

In the United States Bankruptcy Court

for the Northern District of Iowa

DONALD LEE BREEDEN and JUDITH LOUISE
BREEDEN

Debtor(s).

Bankruptcy No. X90-00490F

Chapter 7

FARMERS NATIONAL BANK OF WEBSTER CITY

Plaintiff(s)

Adversary No. X90-0112F

vs.

DONALD LEE BREEDEN and JUDITH LOUISE
BREEDEN

d/b/a B & J Enterprises

Defendant(s)

The Farmers National Bank of Webster City (BANK) asks that debtors' debt to it not be discharged and that debtors be denied discharge of all debts. Trial was held on April 19, 1991 in Fort Dodge. This is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(I) and (J).

I.

Donald L. Breeden and Judith L. Breeden, husband and wife, formed a partnership known as B & J Enterprises for the purpose of selling used cars. Donald also operated a garbage and trash collection business. The latter was incorporated as Breeden Clean Service. Donald was president of the company; Judith was its secretary.

Breedens and the business entities were customers of Farmers National Bank of Webster City. Bank loaned B & J Enterprises (B & J) approximately \$11,000.00 in June of 1988 to purchase used car inventory from another dealer. Several documents were executed as part of the loan transaction. These included note number 428169 and security documents. The evidence is incomplete as to the obligor on the note. The accompanying security agreement was executed by the Breedens on behalf of B & J and on behalf of Breeden Clean Service. This was because not only did B & J pledge the auto inventory as security for the debt, but Breeden Clean Service pledged its interest in a "1975 Ford 13-ton VIN #F70EVV51836" truck as security for the loan. Breedens also executed an "Hypothecation Agreement" by which Breeden Clean Service authorized use of the truck as collateral for bank's loans to B & J.

Donald Breeden cannot say how it happened that the Ford truck was used as collateral as he says he had not owned the truck since 1978. Breedens raised the possibility that the description of the truck had not yet been typed on the security agreement (exhibit 9) or the Hypothecation Agreement (exhibit 10) when they signed, but neither gave strong testimony on this point. Bank loan officer Charles M. Willms testified that the descriptions were there and that the title to the vehicle was delivered at the loan closing on June 30, 1988. Willms says the bank still has the title although, inexplicably, the truck had been sold before the closing. Donald Breeden cannot explain how a "dead title" would have been given to the bank. The court finds that at the time of their execution by Breedens, the security agreement (exhibit 9) and the Hypothecation Agreement (exhibit 10) contained a description of the 1975 Ford 13-ton truck. Bank never had its lien noted on the title to the truck, nor is there evidence it attempted to prior to January 17, 1989.

Subsequent to the loan closing and the purchase of the used vehicles, Judith Breeden delivered the vehicle titles to the

bank where they were kept in the bank's files. As the vehicles were sold, proceeds were applied to the debt, and the bank released its possession of the titles for transfer by B & J to the buyers. Fifteen vehicles had been purchased by B & J. After some sales, it was obvious to the bank and Breedens that the application of sales proceeds was not sufficiently reducing the debt so as to keep the value of the remaining vehicles at a greater amount than the loan balance.

To shore up the bank's secured position, bank agreed to take a security interest in a 1985 Cadillac DeVille and to release the possession of the remaining used car titles. There is a dispute as to who initiated this transaction. Donald Breeden testified that the bank asked for more collateral, and the Breedens offered the cadillac. Willms says the exchange of collateral was Breedens' idea. The dispute is not significant.

Title to the Cadillac was in the name of B & J. The parties dispute whether Breedens disclosed to Willms that the cadillac was actually owned by Donald Breeden's son Donald J. Breeden. Breeden claims he told Willms that although the Cadillac was titled to B & J, it was actually owned by his son. Willms testifies that he did not learn this until after the bank had released the title so Donald Breeden could sell the vehicle at auction.

It appears inferentially from the evidence that as part of the transaction in which the Cadillac was pledged, bank renewed note number 4281679. This note was renewed on January 17, 1989. Donald was not available for the signing so it was handled by Judith who had authority to sign Donald's name. Judith had gone to the bank to deliver the title to the Cadillac. She had not expected to sign any documents, but did so at the request of Willms. There had been no prior indication by Willms to the Breedens that documents would be signed that date. Nonetheless, with her general authority to sign on behalf of her husband, Judith signed a renewal note and a security agreement. The note (number 428660) was in the amount of \$6,918.42. It was to mature in about six months and carried an interest rate of 13 per cent. It referred to a security agreement of the same date. The agreement granted bank security interests in a 1977 GMC truck, a 1977 Chevrolet pickup truck, the 1975 Ford 13-ton truck, and the 1985 Cadillac DeVille. The documents were executed by Judith for herself, Donald, and B & J. No new cash was advanced at the time of the renewal.

Bank's lien was never noted on the title to the Cadillac, but it held the title certificate which had been delivered by Judith Breeden. Sometime later, the bank was asked to surrender possession of the title so the vehicle could be sold at auction in Des Moines.

Willms understood that the proceeds of sale were to be applied to the note. Donald Breeden testified that this was also his understanding. But the parties disagree as to who requested the release of the title and who picked it up at the bank. Willms testified that he gave it to a loan technician to give to Breeden. He assumed it was Donald L. Breeden as he had seen him that day at the bank. Donald says he did not go to the bank and that the title was picked up by his son, Donald J. Breeden. Having heard the two witnesses' testimony about this event, the court finds that Donald L. Breeden's testimony is more reliable. Willms conceded he personally did not surrender the title and was not exactly sure to whom it was given. The court finds that the bank surrendered the title certificate to Donald J. Breeden, the debtors' son.

Donald J. Breeden sold the Cadillac, but did not turn the sales proceeds over to his father or the bank. There was no evidence as to the actual sales price of the car. Willms called Donald about the sale. Breeden says he tried to explain that the son had sold the car but was not returning with the proceeds. Breeden offered the bank a security interest in two other vehicles--a 1979 Cadillac and a 1981 Seville. Willms turned the offer down because he felt the bank could not be sure of their value.

No part of note number 428660 has been paid. Unpaid principal is \$6,918.42. This amount has accrued interest at 13 per cent since January 17, 1989. As of June 26, 1991, accrued simple interest amounts to \$2,195.48.

II.

Bank argues that Breedens' debt to it (the balance due on loan no. 428660) should not be discharged for three reasons. First, because Breedens obtained the loan and the renewal of the loan by pledging as security a 1975 Ford 13-ton truck which they knew they did not own. Bank argues that this was fraud warranting non-dischargeability of the debt pursuant to 11 U.S.C. § 523(a)(2)(A). Second, bank asserts that the security documents granting the security interest in the Ford truck constituted false financial statements rendering the debt non-dischargeable pursuant to 11 U.S.C. § 523(a)(2)(B). Third, bank contends that Breedens fraudulently obtained release of bank's possession of the title to the 1985 cadillac by

agreeing to pay the proceeds of the sale of the vehicle over to the bank. Since proceeds were not turned over, bank claimed that Breedens secured the release of the property by false representation or actual fraud. Thus, bank argues, the indebtedness secured by the Cadillac, also note no. 428660, should not be discharged under 11 U.S.C. § 523(a) (2) (a).

Finally, bank contends that debtors should be denied discharge because defendants transferred the 1985 Cadillac to Donald J. Breeden With an intent to hinder, delay or defraud the plaintiff.

The burden of proof with regard to these allegations is upon the bank; the standard of proof is preponderance of the evidence. Grogan v. Garner, ___ U.S. ___, 111 S.Ct. 654 (1991).

Debtor may be denied discharge of a debt if it is shown that he or she obtained "money, property, services, or an extension, renewal, or refinancing of credit . . . by false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's . . . financial condition" 11 U.S.C. § 523(a) (2) (a).

Bank must prove that debtors falsely represented material facts, that at the time the representations were made, the debtors knew they were false, that debtors made the representations with the intent to deceive the creditor, that the creditor relied on the misrepresentations, and that the creditor sustained damage as a result. J. C. Penney Co., Inc. v. Bonefas (In re Bonefas), 41 B.R. 74, 78 (Bankr. N.D. Iowa 1984). On June 30, 1988, when Breedens, for B & J, obtained a loan from the bank, they pledged as collateral a motor vehicle purportedly owned by Breeden Clean Service. At the time of the pledge, the vehicle was no longer in possession of the clean service as it had been sold. The court does not find credible debtors' testimony that they were not aware the vehicle was being pledged. Donald L. and Judith L. Breeden pledged the vehicle as collateral in order to obtain the bank loan knowing Breeden Clean Service no longer possessed or owned the truck. The representations of ownership implicit in the hypothecation agreement and in the security agreement were false both at the time the loan was obtained in June, 1989, and at the time it was renewed in January of 1989.

Bank, however, has failed to prove that it relied on the misrepresentation of the debtors. There is no evidence that a bank representative ever looked at the truck or asked to look at it, or gave any thought to its value. Bank never attempted, prior to the renewal of the loan, to have its lien noted on the certificate of title. Bank asserted in the "Pretrial Statement" filed in this case that it based the loans upon financial statements executed on January 27, 1987, February 26, 1988, and March 31, 1988. (P. 4, ¶ 2.) None of these listed the truck. Bank loan officer Willms testified that bank would not have given Breedens the money in January of 1989 without being given the truck as security. However, no new money was advanced on that date. The bank has not proven that the taking of a security interest in the 1975 Ford 13-ton truck was a substantial factor in making or renewing the loan.

III.

The bank, having failed to prove reliance under 11 U.S.C. § 523(a)(2) (A), has failed also to prove reliance, much less reasonable reliance, under 11 U.S.C. § 523(a)(2) (B). The court need not reach the issue of whether the hypothecation agreement or security agreement were "statement(s) in writing . . . respecting the debtors' . . . financial condition" under 11 U.S.C. § 523(a) (2) (B) .

IV.

Bank asserts that Breedens fraudulently obtained release of the title of the 1985 Cadillac DeVille by misrepresenting their intent to turn the proceeds of sale of the vehicle over to the bank. The court, having heard the evidence, finds there is insufficient evidence that at the time the release of the title was requested, Breedens had no intent to turn the proceeds over to the bank. The court, therefore, finds no fraud by the debtors in obtaining the release of the certificate of title.

V.

Bank seeks a denial of debtors' discharge on the grounds that debtors transferred the 1985 Cadillac DeVille to Donald J. Breeden with intent to hinder, delay or defraud the bank.

The 1985 Cadillac DeVille was titled in the name of B & J. There has been little explanation of why it was so titled if it

was owned by Donald J. Breeden. If it had been owned by B & J, there was no explanation of why Donald J. Breeden took the initiative to sell the vehicle at auction or why he was able to keep the proceeds. There is little or no evidence regarding whether the debtors consented to the sale or evidence as to who signed the transfer of title when the vehicle was sold. On the whole, the court concludes that there is insufficient evidence to deny the debtors' discharge on the grounds that they transferred the 1985 Cadillac DeVille to Donald J. Breeden with intent to hinder, delay or defraud a creditor. Plaintiff has failed to meet its burden of proof on denial of discharge.

ORDER

IT IS ORDERED that the complaint of Farmers National Bank of Webster City against Donald L. Breeden and Judith L. Breeden is dismissed. Judgment shall enter accordingly.

SO ORDERED ON THIS 27th DAY OF JUNE, 1991.

William L. Edmonds
Bankruptcy Judge