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ADV. NUMBER: 99-1258
JUDGE: M. A. Mahoney
PARTIES: Robert Hammond Wilkins, Betty M. Vandegrift, Jerry Jett, Jack Lowery, Betty Lowery, Bonnie Jett, James Vandegrift, Frances Johnson, Teresa Reid, E. O. Harper, Susan Montgomery
CHAPTER:
ATTORNEYS: J. Anderson, B. Friedman
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UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF ALABAMA

In Re

ROBERT HAMMOND WILKINS, Case No. 99-12592-MAM-7

Debtor.

BETTY M. VANDEGRIFT, et al.,

Plaintiffs,

vs. Adv. No. 99-1258

ROBERT HAMMOND WILKINS
d/b/a WILKINS MANAGEMENT GROUP,

Defendant.

ORDER AND FINAL JUDGMENT GRANTING ROBERT HAMMOND WILKINS d/b/a WILKINS MANAGEMENT GROUP'S MOTION FOR JUDGMENT ON PARTIAL FINDINGS, DISMISSING PLAINTIFFS' CLAIMS WITH PREJUDICE, AND DECLARING DISCHARGEABLE PLAINTIFFS' CLAIMS AGAINST ROBERT WILKINS d/b/a WILKINS MANAGEMENT GROUP

Frank Anderson, Mobile, Alabama, Attorney for Plaintiffs
Barry Friedman, Mobile, Alabama, Attorney for Debtor/Defendant

The plaintiffs, Betty Vandegrift, Jerry Jett, Jack Lowery, Betty Lowery, Bonnie Jett, James Vandegrift, Frances Johnson, Teresa Reid (representative of Jean Parsons, deceased), E.O. Harper, and Susan Montgomery, brought this adversary proceeding requesting that plaintiffs' claims against Robert Wilkins d/b/a Wilkins Management Group be declared nondischargeable pursuant to 11 U.S.C. § 523(a)(4), § 523(a)(2), and/or § 523(a)(6).[1] The Court

[1]Several plaintiffs filed pro se documents taken by the Court to be dischargeability complaints against Robert Wilkins. Some cases were assigned separate case numbers because filing fees were paid. Some cases were designated by the Clerk as "no file opened yet" because filing fees were not paid. Frank Anderson subsequently appeared for the plaintiffs via an amended complaint in Case No. 99-1258 in which all individuals in the separate actions were

has jurisdiction to hear this matter pursuant to 28 U.S.C. § 1334 and § 157 and the Order of Reference of the District Court. This is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(I) and the Court has the authority to enter a final order. The Court held the trial of plaintiffs' complaint on April 11, 2002, at which Robert Wilkins moved for a judgment as a matter of law. The Court has carefully considered the record and applicable law and, for the reasons indicated below, the Court is granting Robert Wilkins' motion for judgment as a matter of law; is dismissing plaintiffs' claims with prejudice; and is declaring dischargeable plaintiffs' claims against Robert Wilkins.

FACTS

This case involves loans which the plaintiffs made to Autoutlet, Inc. and/or Compu-Filter, Inc., two businesses formerly operated by the debtor, Robert Wilkins ("Wilkins"). The evidence presented to the Court reveals the following facts.

Autoutlet, Inc.

Autoutlet, Inc. ("AO") was incorporated on May 3, 1993 by Robert Wilkins. Mr. Wilkins was President of AO and initially owned 100% of the stock. He was responsible for the day-to-day operations of AO. In 1997, he sold a 20% interest to Brian Sims for $100,000. Mr. Sims is not a party to these proceedings, and is currently incarcerated in a federal penitentiary for wrongdoing unrelated to the operations of AO.

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added as plaintiffs in No. 99-1258. The Court granted plaintiffs' motion to amend the complaint on February 8, 2000. Thus, all plaintiffs proceeded with their § 523 claims in Case No. 99-1258.

AO was started by Wilkins using loans he obtained at AmSouth Bank, some of Wilkins' own money, and Wilkins' credit cards. Wilkins had experience in the car business having worked in various capacities at dealerships (including as a finance manager) before starting AO. Wilkins also had a B.S. degree from the University of Alabama in Agri-business and Economics. AO was in the business of selling used cars. AO had two lots in Mobile, although Wilkins testified that AO was in the process of doing business in other areas. One of the goals of AO was to expand to other parts of the country, although that never happened because the Mobile lots never sustained financial success.

AO acquired used vehicles for resale from individuals as trade-ins, from auto auctions (like the Pensacola Auto Auction), and from dealers in Mobile or elsewhere. For several reasons, Wilkins felt that it was important to have a "third party" involved in how AO handled car titles, although according to Wilkins an escrow arrangement is not mandated by law in Alabama (an escrow arrangement is required in some states). Thus, AO set up an escrow arrangement with Arizona Escrow & Financial Corporation (originally AO's escrow arrangement was with First Alabama Bank, which is now Regions Bank). AO switched from Regions to Arizona Escrow because Regions was not making much money on AO and would no longer handle AO's escrow work. A copy of AO's Dealer Agreement with Regions Bank dated August 21, 1996 was placed into evidence. The escrow procedure was utilized by Wilkins' company 95% of the time AO operated. AO purchased 500 to 600 cars while it operated between May 1993 and 1998.

AO acquired cars at the wholesale level and sent the titles to the escrow agent. Basically, the way the escrow arrangement worked is as follows: AO would agree to buy a car at the wholesale level. The wholesale seller made the title available and AO forwarded the title to Arizona Escrow. Arizona then released the amount AO paid for the car to the wholesale seller, and AO would obtain title only upon remitting to Arizona the amount Arizona paid out. Arizona charged AO a one time "set up" fee of approximately $1,000 and a flat fee per transaction to handle AO's business. The escrow arrangement proved to be a major problem for AO during cash poor times: AO sold cars to retail customers for which AO was unable to obtain title because AO did not have the money to pay Arizona to obtain a title release. AO also experienced high overhead, including vehicle acquisition costs, rent payments at two different car lot locations in Mobile, interest payments required to the AO promissory noteholders, insurance payments, and commissions to the AO salesmen. This resulted in Arizona Escrow holding at the time AO filed bankruptcy approximately 100 titles (representing $594,000 worth of vehicles) but AO only having a few cars (approximately 8 to 15) left unsold in AO's car lot inventory.

AO ceased operations in 1998. In 1998, FBI agents appeared at Mr. Wilkins' business and requested production of his records. Wilkins was given one week by the FBI to gather those materials. He then turned over all the records of AO, CF, and Wilkins Management Group to the FBI. Wilkins felt that due to the FBI records seizure and AO's substantial cash flow problems, it was time for AO to stop operating. Mr. Wilkins has appeared before a grand jury. To date, he has not been indicted by the Government.

As AO's debt mounted, cash flow decreased, and sales plummeted, Wilkins "hoped for a miracle" but that never happened and AO filed bankruptcy in 1999 in Mobile. At the time the bankruptcy was filed, AO did have a few cars at AO's Schillinger Road lot. Numerous (but not all) of the documents concerning AO's operations were admitted into evidence. As will be evident from the Court's discussion of the plaintiffs' claims, it is unnecessary for purposes of the Court's holdings to detail all of AO's financial information/history. The Court will, however, mention some of the highlights taken from the limited AO financial information put into evidence. For the year 1996, AO had gross vehicle sales totaling $296,813.64 and expenses of $246,005.81. AO's net profit for 1996 was $19,230.85. In 1997, AO's vehicle sales dropped. Total sales in 1997 were $73,536.40. AO's total expenses in 1997 were $298,861.18, and AO had a net loss of $180,878.21 for 1997. AO's year end financial statements for 1993, 1994, 1995, and 1998 were not placed into evidence.

A summary of checks written by AO from January 2, 1998 to October 8, 1998 was also admitted into evidence. The Court has not totaled all these check amounts but it is apparent from the summary that AO had at least $200,000 and probably more in expenses in 1998. There was no evidence presented that any of AO's expenses were a sham or illegitimate or unreasonable. Some of AO's payroll records were also put in evidence. Wilkins got a small salary from AO. The payroll report of AO dated February 15, 2000 from Confederated Employers & Benefits Company (AO used an employee leasing firm) shows that Wilkins received gross wages of $7,000 from AO in 1998 at the salary rate of $1,000 per pay period (which appears to be monthly). Wilkins testified that he received $15,000 to $18,000 per year from AO in salary.

Compu-Filter, Inc.

Mr. Wilkins was involved with another business during the 1996 to 1998 time frame called Compu-Filter, Inc. ("CF"). Wilkins was on the Board at CF and was CEO. Joe Cooper was president and the owner. CF had a pending patent on filters (Patent Pending was issued March 1, 1997) that go on CP units of computers "that were just like air filters." Joe Cooper invented the filter. The idea behind CF was to develop a marketable filter that applied directly to the CPU of a computer to prevent dust from entering into and building up on the computer's hardware. CF experienced substantial problems during the product development and production stage. CF also had marketing problems, and the evidence presented indicates CF had no sales during 1996 to 1998. The testimony at trial in effect was that the CF tried but never really produced a marketable filter for a variety of reasons. For example, CF purchased $20,000 to $30,000 worth of filters only to find out that they would not work due to a product defect. CF then ordered $50,000 worth of different filters. More filter defects were found, and neither batch of filters was usable.

A document concerning CF's operations entitled "Register Report by Category" was put into evidence. This document purports to detail CF's "in flows" and "out flows" of money between November 1, 1997 and June 30, 1998. Copies of CF's Compass Bank account monthly statements and checks corresponding to expenses for the relevant period were also admitted. These documents show that CF's total expenses for this period were $332,781.34 on total "in flows" of $332,601.35. In addition to a small salary, Wilkins did occasionally receive small income "draws" from CF, including a $2,000 payment in December 1997. His total income and

draws for November 1, 1997 to June 30, 1998 from CF were around $9,500 to $10,000. Wilkins' estimate of his annual salary from CF was $7,000. There was no evidence that any of these expenses were a sham or unreasonable or illegitimate, although the Court notes that not all of CF's corporate financial records were put into evidence. CF had no sales of filters for this period. The "in flows" of cash consisted primarily of money loaned by the plaintiffs (and others) and repayments from AO of loans that CF had made to AO. There were several relatively small intercompany loan transactions whereby CF loaned money to AO and Reclaim Southern Resources, Inc. ("RSR"), another Wilkins company. Copies of promissory notes marked "paid in full" evidencing intercompany loans between CF and AO and CF and RSR were admitted into evidence. By July of 1998 Wilkins relinquished any significant involvement in CF because he and the Board had "decided to go in different directions." Wilkins' efforts to sell CF were unsuccessful.

Wilkins Management Group

Wilkins Management Group ("WMG") was an unincorporated business run by Wilkins out of a downtown Mobile location that provided management and labor support to AO and CF (and Financial Potential, another venture involving Wilkins). In 1997, AO and CF entered into a management agreement with WMG, although no formal written agreement was placed into evidence. It appears that CF paid management fees of approximately $67,792 from November 1, 1997 to June 30, 1998 to AO for WMG services (i.e., labor, computers, etc.) provided to CF. The management fees due WMG from CF were paid to AO and used by AO for operating expenses because WMG was not a separately incorporated entity and had no bank account.

Wilkins testified that CF had used some AO personnel to prevent CF from having to hire more employees, which in turn benefitted CF because it was a fledgling corporation. The financial records of WMG and RSR were not placed into evidence.

Loans from Plaintiffs to AO and CF

Mr. Wilkins needed operating capital for AO and CF. He came up with an idea to obtain loans from individuals because his personal credit cards were "maxed out" and he could not obtain conventional bank loans for AO and CF. Wilkins even tried to get "floor plan" financing from World Omni, but was unsuccessful. AO and CF paid commissions to various "salesmen" (including Mike Russo, Wes Yarbrough, Steve Sample) to "raise promissory note money." These individuals were not employees of Wilkins personally. The plaintiffs are individuals who were approached by AO's salesmen and who agreed to loan money to AO and/or CF. A document placed into evidence by Wilkins reflects that between December 31, 1996 and March 3, 1998, at least $485,800 was loaned (collectively) by plaintiffs to AO, CF, and/or RSR (only $25,000 was to RSR).

Each of the plaintiffs who loaned money to AO and/or CF were presented with a "tri-fold" one page advertising brochure prior to investing which details information about AO/CF, Arizona Escrow (only in the AO brochure), and how to become a lender to AO/CF. Some of the plaintiffs were given advertising brochures on Arizona Escrow & Financial. Wilkins drafted the AO and CF brochures. The AO and CF brochures state in pertinent part as follows under a section entitled "Key Features of the Promissory Note Program":

- You will receive monthly interest check.

- Principal sum of promissory note can be rolled over or returned after 12 months, at your option.
- At all times there will be either cash or documents in your escrow account that reflect your principal sum.
- Tax Form 1099 will be filed for each applicable year.

Bullet point number three above (i.e., "At all times. . .") is not contained in the CF brochure, presumably because CF did not utilize an escrow arrangement due to the nature of its business.

None of the plaintiffs had any direct contacts or conversations with Robert Wilkins prior to loaning money to AO and/or CF. The plaintiffs who did have conversations with Mr. Wilkins had these conversations after they had already loaned AO and/or CF money. During Wilkins' postloan contacts with some of the plaintiffs, he advised that AO was having cash flow problems but expressed his feeling that things would "straighten out," that "everything was fine," and/or that he "wanted to make good" their loans. At the loan stage, plaintiffs dealt with AO/CF's salesmen and not Mr. Wilkins. Wilkins provided the salesmen with the written materials that were presented to plaintiffs. Each of the plaintiffs signed an Escrow Agreement and Lender's Request and Disclosure Form. The plaintiffs then received promissory notes from AO and/or CF reflecting their loans to AO/CF. In one instance, a loan was made by one of plaintiffs to RSR, Inc. Some of the loan proceeds were deposited with Arizona Escrow, some with CF and RSR, and some with AO. Representative unsigned copies of the brochures, Escrow Agreements, Disclosure Forms, and signed AO and CF notes are attached to this Order.

The Court need not detail all the provisions of the Escrow Agreement and Disclosure. It bears noting, however, that the Disclosure contains statements (each of which, in Section III, are separately initialed by the plaintiffs) to the effect that AO is the borrower, each of the plaintiffs

are the lender, and checks are payable to the escrow agent. Section III of the AO disclosure form contains the following provisions:

> c. Neither Borrower [i.e., AO] nor Escrow Agent, [i.e., Arizona or Regions Bank] have made any representation that the promissory note is backed by the Federal Deposit Insurance Corporation (FDIC) or the assets of the Escrow Agent.
> d. Borrower is in the business of buying and selling automobiles as a wholesaler and/or retailer.
> e. Borrower under the terms of the Escrow Agreement from time to time shall withdraw funds from the Escrow Account to purchase inventory for the Borrower and provide the Escrow Agent documentation per the Escrow Agreement and Lender(s) has (have) no rights in that inventory. Lender(s)' rights are to receive interest and return of the principal sum per the terms of the Promissory Note.
> f. Neither the Borrower nor the Escrow Agent made any warranty or representation, other than those contained in the Promissory Note, Escrow Agreement, or Escrow Account. Further, the Borrower has made no other promises and there exist no verbal agreements between the Lender, Borrower, and/or Escrow Agent.
> g. Lender(s) has (have) experience in the handling of financial matters, and has (have) not relied on the Borrower or the Escrow Agent to decide to enter into this transaction.
> h. Lender(s) has (have) only an expectation of monthly interest and return of the principal sum as per the Promissory Note. Lender(s) will receive from the Borrower an IRS Form 1099 for interest earned.
>
> IV. Lender's Certification
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> Lender(s) has (have) read this entire document and have signed the request in Section II and have initialed each item in Section III.

Similar provisions are contained in the CF disclosure form. The AO promissory notes are executed by Robert Wilkins as President of AO. The CF promissory notes are executed by Robert Wilkins as Senior Vice-President of CF. None of the notes are executed in favor of plaintiffs by Robert Wilkins individually. Wilkins put all the money he personally had into the companies and even guaranteed some of AO's corporate debt.

ISSUE

Plaintiffs argue that they were fraudulently induced to "invest" in AO and/or CF based on the advertising brochures and that their claims against Wilkins are therefore nondischargeable under 11 U.S.C. § 523 (a)(4), § 523(a)(2), and/or § 523(a)(6). Defendant Robert Wilkins argues that the evidence is insufficient to make out a *prima facie* case of nondischargeability under any of the foregoing Bankruptcy Code sections and at the close of the plaintiffs' case-in-chief, defendant moved for a directed verdict, which the Court took under submission.[2] The issue presented then is: Have the plaintiffs made out a *prima facie* case of nondischargeability under 11 U.S.C. § 523(a)(4), § 523(a)(2)(A), and/or § 523(a)(6)?

The plaintiffs--as the parties bringing this nondischargeability action--bear the burden of proving each element of their case by a preponderance of the evidence. *Grogan v. Garner*, 498 U.S. 279, 291, 111 S. Ct. 654, 112 L. Ed. 2d 755 (1991).

LAW

Federal Rule of Civil Procedure 52(c) Standard

> Awarding a defendant judgment as a matter of law pursuant to Fed. R. Civ. P. 52(c) "is appropriate where the plaintiff has failed to make out a *prima facie* case or where the plaintiff has made out a *prima facie* case but the court determines that a preponderance of the evidence goes against the plaintiff's claim," *Stokes v. Perry,* 1997 WL 782131, *8 (S.D.N.Y. 1997), *citing* 9A Charles Alan Wright &

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[2]The Court treats Wilkins' motion as a Rule 52 motion for judgment on partial findings, which is the appropriate motion to be made at the directed verdict stage of a nonjury trial. *See Green v. School Board of Hillsborough County, Fla.*, 25 F.3d 974, 977 n.1 (11th Cir. 1994) (Court noting that Rule 41(b) motion to dismiss should be treated as a Rule 52(c) motion); Fed. R. Civ. P. 41 and 52(a) Advisory Committee Comments. Fed. R. Civ. P. 52 is made applicable to adversary proceedings by Fed. R. Civ. P. 7052. This Order constitutes the findings of fact and conclusions of law required by Fed. R. Civ. P. 52(c).

> Arthur R. Miller, Federal Practice And Procedure § 2573.1 (2d ed. 1994). Unlike motions for summary judgment or directed verdict, when a court considers a Fed. R. Civ. P. 52(c) motion, the nonmoving party is not entitled to any special inferences nor is the court to consider the evidence in a light most favorable to that party. *See Regency Holdings (Cayman), Inc. v. The Microcap Fund, Inc. (In re Regency Holdings (Cayman), Inc.),* 216 B.R. 371, 374 (Bankr. S.D.N.Y. 1998) (citations omitted). "Instead, the court acts as both judge and jury, weighing the evidence, resolving any conflicts, and deciding where the preponderance of evidence lies." *Id.* at 374. A judgment pursuant to Fed. R. Civ. P. 52(c) "operates as a decision on the merits in favor of the moving party." *Id.; see also, Matis v. U.S.,* 236 B.R. 562, 569 (E.D.N.Y. 1999) (applying same standard as *Regency Holdings (Cayman), Inc.); Lamarca v. U.S.* 31 F. Supp. 2d 110, 123 (E.D.N.Y. 1998) (same); *Hoseman v. Weinschneider (In re Weinschneider),* 2001 WL 197886, *2 (Bankr. N.D. Ill. 2001) (same).

In re Fanelli, 263 B.R. 50, 59 (Bankr. N.D.N.Y. 2001).

Examination of the evidence before the Court at the close of plaintiffs' case-in-chief reveals that each of plaintiffs' § 523 claims fail as a matter of law because: (1) plaintiffs have failed to make out a *prima facie* case and/or (2) the preponderance of the evidence goes against plaintiffs' claims. Consequently, the Court is granting Wilkins' motion for judgment as a matter of law.

11 U.S.C. § 523(a)(2)(A)

"The elements of a claim under § 523(a)(2)(A) are: the debtor made a false statement with the purpose and intention of deceiving the creditor; the creditor relied on such false statement; the creditor's reliance on the false statement was justifiably founded; and the creditor sustained damage as a result of the false statement." *In re Johannessen*, 76 F.3d 347, 350 (11th Cir. 1996); *Field v. Mans*, 516 U.S. 59, 74-75 116 S. Ct. 437, 446, 133 L. Ed. 2d 351 (1995) (reliance standard under § 523(a)(2)(A) is "justifiable reliance"). It is axiomatic that without proof of a false representation and a monetary loss sustained as a proximate result of the false

representation, there is no actionable fraud under § 523(a)(2)(A). *In re Frick*, 207 B.R. 731, 734 (Bankr. N.D. Fla. 1997).

AO and CF Advertising Brochures[3]

There is no evidence of any false representations by Wilkins to the plaintiffs. The evidence establishes that nothing that the plaintiffs were told in the AO and CF advertising brochures (quoted in the Facts above) proved to be untrue. The plaintiffs did, in fact, receive monthly interest checks over a period of many months. Many of the plaintiffs (e.g., Betty Lowery, E.O. Harper, Susan Montgomery, Betty Vandegrift, Jack Lowery) testified to the receipt of interest checks collectively totaling thousands of dollars, and the CF Register Report shows that the promissory noteholders received $26,703 in interest payments between December 3, 1997 and June 16, 1998. There are, in fact, documents (i.e., car titles) deposited with Arizona Escrow which reflect the principal sums plaintiffs loaned to AO and/or CF. And, tax form 1099s were, in fact, sent in 1996 and 1997. Although 1099s were not sent in 1998, AO had ceased doing business and AO's records had been seized and kept for several years by the FBI. Thus, Wilkins was unable to prepare 1099s for 1998. Because there were no false representations, there can be no fraud.

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[3]The Court assumes without deciding for purposes of discussion of plaintiffs' § 523(a)(2)(A) claims that the salesmen were Wilkins' "agents" in connection with presentation of the advertising brochures and attempting to raise the promissory note money. The Court also assumes without deciding that a § 523(a)(2)(A) claim premised upon the advertising brochures is viable against Wilkins personally in the absence of any "agency" relationship between Wilkins and the salesmen.

In addition to proof of a false representation, there must be proof that the false representation is made "with the purpose and intention of deceiving the creditor." *In re Villa*, 261 F.3d 1148, 1150 (11th Cir. 2001). The alleged false representations in the brochures are all promises to perform future acts. Thus, plaintiffs must also prove a present intent not to perform and an intent to deceive. *In re Capps*, 193 B.R. 955, 960 (Bankr. N.D. Ala 1995) ("A promise to perform an act in the future is a present representation and, if the promise is not ultimately performed, may constitute fraud if, at the time the promise was made, the defendant intended not to do the act promised and intended to deceive the plaintiff."). There is no evidence of any intent to deceive the plaintiffs on the part of Wilkins. And, there is no evidence that Wilkins did not intend to perform the alleged promises in the ad brochures at the time of the loans. Thus, even assuming that false representations were made in the brochures, which they were not, the plaintiffs have failed to prove a § 523(a)(2)(A) claim.

There was no evidence presented that Wilkins concocted a scheme to defraud the plaintiffs or that Wilkins misappropriated or took the money that the plaintiffs loaned AO and CF. Wilkins' stated reason for raising the promissory note money--i.e., to obtain operating capital for AO and CF--is a legitimate one and that is largely how the funds were spent according to the evidence before the Court. There was no evidence that plaintiffs were tricked out of the money, and no evidence of unequal bargaining power between AO and CF's salesmen (who presented the brochures) and plaintiffs. And, there was no evidence that plaintiffs were illiterate and could not read and understand the brochures' contents. In fact, one of the plaintiffs had attended college for two years and worked as a bookkeeper. Another plaintiff worked as a

bank teller. The Disclosure Form signed by plaintiffs contains clear, understandable language warning plaintiffs that their loans are not FDIC insured and not backed by assets of the Escrow Agent, that plaintiffs were relying on their own experience and not on AO/CF or Arizona Escrow in making the loans, and that plaintiffs have no rights in the vehicle inventory of the Escrow Agent. Each of the plaintiffs separately initialed each paragraph of the Disclosure and freely and voluntarily signed.

There was no evidence that Wilkins paid himself an exorbitant salary for little work or that AO and/or CF paid Wilkins' personal expenses from the money loaned by plaintiffs. Indeed, Mr. Wilkins paid himself a very modest salary, and he only did that when the companies had sufficient cash flow. He loaned all of his personal money to AO and sometimes worked as much as 100 hours per week. The evidence further establishes that the money loaned by the plaintiffs was used for operating expenses of AO and to fund the startup expenses associated with CF. AO had substantial vehicle sales in 1996 and showed a year end net profit for 1996. Although CF never had any filter sales during Wilkins' tenure with CF, the record reflects that this was due in large part to manufacturing and marketing problems with the filters, which proved to be a heavy cash drain. Specifically, CF encountered significant problems with the materials originally selected for the filter frame, and CF spent considerable resources experimenting with different types of frames. Like many business ventures, CF simply never got off the ground.

Plaintiffs place great reliance on the fact that AO and CF lost money and subsequently failed as viable entities as well as other evidence relating to events occurring subsequent to the

time plaintiffs loaned AO and CF money. Plaintiffs' emphasis on these events is misplaced, for "[p]roof of intent to deceive is measured by the Debtor's subjective intention at the time the representation was made." *In re Jairath,* 259 B.R. 308, 315 (Bankr. N.D. Ill. 2001). There is no evidence that Wilkins did not intend to keep any of the promises contained in the brochures and/or that Wilkins intended to deceive the plaintiffs at the time of the loans.

In short, this was not a situation where Wilkins unlawfully took the plaintiffs' money and absconded with it. From the record, it appears that AO and CF used these funds to pay the operating expenses of these corporations, none of which were shown to be sham or illegitimate expenses. Furthermore, it was in Wilkins' interest to have AO and CF make a profit and survive, even though ultimately these entities were financially unsuccessful. Wilkins considered himself an entrepreneur and like many other startup business owners that have gone before him, Wilkins "thought he could make it." There is no evidence that at the times the loans were made Wilkins did not believe the statements in the brochure would be honored. At best for the plaintiffs, some of the evidence suggests that Mr. Wilkins had an ill conceived business plan or that he arguably condoned unwise management practices and/or expenses, but such evidence is insufficient as a matter of law without more to render plaintiffs' alleged claims against Wilkins nondischargeable. *In re McCurdy*, 45 B.R. 728, 731, 732 (Bankr. M.D. Pa. 1985) (In a § 523(a)(4) action, court holding that "[a]t best, the evidence reflected poor management of a business by a general manager of a corporation. This alone is not enough to justify any sort of exceptions to discharge"; court further noting that even if court found "that the debtor acted with poor business

judgment or indeed even mismanaged the business, this would not be enough" to sustain a § 523(a)(4) claim).[4]

In addition to the fact that there has been no evidence presented of any false representations with an intention to deceive and no evidence of a present intent not to perform on the part of Wilkins, there was insufficient evidence presented that the plaintiffs' justifiably relied on any alleged false representations. "'A plaintiff may not bury his head in the sand and willfully ignore obvious falsehoods.'" *Jairath*, 259 B.R. at 315 (quoting *In re Tomlinson*, 1999 WL 294879 *12 (Bankr. N.D. Ill. 1999)). And:

> Justifiability is not without limits, however . . . a person is required to use his sense and cannot recover if he blindly relies on a misrepresentation the falsity of which would be patent to him if he had utilized his opportunity to make a cursory examination or investigation. [Justifiable reliance] is a matter of the qualities and characteristics of the particular plaintiff and the circumstances of a particular case.

Jairath, 259 B.R. at 315 (quoting *AT&T Universal Card Services v. Alvi,* 191 B.R. 724, 731 (Bankr. N.D. Ill. 1996).

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[4]That the interest payments eventually stopped, that plaintiffs never received their principal back, that plaintiffs did not receive fully executed copies of the Escrow Agreement, that 1099s were not sent in 1998, and/or that some of the money loaned to one company was deposited in another does not alter the Court's finding that there is no evidence that Wilkins made any false representations with the purpose and intention of deceiving plaintiffs. Otherwise, a mere breach of contract would equal nondischargeable fraud. That is not and cannot be the law. *In re Capps,* 193 B.R. 955, 960 (Bankr. N.D. Ala. 1995) (mere failure to keep a promise alone does not prove an intention to deceive or an intention not to perform the promise under § 523(a)(2)(A)); *cf. Kawaauhau v. Geiger*, 523 U.S. 57, 62, 118 S. Ct. 974, 977, 140 L. Ed. 2d 90 (1998) (even "knowing" breach of contract not enough to render a debt dischargeable under § 523(a)(6)).

There was no evidence presented prior to the close of the plaintiffs' case-in-chief to the effect that any of the plaintiffs had low educational levels, were unable to read, and/or had low intelligence. It was apparent to the Court from the plaintiffs' testimony that all of the plaintiffs are intelligent individuals who can read, understand, and comprehend the English language. Frances Johnson, for example, works as a bookkeeper. Mrs. Johnson went to college for two years and as a bookkeeper writes checks and makes deposits for her employer. Betty Vandegrift worked for many years as a bank teller. Bonnie Jett owns part of and works in a family construction business. There was absolutely no evidence to the effect that the plaintiffs relied on any representations (written or oral) alleged to have been made by Russo or any of the other AO/CF salesmen.

Moreover, all of the plaintiffs freely signed a disclosure form which point blank says that the plaintiffs were experienced in handling financial matters and were not relying on any representations of AO, CF, and/or the Escrow Agents in loaning money. Many of the plaintiffs had other investments that were made either before or after loaning money to Wilkins' company. Jerry Jett even opened an investment account at a brokerage firm in 1995. The disclosure form plaintiffs signed makes it clear that the plaintiffs' money would not be an FDIC insured deposit and that the loans were not backed by assets of the Escrow Agent. The advertising brochure, disclosure form, and the escrow agreement indicate that plaintiffs were loaning money and that the money was to be deposited with the escrow agent. The disclosure form states that the plaintiffs would not have any rights in the car titles or inventory of Arizona Financial. Simply stated, the documents make it clear that the plaintiffs were loaning money without any security

or insurance against loss and without any guarantees of repayment. All of these provisions in the disclosure form are written in clear and understandable language (they are not loaded with complex "legalese"), and each of the paragraphs on the disclosure form are separately initialed by the plaintiffs. There was absolutely no evidence presented that the plaintiffs were not given an opportunity to read the disclosure forms and escrow agreements prior to loaning money, and Susan Montgomery admitted that she read the Disclosure before signing. On the record before the Court, the Court finds and concludes that the plaintiffs did not justifiably rely on any alleged false representations made by the salesmen or contained in the advertising brochures.

Salesmen's Oral Statements

The plaintiffs argued at trial that the brochures were the basis of their § 523(a)(2)(A) claims. It was unclear whether plaintiffs also based their § 523(a)(2)(A) claims upon oral statements made by the salesmen who presented the brochures.[5] Out of an abundance of caution, the Court will briefly address the viability of the § 523(a)(2)(A) claims premised upon the salesmen's alleged oral statements. To the extent plaintiffs rely upon the salesmen's oral statements, their § 523(a)(2)(A) claims also fail for several reasons. Many of the plaintiffs did not testify as to any representations made other than what is contained in the brochures, which the Court has already concluded were not false. Obviously, there can be no fraud claim without proof of a misrepresentation. There was testimony from some plaintiffs (Jack Lowery, Frances Johnson, and Betty Vandegrift, for example) that they were told by the salesmen that Arizona

[5]Wilkins never talked to any of the plaintiffs before they decided to loan money; many of the plaintiffs conceded this point at trial.

Escrow would have good titles for the cars and/or that loaning money would be a "great investment" and/or a "great opportunity." Such statements do not amount to actionable fraud. Statements such as "great investment" and "great opportunity" are mere "salestalk" or "puffery." *See, e.g., Hughes v. Hertz Corporation*, 670 So.2d 882, 885 (Ala. 1995) (statement that car was "fine" car was statement of opinion which was mere "puffery" or "salestalk"); *State Farm Fire & Casualty Co. v. Slade*, 747 So.2d 293, 322-23 (Ala. 1999) (statements that an insurance policy was "the Cadillac of all insurance" and "the very best" were mere puffery in light of plaintiffs' educational level); *Dafofin Holdings v. Hotelworks.com, Inc.*, 2001 WL 940632 *4 n. 6 (S.D. N.Y. 2001) (assurances that investment was "great" and would make "quick money" are mere puffery and do not amount to actionable fraud) (citations omitted). There can be no fraud claim premised upon any of the foregoing statements and/or statements that Arizona Escrow would have good car titles (assuming that these statements were false) because, as discussed above, there is no credible evidence of a present intent not to perform or intention to deceive. The Court also seriously questions whether plaintiffs could have justifiability relied on oral statements such as the above in light of the Disclosure Form provisions discussed in this Order.

For the above reasons, plaintiffs' § 523(a)(2)(A) claims fail.

<u>11 U.S.C. § 523(a)(4)</u>

Plaintiffs argue that Wilkins committed fiduciary fraud and/or defalcation and larceny and/or embezzlement under 11 U.S.C. § 523(a)(4). Plaintiffs must prove two elements to sustain a § 523(a)(4) "fiduciary fraud or defalcation" claim. First, and most important to the facts of this case, plaintiffs must prove the existence of a fiduciary relationship. Second, plaintiffs must

prove that a fraud or defalcation occurred in the course of a fiduciary relationship. *In re Frick,* 207 B.R. 731, 734 (Bankr. N.D. Fla. 1997); *In re Shahrokhi,* 266 B.R. 702, 707 (B.A.P. 8th Cir. 2001).

The question of who is a "fiduciary" for purposes of § 523(a)(4) is one of federal law. *Shahrokhi*, 266 B.R. at 707; *In re Capps*, 193 B.R. 955, 960 (N.D. Ala. 1995).[6] A "fiduciary" under § 523(a)(4) is more narrow than a "fiduciary" under a general common law definition; the fiduciary relationship must arise under an express or technical trust. *Quaif v. Johnson*, 4 F.3d 950, 952-55 (11th Cir. 1993); *Frick*, 207 B.R. at 737-38; *Carey Lumber Company v. Bell*, 615 F.2d 370, 374-75 (5th Cir. 1980).[7] The burden is on the plaintiffs to show the existence of an "express trust." *In re Wright,* 266 B.R. 848, 851 (Bankr. E.D. Ark. 2001). Whether an express trust relationship exists must be determined by reference to Alabama law. *Capps*, 193 B.R. at 960. The elements of an express trust are: "(1) a declaration of trust, (2) a clearly defined trust *res*, and (3) an intent to create a trust relationship." *In re Boshell*, 108 B.R. 780, 783 (Bankr. N.D. Ala. 1989); *see also Coosa River Water, Sewer and Fire Protection Authority v. SouthTrust Bank*, 611 So.2d 1058, 1061 (Ala. 1993). The law is well established that "debtor-creditor

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[6]Plaintiffs conceded this point of law during argument on Wilkins' directed verdict motion.

[7]Several cases cited by plaintiffs recognize and hold that the defalcation provision of § 523(a)(4) arises only upon proof of an express or technical trust. *In re Garver*, 116 F.3d 176, 180 (6th Cir. 1997); *Lewis v. Scott (In re Lewis)*, 97 F.3d 1182, 1185 (9th Cir. 1996). It bears noting that the Sixth Circuit held the debt in *Garver* to be dischargeable because no defalcation had occurred--"the funds were merely lost because the venture turned out to be a poor investment." *Id*. Thus, *Garver* is actually supportive of the Court's conclusions here.

relationships are not covered by Section 523(a)(4)." *Frick*, 207 B.R. at 737 (citations omitted); *Shahrokhi*, 266 B.R. at 707; *In re Fanelli,* 263 B.R. 50, 61 (Bankr. N.D.N.Y. 2001).

There was no proof of an "express trust" relationship. The Escrow Agreement does not create an express trust between the plaintiffs and Wilkins and there was absolutely no evidence of any intention to create a trust relationship. None of the plaintiffs testified that they believed that their loans constituted a "trust." In addition, there is no "clearly defined trust res." Moreover, even if plaintiffs had testified that they believed a "trust" was formed, the result would not change. Why? Because the Disclosure forms and promissory notes which plaintiffs received from AO and CF (and the Escrow Agreements) make it clear that plaintiffs were merely loaning money to AO and/or CF without any security or insurance against loss and without any fiduciary relationship being formed between Wilkins personally and plaintiffs. And, plaintiffs have not pointed the Court to or cited any statutory authority or other law or regulation which plaintiffs contend creates an "express trust" between plaintiffs, on the one hand, and Wilkins, on the other hand, with regard to their loans to AO and/or CF. Moreover, approximately half of the money plaintiffs loaned was deposited directly with Arizona Financial (which is not a party to this adversary proceeding), and the loans were made to AO and CF (and in one instance to RSR, Inc.), not Wilkins personally. Simply stated, there was no express trust between plaintiffs and Wilkins. A mere debtor-creditor relationship is not enough. Consequently, plaintiffs' § 523(a)(4) "fiduciary fraud" claims must fail.[8]

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[8]Because there is no fiduciary relationship, the Court need not decide whether there has been a "defalcation." And, there is no evidence of and the Court finds that there has been no embezzlement or larceny by Wilkins under any definition of those terms based upon the record

The § 523(a)(4) cases cited by the plaintiffs are different. In *In re Lewis,* 97 F. 3d 1182 (9th Cir. 1996), *In re Niles*, 106 F.3d 1456 (9th Cir. 1997), and *In re Moreno*, 892 F.2d 417 (5th Cir. 1990), there were fiduciary relationships present and proven. *Lewis*, 97 F.3d at 1186 (partnership under Arizona law is a "fiduciary" relation under § 523(a)(4)); *Niles*, 106 F.3d at 1459 (under California law, licensed real estate broker was a trustee as to rent funds collected and held in property management account); *Moreno*, 892 F.2d at 421 (In action brought by Trustee of bankrupt corporation, Fifth Circuit assumed that a fiduciary relationship existed since debtor was an officer of corporation; debtor did not dispute that he owed fiduciary duty). Here, no "express trust" relationship between plaintiffs and Wilkins was present or proven. Thus, *Lewis, Niles,* and *Moreno* do not apply.[9]

11 U.S.C. § 523(a)(6)

11 U.S.C. § 523(a)(6) states that a debt is nondischargeable if it results from "willful and malicious injury by the debtor to another entity or to the property of another entity." What is a "willful and malicious injury"? The recent Supreme Court case of *Kawaauhau v. Geiger,* 523 U.S. 57, 118 S. Ct. 974, 140 L. Ed. 2d 90 (1998), is the starting part of this inquiry. In *Geiger*, the Supreme Court held that for purposes of § 523(a)(6), willful requires "a deliberate or intentional injury, not merely a deliberate or intentional act that leads to injury." *Id.* 118 S. Ct. at

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before the Court.

[9]One aspect of *Niles* actually supports this Court's holding. In *Niles*, the Ninth Circuit held that loans to the debtor made out of an account controlled by the plaintiff did not amount to breach of any fiduciary relationship, and the Ninth Circuit found that the bankruptcy court's conclusions that there was no evidence that the debtor did not intend to repay the loans was not clearly erroneous. *Niles*, 106 F.3d at 1462-63.

977. After *Geiger,* there must be an actual intent to cause injury. *Id.* The definition of malicious in § 523(a)(6) was not addressed by the Court. The Eleventh Circuit has defined malicious to mean "wrongful and without just cause or excessive even in the absence of personal hatred, spite or ill-will." *Hope v.Walker (In re Walker),* 48 F. 3d 1161, 1164 (11th Cir. 1995) (citation omitted).[10] Thus, a §523(a)(6) case is difficult to prove.

The evidence presented by the plaintiffs does not meet the above definitions of "willful and malicious injury." There is no evidence that Wilkins actually intended to injure plaintiffs. It was in Wilkins' interest for AO and CF to prosper financially, and it appears from the record before the Court that Wilkins legitimately tried to make AO and CF a success. At best, some of the evidence suggests the possibility of a bad business model and/or bad management, but that is not sufficient to satisfy the willful and malicious injury test of § 523(a)(6). *See, e.g., In re Ballantyne*, 166 B.R. 681, 689-90 (Bankr. E.D. Wis. 1994) (pre-*Geiger* case holding that "corporate mismanagement" does not meet the "willful and malicious" injury standard of § 523(a)(6)).

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[10]Bankruptcy Judge William A. Hill opined in *Security Bank v. Wehri (In re Wehri),* 212 B.R. 963 (Bankr. D.N.D. 1997) that the definition of malicious seemed to be subsumed by the Eight Circuit's expanded definition of willful in *Geiger v. Kawaauhau (In re Geiger)*, 113 F.3d 848, 852 (8th Cir. 1997), *aff'd*, 523 U.S. 57. *See Ehrman v. Feist (In re Feist)*, 225 B.R. 450, 454-56 (Bankr. D.N.D. 1998). This concern is justified in the Eight Circuit based on the similarity between its definition of malicious (intending or fully expecting to injure the plaintiff) and *Geiger's* expanded definition of willful and the fact that the *Geiger* originated in that Circuit. *See, id.* However, because the Supreme Court did not specifically address the definition of malicious in *Geiger* and because this Circuit's definition differs from the Eight Circuit's, this Court finds that willful and malicious are separate prongs of § 523(a)(6) and adopts the definition of malicious applied by the Eleventh Circuit in *Walker*. Moreover, despite Judge Hill's concerns, he also found that willful and malicious are separate prongs of the § 523(a)(6) test. *Feist*, 225 B.R. at 455.

There was no proof of negligence on the part of Wilkins, but even if the plaintiffs had proven negligence or even recklessness in the procurement of money from the plaintiffs and/or in the operations of AO and CF, the elements of § 523(a)(6) are still not satisfied. The United States Supreme Court made it clear in *Geiger* that negligence and recklessness are not enough to invoke § 523(a)(6). *Geiger*, 523 U.S. at 64. Under the *Geiger* standard, plaintiffs' § 523(a)(6) claims must fail. *Id.; see also In re Tomlinson*, 1999 WL 294879 *18 (Bankr. N.D. Ill. 1999) (Court holding that § 523(a)(6) *Geiger* standard not met where although investment advisor acted intentionally, there was no purpose to injure plaintiff investors; advisor acted to "help himself" and his "indifference to the possible effects of his actions upon the plaintiffs was no more than reckless under § 523(a)(6).").

That the plaintiffs never received return of the principal sums that they deposited with Arizona Financial does not alter the Court's conclusion that § 523(a)(6) has not been satisfied. It is well settled law that breach of an agreement does not constitute proof of nondischargeability under § 523(a)(6). *In re Haynes*, 19 B.R. 849, 851 (Bankr. E.D. Mich. 1982); *Geiger*, 523 U.S. at 62. Indeed, the Supreme Court noted in *Geiger* that even a "knowing" breach of contract is not enough to prove a § 523(a)(6) case. *Id.* at 62. This makes perfect sense. Were the law otherwise, every run-of-the-mill breach of contract claim would preclude discharge of that debt rendering the "fresh start" policy of the Bankruptcy Code meaningless for a large class of individual and corporate debtors.[11]

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[11]Another reason why plaintiffs' § 523 (a)(6) claims fail is that their § 523(a)(2) and § 523(a)(4) claims have no merit. On the facts before the Court, plaintiffs should not be allowed to prevail under § 523(a)(6) since their (a)(2) and (a)(4) claims fail.

Plaintiffs cite the Court to cases involving knowing destruction/conversion of a lender's collateral and argue that these cases mandate a finding of nondichargeability. *See, e.g., Ford Motor Credit Company v. Owens,* 807 F.2d 1556 (11th Cir. 1987). "Collateral destruction" cases such as *Owens*, however, do not apply. This is primarily because plaintiffs had no security interest in the escrow deposits or car titles and no other security for the loans that they made. In other words, this case does not involve destruction or wrongful disposition of a lender's collateral or a "conversion" of another's property, much less a "knowing" destruction. Plaintiffs' counsel argues that plaintiffs' "collateral" is missing, but this argument is misplaced because plaintiffs had and have no collateral to secure their loans to AO and CF.

Moreover, *Owens* is different. In *Owens,* there was evidence, among other things, that an experienced car dealer principal sold vehicles "out of trust" in knowing violation of duties set forth in the dealer agreement with the floor plan financing creditor, and there were large intercompany "loans" for which there was no corresponding promissory notes. *Owens,* 807 F.2d at 1557-58.[12] There was no such evidence presented here. In fact, the relatively small loans from CF to AO and Wilkins' other companies were all evidenced by promissory notes which were eventually repaid with interest before AO filed bankruptcy. Contrary to plaintiffs' argument that Wilkins played a "shell game" with the money loaned by plaintiffs, there is no credible evidence in the record to support such an argument. Furthermore, *Owens* is a pre-

[12]Similarly, in *In re Moreno*, 892 F.2d 417 (5th Cir. 1990), there was evidence, among other things, of a large transfer of money to the debtor and to companies controlled by the debtor with no loan agreements or other documents evidencing a bona fide transaction. *Moreno,* 892 F.2d at 421. There was no "corporate purpose" furthered by the transfer and none of the money was repaid. *Id.*

Geiger case which is questionable authority in light of the new § 523 (a)(6) standard announced by the Supreme Court in *Geiger* eleven years after *Owens* was decided. *In re Jenkins*, 258 B.R. 251, 267, 267 n.9 (Bankr. N.D. Ala. 2001) (court noting new standard under *Geiger* and that *Owens* would appear to be overruled by subsequent Eleventh Circuit case *Hope v. Walker* on intent to injure issue).

For the above reasons, plaintiffs' § 523(a)(6) claims fail.

CONCLUSION

It is unfortunate that the plaintiffs decided that loaning money to AO and CF was appropriate. In several instances, the money loaned represented a very large percentage of and, in some cases, plaintiffs' entire net worth. Nondischargeability actions, however, are not actions designed to make parties whole following an unwise loan or bad financial decision without regard to the elements that must be proven under § 523. This case "boils down" to a sad situation where a debtor "convinced innocent parties to foolishly part with their monies." *Frick*, 207 B.R. at 737. Such debtor/creditor relationships do not fall within the nondischargeability provisions of the Bankruptcy Code. *See id*. In reaching these conclusions, the Court is mindful of its "obligation to construe strictly exceptions to discharge in order to give effect to the fresh start policy of the Bankruptcy Code." *Villa*, 261 F.3d at 1152 (citation omitted).

The Court acknowledges that some of the plaintiffs suffered from medical conditions at the time of the loans to AO and CF and that some of these medical conditions are now quite serious. Such evidence, however, is unfortunately completely irrelevant to the legal issues

before the Court.[13] This is a court of law which is duty bound to follow the mandate of the Bankruptcy Code. The Court has carefully considered the relevant evidence presented by the plaintiffs. The FBI records seizure certainly raises "red flags" but on the record presented, the Court must conclude that plaintiffs' claims against Wilkins are dischargeable in bankruptcy. An FBI records seizure alone without proof of the elements required under § 523 does not equal nondischargeability.

It is therefore ORDERED:

1. Robert Wilkins' motion for judgment as a matter of law made at the close of plaintiffs' case-in-chief and treated by the Court as a motion for judgment on partial findings is GRANTED. This Order shall constitute the findings of fact and conclusions of law required by Federal Rule of Civil Procedure 52(c).

2. In accordance with the foregoing, plaintiffs' § 523(a)(2), (a)(4), and (a)(6) claims against Robert Wilkins d/b/a Wilkins Management Group are DISMISSED WITH PREJUDICE with each party to bear their own costs.

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[13]The "lulling letter" cases plaintiffs cited likewise have nothing to do with the issues before the Court. Those cases are criminal cases that address whether a "lulling letter" received by the victim of a criminal scheme may form the basis of a federal mail fraud conviction even though the letter was sent after fraudulent acquisition of money. *See U.S. v. Snowden*, 770 F.2d 393, 397-98 (4th Cir. 1985); *U.S. v. Otto,* 742 F.2d 104, 108-09 (3d Cir. 1984).

Another case cited by plaintiffs, *In re Campbell*, also does not apply. *Campbell* involved a very narrow issue under § 523(a)(2)(B) not involved here. *In re Campbell*, 159 F.3d 963, 964 (6th Cir. 1998).

3. All of the plaintiffs' claims against Robert Wilkins d/b/a Wilkins Management Group are hereby declared to be DISCHARGEABLE in bankruptcy.

Dated: April 25, 2002

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MARGARET A. MAHONEY
CHIEF BANKRUPTCY JUDGE