In the United States Bankruptcy Court

for the Northern District of Iowa

MARK WILLIAM KAUFMAN Debtor.	Bankruptcy No. 94-20551KD Chapter 7
CUMIS INSURANCE SOCIETY, INC. Plaintiff vs. MARK WILLIAM KAUFMAN Defendant.	Adversary No. 94-2070KD
DEAN ROBEY Plaintiff vs. MARK WILLIAM KAUFMAN Defendant.	Adversary No. 94-2094KD

ORDER

On June 28, 1995, the above-captioned matters came on for trial in Dubuque pursuant to assignment. Debtor Mark Kaufman was represented by Robert Klauer and James Reynolds. Cumis Insurance Co. was represented by Chad Leitch. Attorney Jennifer Clemens represented Dean Robey. After the presentation of evidence, the Court took the matter under advisement. The deadline for filing briefs has now passed and these matters are ready for resolution. This is a core proceeding pursuant to 28 U.S.C. 157(b)(2)(I).

STATEMENT OF THE CASE

Trial in this matter involves two separate adversary proceedings arising out of a series of interrelated facts. Cumis Insurance Society, Inc. filed its adversary proceeding against Defendant/Debtor Mark William Kaufman on June 16, 1994. Cumis asserts that under 11 U.S.C. 523(a)(2) Debtor's oligation to Cumis should be excepted from discharge. The allegations in the petition assert Debtor wrote two checks on the East Dubuque Savings Bank in the amounts of $27,000 and $5,000 respectively. These checks were returned for insufficient funds. Eventually, Cumis Insurance Company paid off the loss to East Dubuque Savings Bank at which time it was subrogated to the rights of the Bank. Cumis claims that Debtor was engaged in a fraudulent check kiting scheme. It states that its total loss is $31,539.72 and this amount should be determined to be nondischargeable under 523(a)(2).

The second petition involves interrelated facts which occurred about the same time. This adversary was filed July 20, 1994 by Plaintiff Dean Robey, a resident of Dubuque, Iowa. Robey is involved in the real estate business and is an acquaintance of Defendant/Debtor Mark W. Kaufman. He asserts that on two separate occasions, Debtor tendered checks each drawn in the amount of $5,000. Robey gave Debtor cash on each occasion. The checks were subsequently presented to the bank and returned as insufficient fund checks. Robey asks that these obligations should be excepted from discharge pursuant to 523(a)(2)(A) and further asks the Court to enter a judgment in the amount of the total loss of

$10,000 plus interest and costs.

Debtor denies the allegations of the claims of Plaintiffs Cumis Insurance Society, Inc. and Dean Robey. He asserts that he was a victim in certain business and financial transactions which were unsuccessful and that he lost substantial amounts of money in these various ventures. Debtor claims that while there were insufficient funds in the accounts when the various checks were drawn, it was not his intention to defraud anyone. He states it was his intention to deposit funds to cover the checks as soon as anticipated funds became available.

FINDINGS OF FACT

Debtor Mark Kaufman has lived in Dubuque, Iowa most of his life. He was employed by Federal Express in Dubuque from February of 1988 until August of 1992. During this time, he was introduced to an individual named Richard McGillign by acquaintances in Dubuque. Richard McGillign also went by the name of Richard Starr ("Starr").

Starr represented himself as an individual residing in California with substantial contacts in the entertainment industry. He represented and people accepted his representations that he was in Dubuque for reasons involving the filming of a movie. There were also representations relating to the purchase of real estate for night clubs similar to Planet Hollywood as well as discussion of investments in book and movie rights.

A surprising number of individuals in the Dubuque area accepted Starr's representations without an inordinate amount of curiosity or research into his background. It is uncontested that various individuals lost substantial amounts of money to Starr during these years. Debtor was among those who were apparently seduced by the possibility of great financial reward.

Attempting to define these various elusive financial representations is extremely difficult. Debtor provided few explanatory details as to the exact relationship of all the parties. At various junctures, Debtor described himself as a gofer who did various tasks for Starr in the Dubuque area. No written documentation exists as to their precise business relationship. There also exists no written documentation as to the amount of money which Debtor gave or paid to Starr over the course of several years. Debtor asserts that, in total, he paid Starr between $50,000 and $75,000 based solely on Starr's representation that when a deal was closed for the purchase of various movie or book rights, substantial amounts of money would be paid and the various investors, including Debtor, would realize tremendous profits. Throughout this entire time, no specific terms were ever agreed upon between Starr and Debtor.

Despite the interesting and rather peculiar nature of the foregoing facts, they merely provide a backdrop for what happened in May and June of 1992. By May of 1992, many of the individuals involved had tired of this investment and were becoming disenchanted because little, if anything, had been realized out of their various investments. Debtor, however, continued to be optimistic that some return would be forthcoming. Debtor testified that Starr indicated that the end was in sight and that at least one of these deals, involving Stephen Spielberg and Amblin Entertainment, was going to be finalized. However, in order to finalize this deal, Starr needed expense money. Starr represented to Debtor that he was in California and needed money. Debtor states that he told Starr, "I'm busted. I'm flat busted and can't be trusted." However, Debtor had, according to his calculations, a substantial investment in this series of transactions. He felt that if he could hold on and provide Starr with a final cash infusion, the deal would be closed and he would not only be paid back his investment but receive a substantial profit on this transaction.

Debtor had checking accounts at three institutions: East Dubuque Savings Bank, Federal Express Credit Union, and DuTrac Community Credit Union in Dubuque. Debtor testified that he wanted to protect his investment as best he could and proceeded to accumulate funds purportedly to be paid to Richard Starr to finalize the California transactions. Between May 27, 1992 and June 17, 1992, a series of check transactions occurred which formed the basis for these two adversary proceedings.

On May 27, 1992, Debtor wrote a $5,000 check on his East Dubuque Savings Bank account payable to the Federal Express account. On June 1, 1992, Debtor wrote a check on the Federal Express Credit Union account payable to the East Dubuque Savings Bank and himself. On June 3, 1992, Debtor wrote a check on the East Dubuque Savings Bank account payable to the Federal Express account in the amount of $27,000. On the same date, he wrote a $27,000 check drawn on the Federal Express Credit Union account payable to DuTrac and himself. On June 8, 1992, Debtor wrote a check on his East Dubuque Savings Bank account payable to the Federal Express account in the amount of $5,000. On June 11, 1992, Debtor withdrew $26,000 from the DuTrac Community Credit Union in the form of a check made payable to himself. Also, on June 11, 1992, Debtor wrote a check on the East Dubuque Savings Bank account to himself in the amount of $31,000.

Eventually, the June 3, 1992 check written on the East Dubuque Savings Bank account in the amount of $27,000 to the Federal Express Credit Union was returned for insufficient funds. Also, the June 8, 1992 check written by Debtor on the East Dubuque Savings Bank account to the Federal Express account in the amount of $5,000 was also returned for insufficient funds. It is these two checks which Cumis asserts constitute the damage alleged in its adversary proceeding. It also assert that these various transactions constitute a continuous loop and were all transfers made without adequate funds being present. East Dubuque Savings Bank was the institution at the end of the loop when the kite scheme crashed and was, therefore, left without recourse and eventually suffered the loss.

A second series of transactions involves a series of checks drawn between Defendant/Debtor Mark Kaufman and Plaintiff Dean Robey. The relationship of Robey to this entire series of events is in dispute. At most if not all of the times relevant to this series of transactions, Robey was a realtor working for Remax Realtors in Dubuque, Iowa. Kaufman claims that Robey is and was a successful real estate agent intimately involved in the investments with Starr. Robey testified, however, that his relationship with Starr was purely professional. He testified that he was only involved with Starr in attempting to sell several parcels of real estate to Starr for residential purposes or business purposes involving a night club. For reasons which appear largely irrelevant, neither transaction was closed. Robey testified that beyond this business relationship, he had no financial interest or investment in any of these transactions. He also testified that his relationship to Kaufman was not based on dealings with Starr. Robey testified they were friends since high school and that he trusted Kaufman. Again, these facts are relevant only to provide a background to what subsequently transpired.

On June 6, 1992 and again on June 11, 1992, Debtor went to the offices of Robey. He informed Robey that his money was in an out-of-state checking account and that he needed immediate cash. On June 6, 1992, Debtor wrote Robey a $5,000 check on the Federal Express Credit Union in Memphis, Tennessee. In exchange, Robey gave Debtor $5,000 in cash. Again, on June 11, 1992, Debtor approached Robey and an identical transaction occurred. Both checks were eventually returned for insufficient funds during June of 1992. This $10,000 forms the basis for Plaintiff Robey's claim against Debtor Kaufman.

The foregoing facts are undisputed. However, Debtor asserts that Robey was not merely a real estate agent but was more actively involved in the transactions involving Richard Starr. Kaufman also contends that he informed Robey of what was occurring with the closing of the business deal in California. Most importantly, he testified that he advised Robey that he did not have funds in his checking account to cover these two $5,000 payments. He testified that these were loans and that in lieu of promissory notes, he wrote these checks to Robey which were to be held until the financial dealings were closed in California and the checks could be covered. He testified that it was agreed between himself and Robey that these checks would not be presented for payment in the immediate future.

Robey testified, however, that he had no relationship with Starr beyond that of real estate agent and client. He testified that Debtor approached him as a friend and long time acquaintance representing that he had sufficient money in an out-of-state checking account to cover these two checks but that he needed immediate cash. Robey testified that when the

first transaction occurred on June 6, 1992, he was given the bank account number and telephone number of the Federal Express Credit Union in Tennessee. He testified that he called the Credit Union and was advised that the checking account contained $27,000. Based upon this information, Robey proceeded to give Debtor the $5,000 in cash. He testified that the transaction on June 11, 1992 was identical except that, based upon his prior call, he did not feel that it was necessary to again call the Bank to determine if there were adequate funds in the Federal Express account. Additionally, at this time, the first check had not yet cleared the Bank nor been returned for insufficient funds. Robey testified that he assumed, based on this entire set of facts, that not only was the first check good but that the second check would also clear without problems because Kaufman had $27,000 in this account less than a week earlier. Finally, Robey testified that these were not loans as alleged by Debtor but were checks which were to be immediately negotiated to replace funds taken out of Robey's personal account.

Debtor does not dispute that he was aware that there were insufficient funds in the respective banking institutions at the time the checks, which constitute the basis of these two adversary proceedings, were drawn. What Debtor does contest is that he ever intended to defraud anyone. He asserts that he fully intended to deposit the money which he believed would be forthcoming from Starr after the closing of the Stephen Spielberg transaction in California. Debtor testified that he expected Starr to return both Robey's money and the money he gained through cashing the checks at East Dubuque Savings Bank within a few days. He testified that he was in constant contact with Starr during early June and he was continually reassured by Starr that the money would arrive soon. He further testified that he now understands that Starr did not intend to complete any of these transactions. He further asserts that he also was a victim in that Starr took his investment with no intention of returning the money he forwarded to him in June of 1992 nor the more than $75,000 of his own funds which he had previously invested. Debtor states that because of Starr, he lost all of his savings, his property, and his employment and was forced to file for bankruptcy relief.

CONCLUSIONS OF LAW

Plaintiffs have the burden to prove the elements of their claims under 11 U.S.C. 523 by a preponderance of the evidence. Grogan v. Garner, 498 U.S. 279, 111 S. Ct. 654, 661 (1991). Exceptions to discharge must be "narrowly construed against the creditor and liberally construed against the debtor. These considerations, however, 'are applicable only to honest debtors.'" In re Van Horne, 823 F.2d 1285, 1287 (8th Cir. 1987).

Both Cumis and Robey rely on 523(a)(2)(A) as grounds for excepting their claims from discharge. This section states:

(a) A discharge under section 727. . . does not discharge an individual debtor from any debt

. . .

(2) for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by--

(A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition.

11 U.S.C. 523(a)(2)(A). In this Circuit, a creditor proceeding under 523(a)(2)(A) must prove the following elements:

(1) the debtor made false representations;

(2) at the time made, the debtor knew them to be false;

(3) the representations were made with the intention and purpose of deceiving the creditor;

(4) the creditor relied on the representations; and,

(5) the creditor sustained the alleged injury as a proximate result of the representations having been made.

In re Van Horne, 823 F.2d 1285, 1287 (8th Cir. 1987), as modified by In re Ophaug, 827 F.2d 340, 343 (8th Cir. 1987).

Courts are generally in agreement that the delivery of an insufficient funds check, without more, is not actionable under 523(a)(2)(A). In re Newell, 164 B.R. 992, 995 (Bankr. E.D. Mo. 1994). Courts disagree, however, over what additional requirements are necessary to meet the elements of Van Horne as applied to bad checks. A split of authority exists regarding interpretation of the first of the 523(a)(2)(A) elements. One line of cases holds that a check does not constitute a representation of fact, defeating the first element. In re Scarlata, 979 F.2d 521, 525 (7th Cir. 1992). These cases rely heavily on the United States Supreme Court decision of Williams v. United States, 458 U.S. 279, 285 (1982), which arose out of a criminal case. Scarlata, 979 F.2d at 525. They require some additional proof of an affirmative misrepresentation. In re Hunt, 30 B.R. 425, 438 (M.D. Tenn. 1983); In re Mahinske, 155 B.R. 547, 551 (Bankr. N.D. Ala. 1992) (holding there was no fraud absent a positive statement regarding the sufficiency of the bank account). The opposing line of cases treats the act of tendering a check as an implicit representation that the check is good. In re Kurdoghlian, 30 B.R. 500, 502 (Bankr. 9th Cir. 1983).

Criticizing both lines of authority as indefensible under the Code, the court in In re Anderson, 181 B.R. 943, 949-50 (Bankr. D. Minn. 1995), holds that dischargeability actions based on the passing of bad checks carry the strong aura of debtor wrongdoing that must be subject to sanction. It states that Williams is not binding precedent in a 523(a)(2)(A) proceeding as it applies a criminal statute in a completely different context. Id. at 949. At the same time, the Court holds that finding that tendering a check is an "implicit representation" would recognize the type of "fraud implied in law" which is shunned in a determination of dischargeability. Id. at 950.

The court in Anderson concludes by utilizing the concept of a more passive "false pretense" in the context of bad checks. Id. at 951. It finds support for this analysis in the Eighth Circuit's recognition that a debtor's silence as to a material fact can constitute a false representation actionable under 523(a)(2)(A). Id.; Van Horne, 823 F.2d at 1288; see also In re Wells, Adv. No. L-92-0076C, slip op. at 15-16 (Bankr. N.D. Iowa Mar. 29, 1994) (following Van Horne on the issue of whether debtor's silence can satisfy the first element).

In Anderson, the debtor wrote a series of bad checks within a two-week period for cash to gamble at a casino. 181 B.R. at 945. The court found the debtor had created a semblance that the checks were backed by value, thereby inducing the casino to give him cash to continue gambling. Id. at 951. The Court found that this satisfied the first element of the Van Horne test. Id. The debtor had material information which he failed to disclose, creating a false impression of a different state of affairs. Id.

Robey asserts Debtor told him he had money in his checking account to cover the two $5,000 checks he wrote to Robey for cash. Robey testified Debtor gave him a phone number which he used to obtain information regarding the balance in the account. Debtor denies telling Robey the checks were covered. He testified he told Robey that the checks would be covered when he received the funds from Starr. Cumis does not assert that Debtor made any direct representations concerning whether the checks written in the kiting scheme were good or would be made good.

The Court finds Robey's version of events more credible than Debtor's. Robey testified his inquiry into Debtor's account balance revealed a balance of approximately $27,000. The credit union's records show this was the actual balance in the account on that date. Robey deposited Debtor's check in his own account at the time he turned over the cash to Debtor. If Debtor had told him the check wouldn't be covered until Starr came through with the money, it is fair to conclude Robey would likely have held the check for a few days until it was covered.

Even if Debtor made no statement to Robey regarding the sufficiency of funds in his checking account, the Court finds that Robey and Cumis have both met the first element of their 523(a)(2)(A) claims, false misrepresentation or false pretense. The Court assesses the demeanor of the witnesses and all the underlying circumstances in making this determination. In re Levitsky, 137 B.R. 288, 291 (Bankr. E.D. Wis. 1992).

Debtor's asserted belief that he could make good on the checks through funds gained from Starr was not reasonable. His conclusory statement that there were funds coming in which failed to materialize does not carry any weight absent supporting documentary evidence. In re Damiani, 157 B.R. 17, 21 (Bankr. N.D. Ohio 1993). Debtor's checking account records indicate he never actually had the $10,000 to cover the checks to Robey or the $31,000 to cover the checks written between his accounts at East Dubuque Savings Bank, DuTrac Community Credit Union and FEC Credit Union. The sequence of the check writing events and the proximity in time establish a false representation by Debtor that he had funds to cover the checks. See Newell, 164 B.R. at 996. Debtor did not disclose to Robey or the Banks he intended to cover the checks with funds to be received in the future from Starr. Such a disclosure would undoubtedly have an impact on their decisions to accept and cash the checks. This conduct constitutes a misrepresentation by silence or false pretense which satisfies the first element of 523(a)(2)(A).

Debtor knew at the time he presented the checks he was creating a false impression that the checks would be honored. He admitted at trial he knew he was writing bad checks to cover bad checks. He was aware that his checking accounts did not contain funds to cover the checks. This meets the second element of the Van Horne test that at the time of the representations, Debtor knew them to be false.

The third element requires that Debtor intend to deceive Robey and the Banks. This element requires a review of the totality of the circumstances. In re Edwards, 143 B.R. 51, 54 (Bankr. W.D. Pa. 1992). Relevant factors include the debtor's intent to make good on the checks, knowledge of whether the checks would clear, attempts to make the checks good and whether the debtor ever had enough money to cover the checks. Id. The evidence indicates Debtor's asserted intent to make good through funds from Starr was not reasonable. Debtor knew the checks would not clear, he did not later attempt to make good on the checks and he never had enough money to cover the checks. Based on these conclusions, Robey and Cumis have met the intent to deceive element of 523(a)(2)(A).

The fourth and fifth elements require that the creditors must have relied on Debtor's misrepresentations or false pretenses and sustained injury. Robey and the Banks cashed Debtor's checks based on the impression Debtor created of being able to cover the checks. Robey was injured to the extent of $10,000 by cashing two $5,000 checks for Debtor. Cumis was injured to the extent of its judgment of $31,527.62 plus court costs when East Dubuque Savings Bank cashed Debtor's $31,000 check.

In summary, Robey and Cumis have met all five elements of their 523(a)(2)(A) claims by a preponderance of the evidence. The Court finds that Debtor was manipulating his checking accounts in such a manner that it subjected Robey and Cumis to the consequences of Debtor's unreasonable belief that Starr would provide money to cover these checks. Levitsky, 137 B.R. at 291. Debtor embarked on a check kiting scheme, defrauded Robey and the banks, failed and got caught and now must face the consequences. See In re Blake-Ware, 155 B.R. 476, 478 (Bankr. N.D. Ill. 1993). He made

the implied representation that his checks would clear upon presentation when he in fact knew they would not. He presented the checks with the intent to induce Robey and the banks into giving him an even exchange of cash for the checks.

The record is clear and undisputed that by June of 1992, Debtor was completely out of financial resources. In an attempt to protect his previous investment with Starr, Debtor, without question, manipulated his checking accounts in order to acquire additional funds. It is the finding of this Court that neither East Dubuque Savings Bank or Robey had knowledge of Debtor's plan nor were they willing participants, as investors in this final speculation. By the time the various checks were written, Debtor knew that funds were no longer available. He acquired the additional funds through the ruse of writing checks and speculating that he would be in a position to reimburse these accounts sometime in the unspecified future. However, the reimbursement did not occur and now that the funds have never materialized, Debtor asserts that he is a victim of Starr and that the claims of Robey and Cumis should be discharged. While it may or may not be true that Debtor lost a substantial investment with Starr, that assertion is largely irrelevant to the present analysis. The Bankruptcy Code is designed to protect the honest debtor. Under this evidentiary record, to allow Debtor to discharge these claims, would be to reward dishonest conduct and penalize those who became unwilling participants in this matter. As such, the Court concludes that the claims of Plaintiffs Cumis Insurance Society and Dean Robey against Debtor are excepted from discharge pursuant to 11 U.S.C. 523(a)(2)(A).

WHEREFORE, Plaintiff Dean Robey's Complaint to Determine Dischargeability of Debt is GRANTED.

FURTHER, judgment is entered on behalf of Plaintiff Dean Robey and against Debtor Mark William Kaufman in the amount of $10,000 plus interest.

FURTHER, said judgment is nondischargeable under 523(a)(2)(A).

FURTHER, Plaintiff Cumis Insurance Society, Inc.'s Complaint to Determine Dischargeability of Debt is GRANTED.

FURTHER, judgment is entered on behalf of Cumis Insurance Society, Inc. and against Debtor Mark William Kaufman as per the Order Granting Default Judgment to Cumis Insurance Society, Inc. of the Chancery Court of Shelby County, Tennessee.

FURTHER, said judgment is nondischargeable under 523(a)(2)(A).

SO ORDERED this 18th day of September, 1995.

Paul J. Kilburg
U.S. Bankruptcy Judge