or account to bar a discharge, the false statement must be both material and made with intent. Mertz v. Rott, 955 F.2d 596, 597-98 (8th Cir. 1992); Palatine Nat'l Bank v. Olson (In re Olson), 916 F.2d 481, 483-84 (8th Cir. 1990); Chalik v. Moorefield (In re Chalik), 748 F.2d 616, 618 (11th Cir. 1984)). Noting that the "threshold to materiality is

[3]Debtor asserts that Plaintiff failed to plead a § 727(a)(7) that was based on § 727(a)(4). While it is true that the amended complaint alleges facts not having to do with false oaths, broadly read the amended complaint fairly put Debtor on notice of Plaintiff's expectation of pursuing denial of discharge under all available theories.

fairly low," the Eighth Circuit Bankruptcy Appellate Panel recently articulated the standard for materiality:

> The subject matter of a false oath is 'material' and thus sufficient to bar discharge, if it bears a relationship to the bankrupt's business transactions or estate, or concerns the discovery of assets, business dealings, or the existence and disposition of his property.

In re Sears, 246 B.R. at 347 (quoting In re Chalik, 748 F.2d at 618).

Applying § 727(a)(4)(A) to this case, the Bank offered ample evidence at trial to show the Debtor intentionally omitted numerous asset transfers from his corporate bankruptcy schedules. The Debtor withdrew around $150,000 from Wales Transportation corporate accounts for his personal use between the time he received the $175,000 loan from the Bank, April 13, 1999, and the purchase of his new home, which occurred at the end of January 2000. Indeed, it seems that Debtor systemically wrote corporate check after corporate check to himself once he realized the dire financial condition of his company. All of these transfers were within one year of the filing of the Debtor's corporate bankruptcy case and are clearly material as they directly concern the Debtor's business dealings and his disposition of both personal and corporate property. These transactions should have been, but were not, disclosed on the Debtor's corporate bankruptcy schedules. I find and conclude that these nondisclosures were knowing, fraudulent, and false. In total, more than $200,000 in insider transfers or payments is absent from the Wales Transportation filings made under oath to this Court.[4] These wholesale nondisclosures cannot be excused.

At trial, Debtor raised the advice of counsel defense, maintaining that his failure to schedule certain transfers and assets was not fraudulent because he relied on his attorney's advice in filling out his personal and corporate bankruptcy schedules. A "debtor who acts in reliance on the advice of his attorney lacks the intent required to deny him a discharge of his debts." First Beverly Bank v. Adeeb (In re Adeeb), 787 F.2d 1339, 1343 (9th Cir. 1986). That reliance, however, "must be in good faith." Id. In other words, the reliance must be "reasonable" and based on the debtor's "full and fair disclosure" to his attorney. In re Erdman, 96 B.R. at 985.

In this case, Debtor's testimony that he made accurate disclosures to his attorney and provided his attorney with all

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[4]The evidence offered by the Bank at trial clearly indicated the Debtor also failed to disclose these transfers in his personal bankruptcy schedules. Thus, the Bank could have sought denial of the Debtor's discharge under § 727(a)(4)(A), without resort to § 727(a)(7). However, because the Bank invoked § 727(a)(4)(A), only as it applies through § 727(a)(7), I have addressed only the more narrow issue of the Debtor's failure to disclose adequately certain transfers on his corporate bankruptcy schedules.

relevant tax documents and other financial information sufficiently satisfies the requirement that a debtor make a full and fair disclosure to his counsel. The more problematic issue, however, is whether Debtor's reliance on his attorney's advice was reasonable. I find that it was not. Given that Debtor is a sophisticated entrepreneur who has undertaken various business ventures, though not all successful, in the past decade and understands complicated corporate financial and tax matters, he knew certain assets and transfers had to be scheduled. Regardless of his attorney's advice, this knowing failure to accurately fill out his corporate schedules precludes the Debtor from invoking the advice of counsel defense. See Harkins v. Patterson (In re Patterson), 70 B.R. 124, 128 n.9 (Bankr. W.D. Mo. 1986) ("When intention is an issue, advice of counsel is a factor to be considered, unless the party should know that failure to schedule the asset is forbidden by the law."); see also In re Adeeb, 787 F.2d at 1343 ("In this case, the bankruptcy court found that both Cooper [attorney] and Adeeb 'knew that the purpose of the transfers was to hinder or delay creditors of the debtor.' Such a finding precludes the defense of good faith reliance on the advice of an attorney even if the client is otherwise innocent of any improper purpose."); In re Erdman, 96 B.R. at

985-86 ("Reliance on attorney advice absolves one of intent only where that reliance was reasonable and where the advice given was informed advice. ... Attorney Epeseth correctly advised Erdman that he could convert non-exempt assets to exempt assets without running afoul of section 727(a)(2). However, the manner in which that advice was carried out by Erdman suggests an intent to accomplish more than mere exemption preservation." (internal citations omitted)). Therefore, having rejected the advice of counsel defense, Debtor will be denied a discharge under 11 U.S.C. § 727(a)(4), as referenced in § 727(a)(7), as a result of nondisclosures on his corporate bankruptcy schedules.

B. Debtor's Actions in His Corporate Bankruptcy Case Show an Intent to Hinder, Delay, or Defraud the Bank Under 727(a)(2)

Section 727(a)(2)(A) provides that a debtor's discharge should be denied when:

> the debtor, with intent to hinder, delay, or defraud a creditor or an officer of the estate ... has transferred, removed, destroyed, mutilated, or concealed, or has permitted to be transferred, removed, destroyed, mutilated, or concealed ... property of the debtor, within one year before the date of the filing of the petition.

11 U.S.C. section 727(a)(2)(A) (1994). Because the Bank relies on § 727(a)(2), as it applies through § 727(a)(7), it must show the Debtor violated that provision in his corporate

bankruptcy case with the intent to hinder, delay, or defraud the Bank. See Mercantile Bank v. Nicsinger (In re Nicsinger), 136 B.R. 228, 234 (D.W.D. Mo. 1992) ("[T]he account was property of NUCI [the debtor's corporation], and was transferred within one year prior to the filing of the bankruptcy petition. The transfer was made by Debtor, on behalf of NUCI, with the intent to hinder, delay or defraud the Bank. Thus, Debtor has, on or within one year before the date of the filing of the petition, committed an act specified in section 727(a)(2) in connection with an insider's bankruptcy case.").

While the objecting creditor need not show fraudulent intent on the debtor's part to succeed on a § 727(a)(2)(A) claim, it must show the debtor acted with actual intent to hinder, delay, or defraud a creditor. See Fox v. Schmit (In re Schmit), 71 B.R. 587, 590, 591 (Bankr. D. Minn. 1987)(citing Lovell v. Mixon), 719 F.2d 1373, 1376-77 (8th Cir. 1983); Huntington Nat'l Bank v. Schwartzman (In re Schwartzman), 63 B.R. 348, 360 (Bankr. S.D. Ohio 1986)). Proving the requisite actual intent with direct evidence is difficult. See In re Schmit, 71 B.R. at 590. Thus, such actual intent may be "inferred from the facts and circumstances of the debtor's conduct." Id.

In this case, Debtor violated § 727(a)(2)(A), as it applies through § 727(a)(7), in two ways. First, in his capacity as president and sole shareholder of Wales Transportation, he collected corporate accounts receivable at a discount rate on an accelerated basis, severely depreciating the value of the Bank’s collateral. Second, he converted a sizable portion of the Bank’s cash collateral in Wales Transportation for his personal use in violation of the Bank's security interest. Specifically, Debtor deposited $68,800.53 of checks from the Wales Transportation account at Bank Windsor into his personal checking account at TCF shortly before withdrawing $52,000 from the TCF account to purchase a new home.

At the time of the conversion, Debtor had a home at 401 Fourth Street NE in St. Michael, Minnesota that was pledged as collateral for his corporation’s loan with the Bank. Investing the converted corporate assets into that home would have allowed the Bank to recover the assets through foreclosure of their mortgage. Instead, Debtor has admitted that he purchased a new home, at 9799 Lancaster Lane North, in Maple Grove, Minnesota, to create equity he hoped to shield from the Bank in bankruptcy.

Debtor's actions of first collecting corporate accounts receivable on an accelerated basis, and then converting the Bank's cash collateral to purchase personal exempt assets, evidence a pattern of conduct designed the frustrate the Bank's collection efforts. See In re Schmit, 71 B.R. at 591 (finding that debtor's transfer and conversion of particular non-exempt property to exempt property manifested "a pattern of conduct designed to frustrate" the bank's collection efforts). These actions were clearly intentional on Debtor's part, designed to protect his assets (or, in fact, assets he had converted) from creditors. Accordingly, his discharge will be denied under 11 U.S.C. § 727(a)(2), as limited by § 727(a)(7).

II. NONDISCHARGEABILITY UNDER § 523(a)(6)[5]

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[5]In addition to denying the Debtor his discharge, the Bank seeks to have the Debtor's debt to the Bank excepted from discharge under § 523(a)(6). Though an "exception to discharge is subsumed within a denial of general discharge under section 727(a)," In re Sears, 246 B.R. at 352 (citing Vaughn v. Aboukhater (In re Aboukhater), 165 B.R. 904, 912 (B.A.P. 9th Cir. 1994)), bankruptcy courts often decide an objection to discharge and an exception to discharge in the same adversary proceeding. See, e.g., First Am. Title Ins. Co. v. Lett (In re Lett), 238 B.R. 167, 191-192 (Bankr. W.D. Mo. 1999) (finding debtors debt to bank nondischargeable under § 523(a)(6) and denying debtors' discharge generally under § 727(a)(2)(A)); In re Nicsinger, 136 B.R. at 233, 234 (finding certain debts to bank nondischargeable under § 523(a)(2)(A) in addition to denying debtor his discharge under § 727(a)(7)).

Relying on § 523(a)(6), the Bank claims that it is entitled to an exception from discharge judgment against the Debtor for his wrongful conversion of the Bank's collateral. Overall, "[e]xceptions to discharge must be strictly construed against the creditor, in furtherance of the policy of providing the debtor with a fresh start in bankruptcy." E.W. Wylie Corp. v. Montgomery (In re Montgomery), 236 B.R. 914, 921 (Bankr. D.N.D. 1999) (citing Geiger v. Kawaauhau (In re Geiger), 113 F.3d 848, 863 (8th Cir. 1997), aff'd, 523 U.S. 57 (1998)). Section 523(a)(6) of the Bankruptcy Code specifically excepts from discharge "any debt ... for willful and malicious injury by the debtor to another entity or the property of another entity." 11 U.S.C. § 523(a)(6) (1994). Under this provision, "willful" and "malicious" are separate elements, each of which must be proven by the creditor by a preponderance of the evidence. See Fischer v. Scarborough, 171 F.3d 638, 641 (8th Cir. 1999); Allstate Ins. v. Dziuk (In re Dziuk), 218 B.R. 485, 488 (Bankr. D. Minn. 1998).

As the Supreme Court recently clarified, "willful" requires demonstrating that the actor intended the injury and did not merely intend the act that caused the injury.

Thus, in this case, I will consider both the objection and exception bases pled by the Bank.

Kawaauhau v. Geiger, 523 U.S. 57, 60 (1998). This definition generally includes only those acts that fall within the category of intentional torts, as opposed to negligent or reckless torts. Geiger, 523 U.S. at 60. An intentional tort requires that the actor desire to cause the consequences of the act or believe that the consequences were substantially certain to result. Geiger v. Kawaauhau (In re Geiger), 113 F.3d 848, 852 (8th Cir. 1997) (citing Restatement (Second) of Torts § 8A, at 15 (1965)), aff'd, 523 U.S. 57 (1998)).

By contrast, a "malicious" act under section 523(a)(6) is one that is "targeted at the creditor ... at least in the sense that the conduct is certain or almost certain to cause ... harm." Barclay’s American/Business Credit, Inc. v. Long (In re Long), 774 F.2d 875, 881 (8th Cir. 1985). See also Johnson v. Miera (In re Miera), 926 F.2d 741, 743-44 (8th Cir. 1991). Circumstantial evidence can be used to ascertain whether malice existed. Miera, 926 F.2d at 744.

Accordingly, to prevail under section 523(a)(6), the Bank must show by a preponderance of the evidence that: (1) it suffered an injury as a result of an intentional tort ("willful"); and (2) the Debtor’s actions were targeted at it ("malicious"). See Dziuk, 218 B.R. at 488.

Under the “willful” element, conversion is an intentional tort. _See_ Restatement (Second) of Torts § 222A (1965) (“Conversion is an intentional exercise of dominion or control over a chattel which so seriously interferes with the right of another to control it that the actor may justly be required to pay the other the full value of the chattel.”). As such, courts within the Eighth Circuit have held a debtor’s conversion of a creditor’s secured collateral to be nondischargeable under § 523(a)(6). _See_, _e.g._, _In re Long_, 774 F.2d at 881; _Universal Pontiac-Buick-GMC Truck, Inc. v. Routson (In re Routson)_, 160 B.R. 595, 602 (Bankr. D. Minn. 1993) ("[W]rongful conversion of a secured party's collateral is covered by statute. Debts that result from such conduct are ordinarily nondischargeable in a Chapter 7 bankruptcy case.").

In this case, the Debtor diverted approximately $150,000 from the Wales Transportation corporate account to his personal or insiders' benefits. He used Wales Transportation assets to pay his personal tax liabilities to state and federal authorities. All of these transfers were in violation of the loan agreement and clearly outside the original contemplated purposes of that agreement. At the same time that Debtor was moving corporate assets to his personal checking account for his personal use, Wales Transportation was unable to pay its ongoing expenses and repeatedly incurring bank fees as creditors had checks from the Windsor Bank account returned for insufficient funds.

Debtor knew, or should have known, that all of his diversions amounted to conversion. He continued his diversions even after receiving the Bank's December 27, 1999 letter of default that stated:

> In accordance with the terms of the Security Agreements between the Company and our bank . . . Your authority to utilize cash collateral also is terminated. All cash received as proceeds from the sale or the disposition of collateral subject to our security interest or collected from third parties must be immediately delivered upon receipt.

Debtor ignored this directive. Instead of cooperating with the Bank, Debtor continued to divert Wales Transportation assets subject to the Bank's security interest to his personal use. He wrote check number 20355 in the amount of $11,543.75 on December 30, 1999, and check number 6948 in the amount of $13,253.15 on January 17, 2000. In short, Debtor’s actions were defiant and willful.

On the second element, in American Family Financial Services, Inc. v. Johnson (In re Johnson), the bankruptcy court characterized the debtor’s “wrongful disposition” of a motor vehicle as malicious:

> ‘Loss to the creditor of the interest in the property converted, is, ordinarily, sufficient financial harm to make a willful conversion malicious. Ultimate failure to pay the secured debt is simply the ripening of the harm into a viable cause of action for fixed damages. The misconduct that results in nondischargeability is the incident of knowingly, intentionally and wrongfully destroying the interest converted, not the later failure to pay the underlying debt from some other source.’

166 B.R. 365, 367 (Bankr. D. Minn. 1994) (quoting Routson, 160 B.R. at 607). Similarly, in this case, the Debtor knew the assets of Wales Transportation were pledged as collateral to the Bank; yet, he wrongfully converted those assets, intending to effectively destroy any interest or value the Bank had in them.

In sum, I find that the Debtor committed the intentional tort of conversion with the intent to harm the Bank. Therefore, the Debtor's conversion of the Bank's assets to his personal use entitles the Bank to a judgment of exception from discharge and nondischargeability for the outstanding loan in the amount of $135,761.79, together with pre-petition and post-petition interest of $16,520.03, and collection costs in the sum of $18,000.00.[6]

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[6]The Debtor argued that the Bank did not properly perfect its interest in certain vehicles and equipment of the company. As a result, according to the Debtor, the Bank was not directly harmed and, therefore, not entitled to an exception from discharge judgment against the Debtor. Debtor’s argument

ACCORDINGLY, IT IS HEREBY ORDERED THAT:

1. Debtor is DENIED his discharge pursuant to § 727(a)(4) and § 727(a)(2), as those provisions apply through § 727(a)(7).

2. Judgment is entered in favor of the Plaintiff Bank and against the Defendant Debtor in the sum of $135,761.75, plus interest in the sum of $16,520.03, and attorneys' fees and collection costs in the sum of $18,000.

3. The judgment specified in paragraph 2 is excepted from discharge pursuant to § 523(a)(6).

4. Defendant's request for attorneys' fees and expenses is DENIED.

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is misplaced. The focus in an exception to discharge claim is on the debtor's intent and actions; the creditor's conduct is wholly irrelevant. See, e.g., Collins v. Palm Beach Sav. & Loan (In re Collins), 946 F.2d 815, 817 (11th Cir. 1991) (commenting that "reasonableness of a creditor's conduct after turning over his money is irrelevant to the reasonableness of his reliance on the representation which induced the loan in the first place" in § 523(a)(2)(B) case (internal quotes and citations omitted)); Shiekh v. Mukhi (In re Mukhi), 254 B.R. 722, 730 (N.D. Ill. 2000) (making clear that 523(a)(6) injury must be committed by the debtor and not the result of creditor or third-party conduct); Regency Nat'l Bank v. Blatz, 67 B.R. 88, 91 (D.E.D. Wis. 1986) (refusing to consider creditor's conduct in "intent to deceive" analysis under § 523(a)(2)(B)); Novus Servs., Inc. v. Cron (In re Cron), 241 B.R. 1, 8 (Bankr. S.D. Iowa 1999) (citing AT&T Universal Card Servs v. Ellingsworth, 212 B.R. 326, 340 (Bankr. W.D. Mo. 1997), for the general proposition that debtor's intent, not creditor's conduct, determines dischargeability in credit card case under § 523(a)(2)(C)).

Nancy C. Dreher
United States Bankruptcy Judge