UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF ALABAMA
(PENSACOLA DIVISION)

IN RE:

JON W. SEARCY, CASE NO. 99-42360-PNS3

Debtor. Chapter 7

ELGIN R. WESTBROOK,
AUDREY L. WESTBROOK, et al.

Plaintiffs,

v. ADV. NO. 00-80014

JON W. SEARCY,

Defendant.

ORDER ON COMPLAINT FOR DISCHARGEABILITY AND PLAINTIFFS' MOTION TO AMEND COMPLAINT

This matter came on for hearing on the Plaintiffs' complaint to determine dischargeability of a debt pursuant to 11 U.S.C. § 523(a)(2)(A). Scott Remmington appeared for the Plaintiffs, and Thomas Reed appeared for the Defendant. Prior to the trial of this matter, the Plaintiffs withdrew count two of their complaint, which dealt with dischargeability under 11 U.S.C. §523(a)(4). The parties also agreed to try only the dischargeability issue, and stipulate as to the amount Searcy may owe to the Westbrooks. After due consideration of the pleadings, evidence, testimony and arguments of counsel, the Court makes the following findings of fact and conclusions of law:

FINDINGS OF FACT

The Defendant/Debtor, Jon W. Searcy, worked as a licensed attorney in the State of Florida until approximately 1997. He first met the Westbrooks in 1983 or 1984. Searcy subsequently handled some real estate matters for the Westbrooks and drafted wills for them. In 1993, Searcy drafted living

trust agreements for Uriah and Marjorie R. Westbrook, the parents of Elgin Westbrook (hereinafter "Mr. Westbrook"), a Plaintiff in this action. Mr. Westbrook and his sister, Ruth W. Henderson, served as co-trustees for the Marjorie Westbrook Trust. Searcy also prepared living trusts for the Plaintiffs, Elgin and Audrey Westbrook. He testified that he did not do any legal work related to the funding or allocation of assets for the Westbrooks' living trusts. Mr. Westbrook testified that Searcy had completed the trusts for Mrs. Westbrook and himself, but that the trusts had not been funded at the time that the Marjorie Westbrook Trust loan was made to Searcy. According to Mr. Westbrook, he had planned to have Searcy do the trust allocations, but had to get another attorney to do the work.

On March 26, 1996, Searcy learned that $250,000.00 to 300,000.00 had been embezzled from his law office trust account by Debra Sellers, Searcy's paralegal. He removed her as signatory on all estate accounts. He tried to collect all records in Sellers' possession to enable him to assess the extent of the embezzlement. Searcy testified that he did not report the theft to the authorities because he was trying to convince Sellers to turn over some records so that he could evaluate the extent of the damage. He also believed that he should accept responsibility for Sellers' actions and repay the stolen funds. Searcy's father had been his office manager until his death in 1994. Sellers handled the financial records after Searcy's father's death, and Searcy admitted that he did not properly supervise her activities. Searcy testified that he personally did not take money from his office trust account.

Searcy first went to a personal friend, Pat Tete, to borrow the funds needed to restore the trust account. Tete was willing to loan the money to Searcy, but did not have the cash in March 1996. Tete agreed to loan the money to Searcy in January 1997, after he had liquidated some assets. Searcy then decided to approach the Westbrooks about a loan. Searcy testified that he planned to repay the Westbrooks in full when he received the money from Tete in January 1997. Tete died before he could make the loan to Searcy.

Searcy went to the Westbrooks in the spring of 1996, attempting to borrow money to restore the embezzled funds to the trust account. He testified that he did not have an active case with them as their attorney when he asked for the loan. Searcy arranged to meet the Westbrooks at their home, accompanied by Sellers. He took Sellers with him so that she could experience the embarrassment and humiliation of asking for the loan. Sellers was also going to offer a mortgage on her home to secure the loan. Searcy asked the Westbrooks for a loan of $170,000.00. He explained why he needed the money. Searcy told the Westbrooks that the employee who took the trust fund money had been terminated, which was not true. Searcy testified that he did not terminate Sellers' employment with his office because he was trying to obtain some records in her possession. He also hoped to get back some of the money she had taken. Searcy testified that he was also suffering from severe clinical depression, but he did not realize this at the time. Searcy also stated that he and Sellers had a sexual relationship, but Sellers denied such a relationship.

The Westbrooks were not able to make the loan to Searcy because their assets were committed to a 401k plan. Searcy testified that Mr. Westbrook then suggested borrowing the money from his mother's trust, and offered to take Searcy to his parent's house to ask them. Mr. Westbrook denies suggesting that Searcy ask his parents for the loan. Searcy, Sellers, and Mr. and Mrs. Westbrook went next door to Marjorie and Uriah Westbrook's home to ask for the loan. Ruth Henderson, daughter of Marjorie and Uriah Westbrook, was also at her parents' home. Searcy asked Marjorie Westbrook[1] for the $170,000.00 loan and suggested a 6% interest rate. Searcy offered a mortgage on the office

[1]There was conflicting testimony as to whether Uriah Westbrook was present in the room during negotiations concerning the loan. Searcy stated that he was home, but in another room of the house. Mr. and Mrs. Westbrook and Ruth Henderson testified that Uriah Westbrook was present during the negotiations and took part in them. Searcy later testified that he returned to Marjorie and Uriah Westbrook's home to pick up the checks for the loan. He stated that it may have been on the second trip to the senior Westbrooks' home that Uriah Westbrook was not present.

building that housed his law practice, and a chattel mortgage on his art collection as security for the loan. Searcy believed that the collateral he offered would partially cover the amount of the debt. Searcy testified that he estimated the value of the art collection to be $50,000.00. Searcy testified that he informed the Westbrooks that the office building property had an existing mortgage. He testified that he did not tell the Westbrooks that the loan would be fully secured by the collateral offered. Sellers also offered a third mortgage on her home as security for the loan.[2] Searcy testified that the Westbrooks did not mention collateral for the loan, and the deal was accomplished with very little bargaining.

Marjorie and Uriah Westbrook agreed to make the loan to Searcy. Searcy executed a promissory note for $170,000.00 to Elgin Westbrook and Ruth Henderson, as Trustees for the Marjorie Westbrook Trust, on April 23, 1996. Searcy was to pay $850.00 per month for interest until the principal amount of the loan became due in January 1997. The loan was paid in two checks from the Marjorie Westbrook Trust account. The parties executed a mortgage note on May 4, 1996, which was secured by a mortgage on Searcy's office property and a chattel mortgage on his art collection.[3] Searcy recorded the mortgage on the real property, but did not record the chattel mortgage. Searcy testified that his mother and sister were responsible for packing the items in his art collection when he closed his law practice. He does not know where all of the articles are located, but some of them may be at his mother's home.

Searcy made ten of the $850.00 interest payments required by the loan, but defaulted on the

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[2]Searcy held the first and second mortgages on Sellers' home.

[3]The objects subject to the chattel mortgage were listed in Attachment "A" to the mortgage note. See Plaintiff's exhibit 3. Searcy testified that the list of items in attachment A was originally prepared for insurance purposes. Some the items listed in attachment A belonged to Searcy's parents, and therefore could not be pledged to secure the loan.

$170,000.00 principal payment. Searcy stated that he was aware of the rule of professional conduct regarding conflicts of interest when he solicited the loan from the Westbrooks.[4] He did not fully disclose the terms of the loans to his clients in writing, he did not give them an opportunity to seek independent counsel, and he did not get their consent in writing. He did not feel that the rule governing conflicts of interest applied because he was not actively representing the Westbrooks when he asked them for the loan.

Mr. Westbrook's account of the meeting in which Searcy asked for a loan differs from Searcy's account. According to Mr. Westbrook, when Searcy asked Mr. Westbrook for the loan, Mr. Westbrook told him that it would take some time for him to liquidate assets. Searcy explained that he needed the money quickly, and asked Mr. Westbrook if he thought his parents could loan Searcy the money. Mr. Westbrook replied that he did not know, but Searcy could ask his parents.

Mr. Westbrook said that Searcy told him that one of his employees had embezzled some money from his trust account and that he needed to replace the funds. Mr. Westbrook testified that his father asked Searcy the name of the person who embezzled the funds, and Searcy identified another employee who was Sellers' cousin. Mr. Westbrook said that Searcy intended to prosecute the employee and that she had been terminated. Mr. Westbrook would not have made the loan, as co-trustee of his mother's trust, if he had known that the employee who embezzled the funds was still employed with Searcy. Ruth Henderson, co-trustee for the Marjorie Westbrook Trust, also testified that she would not have agreed to make the loan to Searcy if she had known that Sellers was the embezzler and that she was still working with Searcy.

Mr. Westbrook stated that collateral for the loan was very important to his father, and that his father asked Searcy about the value of the collateral. Searcy told him that the art collection's value

[4]See Plaintiff's exhibit 5.

was approximately $100,000.00, and that the real property offered was worth approximately $100,000.00. Searcy did not mention any other encumbrances on his office building or Sellers' home. Mr. Westbrook testified that he did not request an appraisal or valuation of the property. He felt that there was not time.

Mr. Westbrook verbally agreed to guarantee the loan from his mother's trust to Searcy. The agreement was never reduced to writing. Mr. Westbrook stated that he would not have guaranteed the loan if he had known that Sellers was the employee who took the funds, and that she still worked for Searcy. According to Westbrook, Searcy paid the interest payments until November 1996. After the loan was made and the mortgage executed, Mr. Westbrook's siblings became concerned that Searcy would not repay the money. Ruth Henderson, co-trustee for the Marjorie Westbrook Trust, was especially concerned, and asked Mr. Westbrook to fulfill his promise to guarantee the loan. She and another brother filed suit in June 1996 against Elgin Westbrook for breach of his fiduciary duties as a trustee. Mr. Westbrook eventually repaid Searcy's loan to the Marjorie Westbrook Trust to avoid family conflict. The Trust then assigned its rights against Searcy to Elgin and Audrey Westbrook.

Searcy was convicted of perjury related to another case of Sellers' embezzlement. The perjury charge arose from an estate in which Searcy served as a personal representative. The estate was about to have its final settlement, and a final accounting was due for the estate. Searcy prepared the final accounting and mailed it in mid-March 1996, approximately two weeks before he discovered that Sellers had taken money from the estate. Due to Sellers' embezzlement, Searcy's final accounting was not accurate, and he had verified the information in the accounting with his signature. The falsity of the verified accounting were the basis for his conviction of perjury. The funds were restored to the estate by the time that the estate was closed. Searcy surrendered his license to practice law in Florida and closed his law office.

After Searcy's default, Mr. Westbrook liquidated the collateral which secured the loan. He testified that Searcy did not turnover all of items in the art collection which secured the loan. He was able to liquidate Searcy's office building and Sellers' home.

Sellers worked for Searcy from 1988 to 1996. She testified that she did take money from Searcy's trust account. She also testified that Searcy borrowed money from his trust accounts. Sellers confirmed that she was present when Searcy negotiated the loan from the Marjorie Westbrook Trust. According to Sellers, Searcy did tell the Westbrooks that he had terminated the employee who stole the funds, even though he knew that she stole the funds and that she was still employed with his office. He also assured them that the collateral offered would satisfy the loan. Even after discovering the embezzlement, Searcy allowed Sellers to write out checks, but would sign them himself.

CONCLUSIONS OF LAW

Section 523(a)(2)(A) of Title 11 does not allow a debtor to discharge a debt for money or property which was obtained by "false pretenses, a false misrepresentation, or actual fraud, . . .". To prevail under § 523(a)(2)(A), a creditor must show that: 1) the debtor made a false representation with the purpose and intention of deceiving the creditor; 2) the creditor relied on the representations; and 3) the creditor sustained a loss as a result of the representation. In re Bilzerian, 100 F.3d 886, 892 (11th Cir. 1996). In addition, the creditor must prove that its reliance was justifiable. Field v. Mans, 516 U.S. 59, 116 S.Ct. 437 (1995); In re Vann, 67 F.3d 277 (11th Cir. 1995). The standard of proof for such a claim is a preponderance of the evidence. Grogan v. Garner, 498 U.S. 279, 111 S.Ct. 654 (1991).

The Westbrooks allege that Searcy made two material misrepresentations while persuading them to make the $170,000 loan: first, that the person responsible for embezzling the funds from the account had been terminated, and secondly, that the collateral pledged to secure the loan would fully

satisfy the loan. Searcy admits that he told the Westbrooks that the person who stole the trust account funds had been terminated, but he maintains that the misrepresentation was not material to the Westbrooks' decision to loan the money.

While materiality is not explicitly stated as a requirement under 11 U.S.C. § 523(a)(2)(A), it is assumed that Congress did not intend "to bar discharge to a debtor who made unintentional and wholly immaterial misrepresentations having no effect on a creditor's decision" when enacting this code section. Field v. Mans, 516 U.S. 59, 68, 116 S.Ct. 437, 443 (1995). When approaching the Westbrooks for the loan, Searcy had to explain why he needed the funds and the urgency of getting the money quickly. He told the Westbrooks that he had fired the person responsible for the theft to show that he had taken control of the situation, and eliminated the person who posed a threat to his financial stability. Searcy could also disassociate himself from any wrongdoing by terminating all contact with the embezzler. Admitting that Sellers was the embezzler and explaining his plan to get records and further information from her by allowing her to continue in his employ would only have complicated his attempts to get the loan from the Westbrooks. It is logical to assume that the Westbrooks would have been reluctant to make the loan if they had known that Searcy was still associated with the person responsible for the theft. The Court therefore finds that Searcy's misrepresentation regarding termination of the person who embezzled funds from his trust account was a material misrepresentation. Searcy admitted that he made the misrepresentation. Mr. Westbrook testified that he would not have loaned the money to Searcy if he had known that Sellers was the person who embezzled the funds, which shows his reliance on the statement. Finally, Mr. Westbrook suffered a loss when Searcy defaulted on the loan, and he had to repay the trust.

The second representation at issue is the sufficiency of the collateral offered by Searcy to secure the loan from the Westbrooks. Searcy maintained that the collateral was not important in the

Westbrooks' decision to make the loan. He testified that it was barely discussed. Searcy denies that he told the Westbrooks that the collateral offered to secure the loan would fully satisfy the loan. He testified that he told the Westbrooks that the art collection was worth $50,000.00, and that his office building and Sellers' home had prior encumbrances. Mr. Westbrook testified that Searcy told him that his art collection was worth $100,000.00, and did not mention any prior liens on his office building or Sellers home. Debra Sellers and Ruth Henderson testified that Searcy told the Westbrooks that the collateral pledged would more than satisfy the loan.

Searcy asserts that the Westbrooks' reliance on Searcy's subjective valuation of his art collection was not justified. He also points out that the Westbrooks delivered the funds to Searcy before the security agreement was even executed. Under justifiable reliance, "'[j]ustification is a matter of the qualities and characteristics of the particular plaintiff, and the circumstances of the particular case, rather than of the application of a community standard of conduct to all cases.'" Field v. Mans, 516 U.S. 59, 71, 116 S.Ct. 437, 444 (1995) *quoting* The Restatement (Second) of Torts (1976), §545A, comment b. Mr. Westbrook testified that he did not request an appraisal of Searcy's office property because he did not feel that there was time. The same is probably true for an appraisal of the art collection. Although Mr. Westbrook appears to be an educated person, he felt pressured to get the funds to Searcy as soon as possible. Searcy had acted as Mr. Westbrook's attorney in the past, and had his respect and trust. Searcy failed to provide Westbrook with the protections outlined in Rule 4.18 of the Florida Rules of Professional Conduct which were designed to prevent this exact situation. Under these circumstances, the Court finds that Mr. Westbrook justifiably relied on Searcy's representations regarding the value of his real property and his art collection.

The Westbrooks brought this action as assignees and subrogees of the Marjorie Westbrook Trust. Searcy argues that the Westbrooks have no standing to recover as either assignees or

subrogees. As an assignee, Searcy claims that Mr. Westbrook is subject to his defense that Ruth Henderson and the elder Westbrooks relied on Elgin Westbrook's guarantee more than the representations made by Searcy. The extent to which the Westbrooks and Ruth Henderson relied on Elgin Westbrook's guarantee was not established at trial. Ruth Henderson testified that she would not have agreed to the loan from the trust if she had known that Sellers was the person who embezzled the funds from Searcy and that she was still employed by him. Her testimony shows at least partial reliance on Searcy's misrepresentation that he had terminated the person responsible for the theft. Partial reliance is sufficient to prohibit discharge under §523(a)(2)(A). See Matter of Seaborne, 106 B.R. 711, 714-15 (Bankr. M.D. Fla. 1989), citing Matter of Bonanza Import & Export, Inc., 43 B.R. 570, 576 (Bankr. S.D. Fla. 1984).

Searcy contends that the Westbrooks cannot claim status as subrogees of the Marjorie Westbrook Trust because subrogation is not available to those who voluntarily pay the indebtedness of another. Searcy maintains that Elgin Westbrook's oral offer to guarantee the loan to Searcy was not binding because it was not in writing as required by Florida's Statute of Frauds. Therefore, Mr. Westbrook's repayment of the Searcy loan was voluntary and not required by law. Searcy's argument ignores Elgin Westbrook's responsibility as a co-trustee of his mother's trust. Mr. Westbrook had been sued by his sister and brother for breach of his fiduciary duties as a co-trustee. It is clear that Mr. Westbrook had some liability in relation to the Searcy loan, and therefore was not a volunteer. See Watts v. Riley, 72 Fla. 126, 72 So. 646 (1916) (trustee who paid a mortgage on behalf of a church was not a mere volunteer).

At the close of the trial in this matter, the Westbrooks moved to amend their complaint to conform to the evidence and to include the Westbrooks individually. Searcy objected to the motion to amend. Bankruptcy Rule 7015(b) provides:

> When issues not raised by the pleadings are tried by express or implied consent of the parties, they shall be treated in all respects as if they had been raised in the pleadings. Such amendment of the pleadings as may be necessary to cause them to conform to the evidence and to raise these issues may be made upon motion of any party at any time, even after judgment; but failure so to amend does not affect the result of the trial of these issues. If evidence is objected to at the trial on the ground that it is not within the issues made by the pleadings, the court may allow the pleadings to be amended and shall do so freely when the presentation of the merits of the action will be subserved thereby and the objecting party fails to satisfy the court that the admission of such evidence would prejudice the party in maintaining the party's action or defense upon the merits. The court may grant a continuance to enable the objecting party to meet such evidence.

As noted by counsel for the Westbrooks, the parties stipulated that the Westbrooks were subrogees of the Marjorie Westbrook trust in their joint pre-trial statement.[5] In addition, Searcy did not object to any evidence offered as being outside the scope of the pleadings. Based on these facts, the Court finds that the Westbrooks' motion to amend their complaint should be granted.

Based on the foregoing, the Court finds that the relief sought in the Plaintiffs' complaint to determine dischargeability of a debt pursuant to 11 U.S.C. § 523(a)(2)(A) should be granted, and the debt owed by Searcy should be held to be non-dischargeable. The Plaintiff's motion to amend their complaint should also be granted. It is hereby

ORDERED that the relief sought in the Plaintiffs' complaint to determine dischargeability of a debt pursuant to 11 U.S.C. § 523(a)(2)(A) is **GRANTED**, and the debt owed by the Debtor to Elgin and Audrey Westbrook as assignees and subrogees of the Marjorie Westbrook Trust is **NON-DISCHARGEABLE**; and it is further

ORDERED that the parties provide the Court with a stipulated amount for damages so that a judgment may be entered in favor of the Westbrooks; and it is further

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[5]See Joint Pre-trial Statement, para. 16.

ORDERED that the Plaintiffs' motion to amend their complaint is **GRANTED**.

DATED: November ___, 2000

WILLIAM S. SHULMAN
U.S. BANKRUPTCY JUDGE