

UNITED STATES BANKRUPTCY COURT
DISTRICT OF MINNESOTA
THIRD DIVISION

In Re:

Patrick E. Henry and Pamela H. Henry,
Debtors.

CHAPTER 7

Bky. 93-30755

Fort Wayne Pools of Minnesota,
a division of Fort Wayne Plastics, Inc.,
an Indiana corporation,
Plaintiff,

v.

Patrick E. Henry,
Defendant.

Adv. 93-30115
ORDER

This matter came on for trial on December 10, 1993. Appearances are noted in the record. The Court having heard and received all relevant testimony and documentary evidence, briefs and arguments of the parties; and, having carefully considered the matter and being fully advised therein; now, makes this ORDER pursuant to the Federal and Local Rules of Bankruptcy Procedure.

I.

Patrick E. Henry (Debtor) was the sole shareholder, officer and director of Prestige Pool and Patio, Inc. (Prestige). In 1989, the Debtor, acting on behalf of Prestige, entered into a relationship with Plaintiff Fort Wayne Pools of Minnesota (FWP), in which Prestige purchased pool parts, equipment and supplies for public sale and installation. At the end of the 1989 season, Prestige owed FWP approximately \$80,000 on open account.

Prior to commencement of the 1990 pool season, the parties negotiated a plan for Prestige to bring current its account, and to continue purchases and sales on open account for that year. However, by December of 1990, Prestige owed FWP approximately \$171,000.00.

A second payment plan was negotiated by the parties during the winter of 1991. The arrangement included a secured note from Prestige to FWP for the balance owing, with periodic payments of \$14,166.66, due on May 31, June 30, and July 31 in 1991, 1992 and 1993. Additionally, the parties agreed that Prestige would continue to purchase its materials, equipment and supplies from FWP during the period. The Debtor guaranteed the note and all future purchases by Prestige from FWP on open account.

All payments were made and the agreements were performed by the parties during the 1991 season, but the deal fell apart in 1992. Prestige missed the May 31, 1992, payment in the amount of \$14,666.66. On Friday, May 29, the Debtor informed FWP through its local manager, Mr. Shuherk, that payment would not be forthcoming since the company had no available funds.

Mr. Shuherk immediately relayed that information to his superior, who instructed him to cease all delivery of products to

Prestige until the account was current and to thereafter sell to the company only on a C.O.D. basis. Mr. Shuherk informed the Debtor of these requirements by telephone on that same day. The Debtor responded by delivering to FWP, the following Monday, June 1, a check issued by Prestige in the amount of \$34,130.84. The check was deposited in the ordinary course by FWP the next day. It was paid by the drawee bank, also in the ordinary course.

Two days later, on Wednesday, June 3, the Debtor delivered another check from Prestige to FWP in the amount of \$18,401.31 for the purchase of inventory. On the early afternoon of Friday, June 5, the Debtor issued a stop payment order on that check. Neither the check, nor the underlying obligation that it represented, was ever paid.

On that Friday morning, June 5, the Debtor and Mr. Shuherk met at a local Perkins restaurant. The purpose of the meeting, according to Mr. Shuherk, was to facilitate the delivery and acceptance of four additional checks from Prestige to FWP that would bring the account current and allow Mr. Shuherk to release materials to Prestige for the scheduled Friday installation of a customer's pool. Upon receipt of the checks and, according to Mr. Shuherk, assurances from the debtor that they would be honored, Mr. Shuherk released the pool materials shortly after 9:00 a.m.. Three of the four checks were for materials traceable to lienable customer sites.(FN1)

The fourth check, in the amount of \$5,836, was for inventory. The Debtor issued a stop payment order on that fourth check early that same afternoon at the same time he stopped payment on the \$18,401 check delivered to FWP two days earlier. The check for \$5,836 was never paid either. Prestige subsequently went out of business, and there remains owing as a result of the two stop payment orders, the sum of \$24,237.(FN2)

FWP objects to dischargeability of Prestige Pool's obligation guaranteed by the Debtor, in the amount of \$24,237. The Plaintiff alleges that the debt was incurred through fraud of the Debtor, making it nondischargeable under 11 U.S.C. Section 523 (a)

(2)(A).(FN3)

FWP claims that the Debtor issued the two checks for the inventory to induce the release of needed materials for the scheduled Friday, June 5, 1992, customer installation. According to the Plaintiff, Mr. Henry never intended that the inventory checks be honored, but he specifically targeted them for stop payment orders since they represented debt that could not be liened against Prestige customers' properties.

The Debtor asserts that he caused the inventory checks to be issued and delivered in good faith. Mr. Henry claims that he did not target these checks for stop payment orders at the time he issued them, and that he ultimately stopped payment only because he had no choice, due to the breach of an agreement by FWP to hold the checks. The Debtor claims that the parties had a long standing arrangement whereby FWP would typically hold checks on account delivered by Prestige until notified that sufficient funds were in the drawee account to pay them. Mr. Henry claims that, at approximately noon on Friday, June 5, 1992, Mr. Shuherk, who by then had possession of all the checks, notified him for the first time that he intended to immediately deposit them. Since there existed insufficient funds to cover all the checks, according to Mr. Henry, he had no choice other than to stop payment on some of them. The Debtor did not clearly articulate why these two particular checks were chosen.

Mr. Shuherk concedes that during the course of their

relationship, he held some Prestige checks, occasionally for ten days or more, until advised by Mr. Henry that there were sufficient funds in the drawee account to cover the checks. However, he testified that he had been ordered by his superior to discontinue the practice in late April of 1992. Nevertheless, he still continued to hold checks, he admitted, until May 29, but for no more than five days.

Mr. Shuherk testified that when he informed his superior on May 29 that the May 31st payment from Prestige Pools would be missed, he also disclosed that he was holding two Prestige checks from May 26. According to Mr. Shuherk, the disclosure was not well received. He was ordered to immediately deposit the checks and to refrain from holding any Prestige checks in the future. Mr. Shuherk testified that he informed Mr. Henry by telephone that same day that he would be unable to hold checks in the future.

II.

Mr. Henry's version of events and explanation of his actions are not credible. The recent financial transactions between the parties, prior to June 5, do not support his assertion of a continuing agreement by Mr. Shuherk to hold Prestige Pool's checks after it missed the May 31st scheduled payment. They do support Mr. Shuherk's testimony. See Stipulation of Undisputed Facts, par 11 (Dec. 8, 1993).

More importantly, Mr. Henry seemed less candid regarding his recollections of significant events and their timing. He testified that he did not recall meeting with Mr. Shuherk at the Perkins restaurant and delivering the four checks on Friday morning, June 5.(FN4) That was the same day on which Mr. Henry claims that Mr. Shuherk allegedly later informed him by phone that no more checks could be held. And, it was the same day that he stopped payment on the two checks, one of which he had delivered that very morning along with three others that were allowed to clear the drawee bank.

Mr. Shuherk likely informed Mr. Henry on Friday, May 29, 1992, that: the Prestige account had to be brought current before any more materials could be delivered; and, that Prestige checks could no longer be held. Mr. Henry needed materials for a scheduled installation. He likely issued the checks to assure delivery, and when he received the materials on Friday, June 5, he stopped payment on the two checks which represented obligations that could not be liened against his customers. In short, he never intended that the two checks be paid.

The evidence favors the Plaintiff by preponderance, which is the standard of proof. See: *Grogan v. Garner*, 498 U.S. 279 (1991). The evidence suggests that the Defendant fraudulently issued the checks to the Plaintiff, not intending that they be honored, but only that they induce the Plaintiff to deliver needed materials to Prestige. After release of the materials by the Plaintiff in reliance on the checks received, Defendant wrongfully stopped payment on the checks.

The Plaintiff is entitled to a judgment of nondischargeability against the Defendant in the amount of \$24,237, the total of the two checks for which payment was stopped. Plaintiff was induced to give up its leverage of withholding needed materials until it received payment on a past due debt. The Defendant, by his fraud, obtained an extension of credit regarding the debt, within the meaning of 11 U.S.C. Section 523(a)(2)(A). See: *In re Wagenti*, 110 B.R. 602 (Bkrtcy.S.D. Fla. 1990); and *In re Horowitz*, 100 B.R. 395, (Bkrtcy.N.D.Ill. 1989).

FWP seeks attorneys fees in prosecuting this proceeding, arguing that the guaranty agreement grants it fees and costs in

collecting open account purchases owing by Prestige Pool. FWP cites In re Hunter, 771 F.2d 1126 (8th Cir. 1985), holding that reasonable attorney's fees may be recovered as part of an 11 U.S.C. Section 523(a) action where there is a contractual provision authorizing the recovery of fees, and they are incurred in connection with the debt to be nondischargeable. Accordingly, the Plaintiff is entitled to its reasonable fees and costs.

III.

Based on the forgoing, it is hereby ORDERED:

1) Fort Wayne Pools of Minnesota is entitled to judgment against Patrick E. Henry in the amount of \$24,237, which is not discharged by his general discharge that has or will be entered in Bankruptcy Case No. 93-30755 pursuant to 11 U.S.C. Section 727.

2) Fort Wayne Pools of Minnesota is entitled to recover its reasonable fees and costs incurred in this proceeding, to be allowed through appropriate motion, which award can be added by amendment to the judgment to be entered pursuant to paragraph 1.

LET JUDGMENT BE ENTERED ON PARAGRAPH 1) ACCORDINGLY.

Dated: January 31, 1994

By The Court:

DENNIS D. O'BRIEN
U.S. BANKRUPTCY JUDGE

(FN1) Minn. Stat. Ann. Section 514.01, et. seq. (West 1990), provides for the fixing of liens against real property by workers and suppliers for the cost of labor and materials furnished in improvement of the property.

(FN2) The total debt owing FWP by Prestige is much larger, but FWP seeks nondischargeability of only the amount represented by the two checks, based on alleged fraud of the Debtor in issuing and then stopping payment.

(FN3) 11 U.S.C. Section 523(a)(2)(A) provides, in part:
523. Exceptions to discharge

(a) A discharge under section 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...

(FN4) Mr. Shuherk introduced a receipt from Perkins for \$9.14. Apparently, he bought breakfast. See Exhibit 4.

END FN