UNITED STATES BANKRUPTCY COURT
DISTRICT OF MINNESOTA

In Re:

Thomas David Gustafson, and Linda Carol Gustafson, a/k/a Linda Carol Silver, Debtors.	Bky. 98-60087 Chapter 7 Case
Auction Finance Program, Inc. Plaintiff, v. Thomas David Gustafson Defendant.	Adv. No. 98-6016 MEMORANDUM ORDER

I. Introduction

This adversary proceeding came on for trial before the Honorable Dennis D. O'Brien on January 27, 1999 on the Plaintiff's Complaint to bar the discharge of a debt under a loan and security agreement guaranteed by the Debtor Defendant. The Plaintiff, Auction Finance Program, Inc. (AFP), was represented by Edward Klinger. The Defendant Debtor, Thomas David Gustafson, was represented by John R. Koch. This is a core proceeding and the Court has jurisdiction pursuant to 28 U.S.C. Section 157 and 1334. This Order is issued pursuant to the Federal and Local Rules of Bankruptcy Procedure.

The Court must determine whether the Debtor Defendant's failure to pay over to the Plaintiff the proceeds of certain car sales, financed under a "floor plan" security agreement, resulted in nondischargeability of the debt under 11 U.S.C. Section 523(a) (2)(A), (a)(4), or (a)(6).

II. Facts

The Defendant Debtor in this case, Thomas Gustafson, has over 30 years of experience in the used car business. From 1995 to 1997 he operated a used car dealership, known as Silver Motors, with his wife.(1) Silver Motors was incorporated as T.L. Corporation and Mr. and Mrs. Gustafson were the only owners. The dealership originally opened in Waite Park, Minnesota in March of 1995. In October of 1997 the Gustafsons signed a one year lease and moved the business from St. Joseph, Minnesota to a promising new location in St. Cloud, Minnesota. Unfortunately, the Gustafsons' new landlord had promised the lot to another tenant. As a result, Silver Motors was drawn into civil litigation resulting in a state court order on or around November 24, 1997, forcing the Gustafsons to vacate the St. Cloud location on or before November 30, 1997. Unable to relocate, Silver Motors ceased doing business on December 1, 1997.

After liquidation the Gustafsons were unable to pay for three automobiles financed by the AFP. That default led to this nondischargeability action against Mr. Gustafson.

Silver Motors purchased its inventory at auction and financed these purchases under secured lending arrangements (floor plans), which treated each vehicle transaction as a

separate loan. Silver Motors sold vehicles financed under another floor plan in addition to the Plaintiff AFP's. Mr. Gustafson testified that he was familiar with the provisions of his AFP floor plan and floor plans in general.(2)

The business relationship between Gustafson and AFP began in June of 1997. The agreement was memorialized in a written loan and security agreement, personal guarantee by Mr. Gustafson, and a credit application, all signed on October 8, 1997. AFP filed a UCC financing statement on the Debtor's collateral(3) on December 16, 1997 with the Minnesota Secretary of State. Before going out of business Silver Motors financed $135,595 worth of vehicles under the AFP floor plan, $78,235 under the written security agreement.

Silver Motors maintained two separate banking accounts. An operating account was located at a St. Cloud bank, and an account for vehicle proceeds was at the 1st National Bank of Cold Springs. Under the floor plan with AFP, Mr. Gustafson provided two checks to AFP for each vehicle he purchased at auction, then he was allowed to remove the vehicle to his lot. The first check represented the prepayment of interest at the contract rate of 10.75 percent (at the time of purchase Mr. Gustafson could designate a loan period of either 14, 28, or 42 days) as well as a transaction fee. This check was immediately deposited by AFP. The second check was written on the Cold Springs vehicle account and was deposited on the earlier of two occasions: sale of the vehicle and receipt of the proceeds by the dealership, or expiration of the prepaid credit period. Mr. Gustafson could request an extension of credit before the payment was due, but only if the vehicle remained unsold.

Five vehicles remained under finance with AFP on December 1, 1997 when Silver Motors went out of business. One of the vehicles was sold to another dealer with the proceeds paid to AFP, another vehicle was returned to the auto auction and sold to pay AFP. Three vehicles had been sold previously with the proceeds used for other business expenses. Mr. Gustafson stopped payment on the three checks being held by AFP for those vehicles in the amounts of $ 4,465 (for a 1995 Chevrolet), $11,395 (for a 1992 Chevrolet), and $5,015 (for a 1990 Dodge Ram).

Mr. Gustafson testified at trial that he understood that the proceeds from the sale of a particular vehicle were to be used to pay off the Silver Springs check being held by AFP for the purchase price of that vehicle. This was not the practice followed at Silver Motors. Mr. Gustafson testified that although he understood vehicle proceeds were to be paid to AFP to satisfy the security interest in the vehicle sold, he often deposited customer payments in his general operating account in St. Cloud.

II. Analysis

The Plaintiff presented arguments for nondischargeability under 11 U.S.C. Section 523(a) (2)(A), (4), and (6). The standard of proof for dischargeability actions under each of these three provisions of the Bankruptcy Code is by a preponderance of the evidence. See Universal Pontiac-Buick-GMC Truck Inc. v. Routson (In re Routson), 160 B.R. 595, 602 (Bankr. D. Minn. 1993).

Under 11 U.S.C. Section 523(a)(6) a debtor is not

discharged from any debt "for willful and malicious injury by the debtor to another entity or the property of another entity." 11 U.S.C. Section 523(a)(6). The question before the Court in this case has already been answered in Routson:

> Did Mr. Routson convert Norwest's collateral by depositing proceeds from the sale of floor planned vehicles into a general account and using the value thereby created for purposes other than paying floor plan obligations on the vehicles sold? Routson, 160 B.R. at 603.

"Wrongful conversion of a secured party's collateral is covered by (Section 523(a)(6))." Id. at 602; see also In re Long, 774 F.2d 875 (8th Cir. 1985). The Defendant seeks to distinguish this case from Routson because Mr. Gustafson's security agreement with AFP did not require a separate trust account for vehicle sale proceeds. However, conversion of proceeds in which a creditor has a security interest does not depend upon a requirement for deposit in a trust account.

"Necessary elements of actionable conversion are: (1) a plaintiff's ownership or right to possession of the property at the time of conversion; (2) a defendant's conversion by wrongful act or disposition of plaintiff's property rights; and (3) damages." Routson, 160 B.R. at 603. The Defendant concedes that his default under the security agreement resulted in damages, but argues that cash proceeds cannot be the subject of a conversion. This argument is defeated by his own testimony.

Mr. Gustafson testified that he was to pay to AFP the cash proceeds from each car sold to pay for the loan on that car, establishing the first element of actionable conversion, AFP's right to possession of the cash proceeds. His admission that he routinely violated the floor plan agreement establishes the second element of conversion, the wrongful disposition of AFP's collateral.(4) Mr. Gustafson's actions were nondischargeable conversion under 523(a)(6) and Routson.

> The misconduct that results in nondischargeability is the incident of knowingly, intentionally and wrongfully destroying the interest converted . . . He knew that it was wrong to sell floor planned vehicles without paying for them, either from the proceeds or the value created by their deposits. Indeed, Mr. Routson chose to convert Norwest's proceeds with full knowledge that it was wrong. He did so because he had other, more immediate, uses for the money[.] Routson, 160 B.R. at 607- 608.

The 8th Circuit standard for willful and malicious was recently confirmed by the Supreme Court's decision in Kawaauhau v. Geiger, 118 S.Ct. 974 (1998). In Kawaauhau the Supreme Court reviewed an Eighth Circuit decision reversing the bankruptcy and district court holdings that a medical malpractice award was nondischargeable under 11 U.S.C. Section 523(a)(6). Ms. Kawaauhau had a state court judgment against Dr. Geiger, the debtor, for her loss of a leg due to Dr. Geiger's negligent care. While conceding the egregious nature of Dr. Gieger's conduct, the Supreme Court concluded that while negligent, and perhaps even reckless, the malpractice

was dischargeable because it was not an intentional tort.

> Section 523(a)(6)'s words strongly support the Eighth Circuit's reading that only acts done with the actual intent to cause injury fall within the exception's scope. The section's word "willful" modifies the word "injury," indicating that nondischargeability takes a deliberate or intentional injury, not merely, as the Kawaauhaus urge, a deliberate or intentional act that leads to injury." Kawaauhau, 118 S.Ct. at 975.

Mr. Gustafson's conduct was malicious because it was targeted at AFP. He understood that the sale proceeds belonged to AFP but he spent them on other business expenses with the knowledge that AFP would not get paid:

> When transfers in breach of security agreements are in issue, we believe 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 or almost certain to cause financial harm. In re Long, 774 F.2d 875, 881 (8th Cir. 1985).

This Court reached the same conclusion in Routson:

> [H]e intentionally converted the proceeds to unauthorized uses, knowing and intending that his actions would destroy Norwest's financial interest in property converted. Accordingly, Mr. Routson's conduct constituted willful and malicious injury to Norwest's property rights. Routson, 160 B.R. at 608.

AFP was damaged by Mr. Gustafson's conversion of the sale proceeds of the sale of the in 1995 Chevrolet in the amount of $4,465, the 1992 Chevrolet in the amount of $11,395, and the 1990 Dodge Ram in the amount of $5,015, for a total of $20,875. Because Mr. Gustafson's debt is held nondischargeable under 11 U.S.C. Section 523(a)(6), the Court declines to review AFP's claim under either 11 U.S.C. (A)(2)(A)(5), or (a)(4).

III.

Based upon the proceedings and upon all of the files and records herein, IT IS HEREBY ORDERED THAT:

1) Plaintiff is entitled to judgment against the Defendant that the debt of $20,875 together with all Plaintiff's allowable costs and fees incurred in connection therewith, are nondischargeable under 11 U.S.C. 523(a)(6); and, were not discharged by Debtor's general discharge entered on May 6, 1998.

LET JUDGMENT BE ENTERED ACCORDINGLY.

Dated: March 17, 1999

By the Court:

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Dennis D. O'Brien
Chief United States
Bankruptcy Judge

(1) Mr. Gustafson's wife, Linda Carol Gustafson, is not a party to this adversary proceeding although she is a debtor in the Chapter 7 Bankruptcy. Only Mr. Gustafson signed the guarantee and security agreement which is the basis of this nondischargeability action.

(2) The testimony at trial showed agreement of the parties about the relevant provisions of their agreement, but that understanding was sometimes different from the actual security agreement language. For example, both Mr. Gustafson and Ms. Grimsley (of AFP) testified that he was required to inform AFP in writing and pay for a vehicle within 24 hours of sale. Mr. Gustafson admitted that he never gave written notice and rarely paid the proceeds within 24 hours. Ms. Grimsley explained that this requirement allowed dealers to receive rebates for prepaid interest. In fact, Section 5.2 of the Security Agreement requires 24-hour notice of sale but is silent on payment.

(3) The collateral in this case was not limited to the vehicles financed and proceeds. It included essentially all assets of the Debtor and the corporation.

(4) Mr. Gustafson testified that he always used the proceeds of a AFP floor planned vehicle sale to pay off the oldest car on the AFP floor plan. If that were true, then the liquidation of the Silver Motors vehicle stock would have covered all outstanding floor plan obligations, which it did not.

(5) The analysis in this Court's recent unpublished decision, Merchants National Bank of Winona v. Moen (In re Moen), Ch. 7 Case No. 97-36925, Adv. No. 98-3014, (Bank. D. Minn. 1999), suggests that AFP's claim would also succeed under 11 U.S.C. 523(a)(2)(A).