UNITED STATES BANKRUPTCY COURT
FOR THE WESTERN DISTRICT OF VIRGINIA
HARRISONBURG DIVISION

In Re: MICHAEL L. HELTON	)	
Debtor	)	**Chapter 13**
	)	**Case No. 04-51990**
SHENANDOAH WINDOWS INC.,	)	
Plaintiff	)	
v.	)	**Adversary Proceeding No. 05-05009**
MICHAEL L. HELTON	)	
Defendant	)	

DECISION AND ORDER

At Harrisonburg in said District this 5th day of May, 2006:

The matter before the court is the complaint of Shenandoah Windows, Inc. (hereinafter "Shenandoah") for exception to discharge pursuant to 11 U.S.C. § 523(a)(6). On November 21, 2005, the court conducted a trial on the complaint, with Shenandoah Windows appearing by counsel, and the Debtor appearing *pro se*. Following the trial, Shenandoah Windows requested, and the court granted leave until December 23, 2005, for both parties to file a Memorandum and Points of Authority addressing the issue of whether the proof presented at trial was adequate to establish Shenandoah Windows' claim of

nondischargeability pursuant to § 523(a)(6). Both parties have submitted memorandum, and the matter is ripe for adjudication.

BACKGROUND

On December 16, 2004, the debtor filed a Chapter 7 voluntary petition for relief. The debtor owned several business corporations, including Butterfly Dreams LLC, Sun-Glass Inc., For All Seasons LLC, and K-Mec LLC, which were included as trading names on the debtor's petition. These entities installed sunrooms and custom windows.

Prior to assuming an ownership position, the debtor was employed for twelve years by Shenandoah. The debtor purchased the assets of Shenandoah from its owner, Harvey Senger, in February 2003 for $455,000. The debtor paid $50,000 in cash and entered into seller financing with Senger for $405,000. The debtor collateralized the deferred purchase money with a deed of trust on his residence, and he executed security agreements on behalf of K-Mec, LLC for the assets transferred to this entities from Shenandoah. The debtor is the sole shareholder and manager of both K-Mec, LLC.

The debtor filed suit over a dispute for the purchase of Shenandoah, and sought a determination that his bank, Second Bank and Trust, held the first-lien position on the assets purchased from Shenandoah. Shenandoah cross-claimed against the debtor for a first-lien position on the debtor's residence and the security

agreements with K-Mec, LLC. During the pendency of the state court proceedings, the debtor sought permission from Shenandoah and Second Bank and Trust to sell certain assets of K-Mec, LLC, but was specifically denied permission by Shenandoah. The debtor liquidated the assets in spite of the denial of permission to sell them.

On November 1, 2004, the Circuit Court of Rockingham County found in favor of Shenandoah for $435,255.40 with interest at 8% from October 29, 2004 until paid (herein the Judgment). Shenandoah accepted a deed in lieu of foreclosure upon the debtor's residence, subject to two mortgages with a combined value of $160,000. Shenandoah was also found to have a perfected, first-in-priority lien on all inventory, machinery, tools and equipment, furniture and fixtures of K-Mec, LLC.

On March 8, 2005, Shenandoah filed the above captioned complaint seeking to except from discharge $40,000 of the Judgment against the debtor pursuant to 11 U.S.C. § 523(a)(4) & (6).[1] Shenandoah argues that the debtor as sole owner and manager of K-Mec, LLC, without regard for Shenandoah's right, and in direct contravention of Shenandoah's denial of permission, willfully and intentionally transferred, sold and/or concealed certain assets of K-MEC, LLC, failing to deliver the proceeds of such transfer or sales to Shenandoah.

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[1] The plaintiff appears to have dropped pursuit of nondischargeability under § 523(a)(4). *See* Trans. pp. 154-55.

Shenandoah pleads for the $40,000 figure as an estimate of the missing assets of K-Mec, LLC, which the debtor sold. The debtor denies that he failed to advise the plaintiff of the asset sales, and he states in his response to the complaint that a substantial sum from the sale of the assets of K-Mec, LCC, was in fact paid to Shenandoah.

At trial on November 21, 2005, the debtor testified that he sold collateral of K-Mec, LLC following Shenandoah's refusal of his request for permission to sell equipment and materials subject to the security agreement. The debtor testified that he remitted some of the proceeds to Shenandoah in three payments totaling $8,100.00, but that K-Mec also spent a portion of those proceeds. The debtor testified that some of the assets sought by Shenandoah were returned to the former owner Harvey Senger, while others were stolen, and the whereabouts of other assets were unknown.

Senger testified that several of the items in question were liquidated by the debtor for amounts below fair market value. Senger testified that leading up to the purchase the parties created a list of larger assets that were to convey from Shenandoah, but the list did not include a line item inventory. Trans. pp. 62-67. Senger also testified that a mutually agreed upon Shenandoah employee performed an inventory of materials which was used to establish the final sale figure, but that no line item inventory was prepared for each tool or piece of equipment that would transfer through the sale. Senger testified that the parties made a general

agreement that equipment used to operate the business of Shenandoah would convey in the sale.

In defending the diversion of cash receipts from sale of collateral the debtor offered the testimony of the bookkeeper, Barbara Shifflett. She testified that she was not privy to information that proceeds from the sale of assets were to be segregated from other cash receipts, and that they were not to be used to fund business operations. Thus, she deposited the check received in the mail from the purchaser of certain welders into the operating account. Shifflett testified that she met with the debtor approximately ten (10) days after depositing the check, at which time the debtor informed Shifflett that the check should not have been deposited. Shifflett testified that about half of the $11,700 deposit was disbursed for operations, and that the debtor removed the remaining funds from the bank account by cashiers check once he learned of the deposit. These funds were remitted to Senger.

The debtor admitted that he spent some of the proceeds from the sale of the welders, but denied that his acts to liquidate the equipment can be construed as evasive. The debtor offered evidence that he made an accounting of the receipts and expenses related to sale of the equipment. The debtor testified that prior to the state court trial the parties attempted to negotiate an escrow agreement to receive receipts from the sale of the business. However, due to a disagreement between the parties as to the amounts that should be paid into escrow and the amounts that

should be paid directly to Senger by the debtor, it was never executed.

In defending the allegation of missing items of collateral the *pro se* debtor elicited testimony from an employee, Peggy Simmons. She testified that after the debtor purchased Shenandoah from Senger, the debtor moved into a new building for use as the workshop and storage facility. Simmons testified that some of the assets in question, like the air compressor and racks, were transported to the new building but were not installed, either because they were damaged in transit or they were not needed in the new facility. Simmons testified that some equipment, like the air compressor, remained outside the new facility after it was damaged, and some items, like the racks, remained outside the new facility until they were transported away. Simmons testified that some of the equipment, like the siding break and nine-inch saw, were transported to job sites but did not return to the debtor's workshop facility. Simmons also testified that some equipment, like the carts, was loaded for transport at the old facility but she never saw it arrive at the new facility.

The debtor also testified that (1) the tiger stop and carts were sold and shipped to a company in Baltimore; (2) the air compressor deteriorated and became non-functional; (3) the racking was not standard for use generally in most retail applications and became obsolete following a change in shipping methods by vinyl siding suppliers; (4) some items were discarded at the landfill for an expense; (5) some items were left out for Senger to retrieve; and (6) some items never

returned to the workshop from the job site and the debtor assumed that they were stolen or fell off the work trucks.

Following closing arguments of Shenandoah, the court expressed concern that the plaintiff had not proffered sufficient evidence to satisfy the malice element of proof under 11 U.S.C. § 523(a)(6). The court asked the plaintiff to submit authority related to facts as presented that would prove malice. The court granted leave to file post-trial memorandum to the parties, and both parties complied.

LAW AND DISCUSSION

This court has jurisdiction over the parties and subject matter of this proceeding under 28 U.S.C. §§ 151, 157, and 1334. This is a case filed under title 11, and the court may hear and determine such proceeding under 28 U.S.C. § 157(b)(2)(I). Venue is proper in this District under 28 U.S.C. § 1409(a).

Pursuant to 11 U.S.C. § 523(a)(6), debts for willful and malicious injury by the debtor to the property or person of another are nondischargeable.[2] In order to prevail under § 523(a)(6), the plaintiff must carry the burden of proof by a preponderance of the evidence. Grogan v. Garner, 498 U.S. 279, 291 (U.S. 1991).

The Supreme Court of the United States addressed the issue of nondischargeability under § 523(a)(6) in Kawaauhau v. Geiger, 523 U.S. 57 (U.S.

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[2]

> A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title [11 USCS § 727, 1141, 1228(a), 1228(b), or 1328(b)] does not discharge an individual debtor from any debt--for willful and malicious injury by the debtor to another entity or to the property of another entity . . . .

11 U.S.C. §523(a)(6).

1998). In its analysis of the plain wording of the statute, the Geiger Court determined that the word "'willful'. . . modifies the word 'injury'". Geiger, 523 U.S. at 61. The Court segued into a conclusion that "nondischargeability takes a deliberate or intentional injury, not merely a deliberate or intentional act that leads to an injury." *Id*. This conclusion clearly springs from the Court's estimation of the term "willfull". However, the Geiger court does not explicitly state whether "willfull" and "malice" remain separate prongs for inquiry as in the past[3] or whether "willful and malicious" constitute a compound adjective modifying "injury" as a single unit. Miller v. J.D. Abrams Inc. (In re Miller), 156 F.3d 598, 606 (5th Cir. 1998). Further, The Geiger Court did not analyze the role of the term "malice" in the statute, and at least one Circuit has reasoned that the post-Geiger test for "willful and malicious injury" is a single inquiry. Williams v. IBEW Local 520 (In re Williams), 337 F.3d 504 (5th Cir. 2003) (finding failure to obey a court order is willful and malicious conduct excepted from discharge). Having adopted the implied malice standard for nondischargeability under § 523(a)(6) for the Fifth Circuit, the Williams Court noted that a debtor acts with implied malice when he acts "with the actual intent to cause injury", which is the same conclusion the Geiger court reached to define willful injury.

The Fourth Circuit has not reached the issue whether to merge the separate

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[3] *See e.g.*, In re Hodges, 4 B.R. 513, 516 (Bankr. W.D. Va. 1980).

prongs of inquiry for willfulness and malice for nondischargeability under § 523(a)(6). Thus, after Geiger, the task for this court remains to analyze the acts of the debtor and determine if they rise to the level of willful and malicious injury as interpreted by Geiger and standing case law. In re Bundick, 303 B.R. 90, 110 (Bankr. E.D. Va. 2003). At the end of the day, Geiger stands for the premise that in order to satisfy the requirements of § 523(a)(6), the plaintiff must plead and prove that the debtor engaged in acts that caused an injury to the plaintiff, and (a) that the debtor acted willfully, with actual intent, objective or subjective, to cause injury to the plaintiff, where the harm was not merely the result of negligent or reckless acts of the debtor, and (b) that the debtor acted with malice. In re Bundick, 303 B.R. at 114-117.

As to the malice element, it is assessed under a subjective intent standard in the Fourth Circuit, and can be implied from the debtor's actions. Power v. Robinson (In re Robinson), 2006 Bankr. LEXIS 497 (Bankr. E.D. Va. 2006) (quoting J. Tice's reiteration of the implied malice standard, post-Geiger, in Johnson v. Davis (In re Davis), 262 B. R. 663, 670-71 (Bankr. E.D. Va. 2001)). According to the Fourth Circuit, "malice," does not mean the same thing in Section 523(a) that it often does in other contexts. A debtor may act with malice even though he bears no subjective ill will toward, and does not specifically intend to injure, his creditor. First Nat'l Bank v. Stanley (In re Stanley), 66 F.3d 664, 667 (4th Cir. 1995). In the bankruptcy context, the plaintiff may imply malice on the

part of the debtor for acts that the debtor committed "deliberately and intentionally in knowing disregard of the rights of another". First Nat'l Bank v. Stanley (In re Stanley), 66 F.3d 664, 667 (4th Cir. 1995) (citing St. Paul Fire & Marine Ins. Co. v. Vaughn, 779 F.2d 1003, 1010 (4th Cir. 1985)).

Rarely, will a debtor admit that his acts were performed with a "depraved heart" or with substantial certainty that his acts would cause harm to his creditors. Thus, the case for maliciousness or implied malice needs to be proven with circumstantial evidence. In the case at bar, the plaintiff conducted in-depth examinations of the debtor and Senger at trial. The court assessed all of the testimony and evaluated the demeanor of the witnesses. In this case the direct evidence shows that the debtor acted deliberately in knowing disregard of the rights to the collateral possessed by Senger.[4] Nevertheless, other evidence indicates that debtor did not sell with intent to deprive Senger of the value of his collateral.

As to the willful injury element, the Geiger court noted that a willful injury subject to nondischargeability under § 523(a)(6) should "trigger in the lawyer's mind the category 'intentional torts'", as opposed to the category of reckless or negligent torts. However, the Supreme Court stopped short of a *per se* rule to define a § 523(a)(6) injury as any act which satisfies the elements of an intentional

[4] For example, Senger's right to realize on the collateral under his contract and the U.C.C. in the event of a default. Clearly, debtor knew Senger had asserted rights in the collateral, otherwise, he would not have asked for permission to sell the collateral.

tort at state law. The Court reasoned that such a definition would be too broad as to exempt from discharge merely intentional acts that lead to an injury, which is counter to the "well known guide that exemptions to discharge should be confined to those plainly expressed [by Congress]." Geiger, 523 U.S. at 62. Further, such judicial legislating would subvert the prerogative of Congress to decide which injuries are nondischargeable in Bankruptcy because a *per se* rule for interpreting injuries under § 523(a)(6) may well have rendered superfluous § 523(a)(9) (nondischargeability for injuries caused while illegally driving under the influence) and § 523(a)(12) (nondischargeability for reckless and malicious failure to fulfill certain commitments to federally insured banks). *Id*. Nor has the Fourth Circuit defined a state of mind that satisfies the § 523(a)(6) "willful" standard. *See* E.L. Hamm & Assoc., Inc. v. Sparrow (In re Sparrow), 306 B.R. 812, 837 (Bankr. E.D. Va. 2003)

Decisions of this court hold that a deliberate or intentional act is a willful act, but not necessarily a willful and malicious injury exempt from discharge under § 523(a)(6). *See* Brown v. Brown (In re Brown), 331 B.R. 243, 249 (Bankr. W.D. Va. 2005). Again, the Geiger ruling compels the court to conduct an inquiry into willfulness beyond whether the act causing the injury was merely voluntary, but rather requires a finding that the debtor intended the injury, or was substantially certain injury would occur. Johnson v. Dade (In re Dade), 296 B.R. 388, 392 (Bankr. E.D. Va. 2001). Further, a court called upon to determine the

nondischargeability of a judgment debt based on willful and malicious injury, as requested here, should look to the entire record to determine the wrongfulness of the act. 4 COLLIER ON BANKRUPTCY P 523.12[3] (Alan N. Resnick & Henry J. Sommer eds., 15th ed. rev.).

In this case, the debtor admits that his actions were voluntary and that he intentionally disregarded the denial by Senger and Shenandoah of permission to sell assets of the business securing liens held by Shenandoah. However, the plaintiff has not shown by a preponderance of the evidence that the debtor acted with actual objective or subjective intent to cause injury to the plaintiff when he liquidated the collateral and spent half of the cash receipts from the sale on business operations. At the conclusion of statutory analysis the court must apply meaning of all the words of the statute to the facts of the case. Debtor's act of selling the assets was deliberate. But that is not sufficient to deny discharge.

The subjective state of the debtor's mind during the acts in question is evidence that actual or subjective intent to cause an injury is absent. According to the debtor's testimony, at the time of the asset sales the company was on shaky ground, but it was not his intention to keep the money, and he forwarded to Senger a cashier's check for the remaining sales proceeds once his bookkeeper notified him of the failure to segregate the funds from the sale of the assets.[5] The court is

[5] Even the plaintiff acknowledged that the company was running on a "wing and a prayer." Trans. p. 152.

satisfied that the debtor did not sell the assets with the intent to divert proceeds from Senger thereby causing him loss. Debtor's failure to properly safeguard all sales proceeds may have been negligent but it was not in the nature of an intentional tort.

Many of the cases where the implied malice standard seems to fit contain facts showing the debtor committed actual conversion of funds or property, and find that the "wrongness" of the act should preclude the dishonest debtor from a discharge of debt. *See e.g.*, In re Lee, 90 B.R. 202, 208 (Bankr. E.D. Va. 1988) (finding nondischargeability for conversion of bonus fund and failing to disclose entity liens); *Cf.* Robbins v. Chase Manhattan Bank, N.A., 1993 U.S. Dist. LEXIS 11278 (W.D. Va. 1993) (finding that the debtor had made the subjective decision to keep the partnership funds he received when he knew that he was not entitled to them, and that he spent them on personal expenses, including insurance for his children's trust funds and Super Bowl tickets). *See generally* Davis v. Aetna Acceptance Co., 293 U.S. 328, 332 (U.S. 1934) (finding that a conversion which is innocent or technical without wilfulness or malice or other "aggravated features" is dischargeable).

Here, the debtor admits that he sold the assets after being denied permission by Senger to do so, but the debtor claims that he acted with the belief that Second Bank and Trust, which neither gave or withheld permission to sell the assets, was in the first-lien position. This act was intentional, but there is insufficient proof of

"knowing" disregard of Senger's rights. Proceeds from asset sales ended up in the firm's general account. There is no evidence that the debtor knew this happened until after the fact. He may not have properly instructed his bookkeeper but the closest that this gets to willfulness is that debtor is liable on an agency theory for the willful act of his bookkeeper in depositing the funds. There is no evidence that debtor withdrew these funds for personal use and there is evidence that he did not know of their business use until after the fact. Here is where the debtor could have blatantly acted intentionally with an aim to injure the plaintiff, but he did not. When he discovered the error, he treated the funds as if he were disbursing them from an escrow account by certified bank check to Senger. Thus the debtor's belief about lien priority and his remittance of funds to Senger persuade the court that willful and malicious injury has not been proved.[6]

As to the sale of assets for amounts far below market costs, the plaintiff failed to persuade the court of the fair market value of the assets at their time of sale, and thus failed to show the debtor intended to liquidate them below market values in an attempt to injure the plaintiff.[7]

CONCLUSION

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[6] As the Stanley decision, *supra*, states "although a person need not know that someone else has superior ownership rights in the property to be technically liable for the tort of conversion . . . St. Paul's test for malice requires such knowledge on the debtor's part before discharge will be denied - - in . . . other words, the debtor must have engaged in a "wrongful" conversion." Stanley, 66 f.3d at 668.

[7] In the development of evidence of value, Senger appeared more informed about the nature and classes of the assets liquidated by the debtor. However, the debtor was successful in his *pro se* case to show that many of the assets were irregular or significantly aged as to avoid accurate valuation as advocated by the plaintiff.

For the foregoing reasons it is

ORDERED:

That Shenandoah Window's complaint for nondischargeability pursuant to 11 U.S.C. § 523(a)(6) is DENIED.

Copies of this Order are directed to be sent to the Debtor, Michael Helton, 1790 Dealton Avenue, Harrisonburg, VA 22801; Counsel for the Plaintiff, Bill E. Shmidheiser III, Esq., Keeler Obenshain, 90 North Main Street, Suite 201 Harrisonburg, VA 22803; and to the Counsel for the Chapter 7 Trustee, Dale A. Davenport, Esq., 342 South Main Street, Harrisonburg, VA 22801.

Ross W. Krumm

Ross W. Krumm
United States Bankruptcy Judge