In the United States Bankruptcy Court

for the Northern District of Iowa

MATTHEW J. SCHUSTER LISA M. SCHUSTER *Debtor(s).*	Bankruptcy No. 96-22380-D Chapter 7
BUFFALO BAY GRAIN *Plaintiff(s)* vs. MATTHEW J. SCHUSTER LISA M. SCHUSTER *Defendant(s)*	Adversary No. 97-9004-D

ORDER

On December 17, 1997, the above-captioned matter came on for hearing pursuant to assignment. Plaintiff Buffalo Bay Grain appeared by Attorney Marty Hagge. Debtors/Defendants appeared in person with Attorney Frances Henkels. Evidence was presented after which the Court took the matter under advisement. The time for submitting briefs has now passed and this matter is ready for resolution. This is a core proceeding pursuant to 28 U.S.C. sect; 157(b)(2)(I).

STATEMENT OF THE CASE

This adversary proceeding is brought under 11 U.S.C. sect;523(a)(2)(A). Plaintiff alleges that Debtors engaged in fraud by tendering a check without sufficient funds in their checking account. Plaintiff seeks a determination that the debt owed to it by Debtors be declared nondischargeable pursuant to sect;523(a)(2)(A).

FINDINGS OF FACT

Debtor Matthew Schuster is a farmer living near Lamotte, Iowa. In August of 1996, he contacted Buffalo Bay Grain to buy corn. Ann Siddell is the bookkeeper and office manager at Buffalo Bay Grain located in Coggon, Iowa. The business sells feed and grain to farmers. It has been in business as a corporation since 1974. Ms. Siddell is the only person working in the office and takes grain orders from farmers. Most orders are placed to her by phone. She recalls receiving a telephone call from Mr. Schuster to buy corn in August of 1996. She testified that, as part of her business routine, she routinely tells farmers that when grain is delivered, the driver will need a check. She testified that there was nothing extraordinary in this delivery to warrant a change in this routine.

Mr. Schuster testified that he called in the grain order in August of 1996. He testified that he recalls asking the people at Buffalo Bay Grain to hold the check as he knew there would be insufficient funds

in the checking account to cover the check at the time it was delivered on August 9, 1996. However, when asked to testify as to whom spoke, he did not recall. He was then asked whether the person was a man or a woman to which he also testified that he did not recall. Finally, Mr. Schuster was asked whether he was present when the grain was delivered. He testified that he did not specifically remember. However, the evidence establishes that the check was signed in blank and the remainder of the information on the check was filled out by the delivery person, who is Ms. Siddell's son. Ms. Siddell identified the handwriting on the check as that of her son.

Mr. Schuster testified that Buffalo Bay Grain had agreed in the past to hold checks. He testified that he had always paid by check and that all checks were paid when presented. However, Ms. Siddell testified that Mr. Schuster had never asked for time to make good on a check. All prior checks had been cashed immediately and were paid upon presentment. She testified that there was no conversation in the present instance in which Mr. Schuster asked Buffalo Bay Grain to hold his check so that certain livestock sales could be completed and funds placed in the account.

Shelled corn was delivered to Debtor Matthew Schuster on August 9, 1996. The quality of the corn is not in question nor the amount delivered. Debtor agrees that he received value equal to the amount charged and that the check was in the amount of $2,592.84.

It is uncontested that there were insufficient funds in the Debtor's bank account to pay the check when presented. The check went from Buffalo Bay Grain to its depository bank, Citizens State Bank. Citizens State Bank then submitted the check to Debtors' bank, which was a branch office of the Mercantile Bank located in Lamotte, Iowa. The check was rejected by Mercantile Bank as having insufficient funds. Citizens State Bank ran the check through a second time and it again was rejected for insufficient funds. Mercantile Bank records reflect many overdraft charges to Debtors' account during this period. On August 21, 1996, Mercantile Bank wrote Debtors a letter closing this checking account and seeking reimbursement for charges of $132.13.

Ms. Connie Neyens is the accounting officer at Mercantile Bank. She testified that the Schusters had been on "return" status since February of 1995. This status meant that any checks received for which there were insufficient funds to cover were not paid but were returned unpaid. This action was taken because of continual overdrafts. Prior to that time, there had been occasional overdrafts which were covered by the bank. Because of continuing problems, however, Ms. Neyens testified that she sent a warning letter to Debtors on August 15, 1996, stating that Debtors needed to immediately bring their checking account to a satisfactory basis or Mercantile Bank would be forced to close the account. Subsequently, on August 21, 1996, as previously indicated, the account was closed. Ms. Neyens testified that if Debtors would have come in between August 15 and August 21 and deposited a sum of money to cover the outstanding checks, the Bank would have accepted these funds to cover outstanding checks on an interim basis. However, she testified that no such funds were deposited.

The course of dealing between Debtors and Buffalo Bay Grain was set forth in a transaction sheet offered into evidence and marked Plaintiff's Exhibit 7. For the years 1989 and 1990, a moderate amount of activity transpired between Debtors and Buffalo Bay Grain. However, there were only two transactions in 1992 and then none until the year in question. In 1996, there were two transactions approximately one month apart. The first transaction took place on July 6, 1996, which was recorded as a delivery of grain in the amount of $2,727.18. This amount was paid by check which apparently cleared without incident. There was nothing in the evidence to indicate that the check was held for any period of time. The second transaction was the one in question. This transaction occurred on August 9, 1996, and was in the previously specified amount of $2,592.84. This amount was paid by

check but was returned for insufficient funds. Debtors have not paid any of the outstanding balance nor returned any of the grain. Thus, the total amount remains due and owing as of this time.

CONCLUSIONS OF LAW

Plaintiffs bear the burden to prove the elements of its claim under 11 U.S.C. sect;523 by a preponderance of the evidence. See Grogan v. Garner, 498 U.S. 279 (1991). Exceptions to discharge must be "narrowly construed against the creditor and liberally against the debtor, thus effectuating the fresh start policy of the Code. These considerations, however, 'are applicable only to honest debtors.'" In re Van Horne, 823 F.2d 1285, 1287 (8th Cir. 1987) (citations omitted).

Plaintiffs rely on sect; 523(a)(2)(A) as grounds for excepting its claim from discharge. This section states:

> a. A discharge under section 727 . . . does not discharge an individual debtor from any debt
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> . . .
>
> 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. sect;523(a)(2)(A) (1993). In this Circuit, a creditor proceeding under sect;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 justifiably relied on the representations; and,
5. the creditor sustained the alleged injury as a proximate result of the representations having been made.

Van Horne, 823 F.2d at 1287, as modified by Field v. Mans, 516 U.S. 59, 74-75 (1995) (holding that "sect; 523(a)(2)(A) requires justifiable, but not reasonable, reliance") and In re Ophaug, 827 F.2d 340, 343 (8th Cir. 1987) (holding that a "creditor need not prove that his reliance was reasonable"). The Court will analyze each of the elements under sect; 523(a)(2)(A).

Because the first and second elements under sect; 523(a)(2)(A) address false representations and the Debtor's knowledge of such representations, these two elements will be analyzed together. A split of authority exists whether the delivery of an insufficient funds check satisfies the first element. This conflict is due largely to the "notion that a 'false representation' suggests an affirmative statement of fact, objectively and actively manifested by the debtor." In re Anderson, 181 B.R. 943, 948 (Bankr. D. Minn. 1995). A check, however, ordinarily is not accompanied by any such affirmative statement by the debtor that "the check is good." Id. at 948-49.

One line of cases holds that a check does not constitute a representation of fact, thereby defeating the first element. See In re Scarlata, 979 F.2d 521, 525 (7th Cir. 1992). Relying heavily on a United States Supreme Court criminal case, Williams v. United States, 458 U.S. 279, 285 (1982), these cases require some additional proof of an affirmative misrepresentation. See, e.g., In re Mahinske, 155 B.R. 547, 551 (Bankr. N.D. Ala. 1992) (holding that there was no fraud absent a positive statement regarding the sufficiency of the bank account); Hammett v. Hammett, 49 B.R. 533, 535 (Bankr. M.D. Fla. 1985) (deeming themselves bound by Williams and thus rejecting "the approach that the presentation of a check drawn on insufficient funds is per se probative of intent to deceive"); In re Pokrandt, 54 B.R. 691, 692 (Bankr. W.D. Wis. 1985) (stating that "[t]he fact that a debtor knowingly issues an [insufficient funds] check does not establish a misrepresentation"); In re Hunt, 30 B.R. 425, 438 (B.A.P. M.D. Tenn. 1983) (requiring "additional proof in connection with the issuance of [an insufficient funds] check to establish a misrepresentation for sect; 523(a)(2) purposes").

The opposing line of cases treats the act of tendering a check as an implicit representation that the check is good. See, e.g., In re Damiani, 157 B.R. 17, 21 (Bankr. N.D. Ohio 1993) (holding that the issuance of an insufficient funds check constitutes a prima facie case of fraud); In re Mullin, 51 B.R. 377, 378 (Bankr. S.D. Ind. 1985) (treating the act of tendering a check, knowing that there are insufficient funds to cover the check, as a false representation); In re Kurdoghlian, 30 B.R. 500, 502 (B.A.P. 9th Cir. 1983) (same).

Both lines of authority were criticized as indefensible under the Bankruptcy Code in In re Anderson, 181 B.R. 943, 949-50 (Bankr. D. Minn. 1995). The Anderson court observes that "[m]any dischargeability actions based on the passing of bad checks carry the strong semblance of debtor wrongdoing that should be subjected to sanction." Id. at 950. The Anderson court also concluded that finding the mere tendering of a check to be an implicit misrepresentation would recognize the type of "fraud implied in law" which is shunned in a determination of dischargeability. Id.; see also In re Simpson, 29 B.R. 202, 209 (Bankr. N.D. Iowa 1983) (stating that a plaintiff must prove actual fraud, such as a moral turpitude or an intentional wrong, and not merely fraud implied in law to prevent discharge for fraud under sect;523(a)(2)(A)). The Anderson court determined that Williams is not binding precedent in a sect;523(a)(2)(A) proceeding as it applies a criminal statute in a completely different context. Anderson, 181 B.R. at 949.

The Anderson court concludes by utilizing the concept of a 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 sect;523(a)(2)(A). See 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 a 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. See Anderson, 181 B.R. at 945. The court found the debtor had made a false representation that the checks were backed by value, thereby inducing the casino to give him cash to continue

gambling. Id. at 951. The Anderson court concluded that the debtor's actions satisfied both the first and second elements of the Van Horne test. Id.

Here, Debtor tendered the check to Plaintiff when knowing that there were insufficient funds in the account to cover the check. See Kurdoghlian, 30 B.R. at 502. Although Debtor claimed that he asked Plaintiff to hold the check at the time of delivery until certain livestock sales could be completed and funds placed in the account, Ms. Siddell testified that Debtor never asked for any such additional time to make good on the check. The Court finds Ms. Siddell's version of the events more credible and consistent with surrounding facts than Debtor's. Furthermore, Debtor had been put on "return" status since February of 1995, so Debtor should have known that Mercantile Bank would return the check in unpaid status if presented with insufficient funds in the account. By tendering the check, Debtor created a false impression that the check was backed by value, which satisfies both the first and second elements of sect;523(a)(2)(A).

The third element requires that Debtor intended to deceive Plaintiff Buffalo Bay Grain. Because actual proof of intent is often difficult to obtain, a creditor may present circumstantial evidence from which intent may be inferred. See Van Horne, 823 F.2d at 1287; see also In re Newell, 164 B.R. 992, 995 (Bankr. E.D. Mo. 1994) (considering the surrounding circumstances when analyzing the third element under sect; 523(a)(2)(A)); In re Edwards, 143 B.R. 51, 54 (Bankr. W.D. Pa. 1992) (holding that courts must look to the totality of circumstances to establish a debtor's intent). Debtors cannot overcome this inference with an "unsupported assertion of honest intent." In re Simpson, 29 B.R. 202, 211-12 (Bankr. N.D. Iowa 1983). The focus of this third element is on "whether the debtor's actions 'appear so inconsistent with [his] self-serving statement of intent that the proof leads the court to disbelieve the debtor.'" Van Horne, 823 F.2d at 1288 (brackets in original). Relevant factors include the debtor's intent to make good on the insufficient funds check, knowledge of whether the check would clear, attempts to make the check good, and whether the debtor ever had enough funds in the account to cover the check. See Edwards, 143 B.R. at 54 (listing the above factors). In this case, Debtor knew the check would not clear, he did not later attempt to make good on the check, and he never had enough money to cover the check. Based on these conclusions, Plaintiff has satisfied the intent to deceive element of sect;523(a)(2)(A).

The fourth element requires that Plaintiff must have relied on Debtor's misrepresentations or false pretenses. See In re Maier, 38 B.R. 231, 233 (Bankr. D. Minn. 1984). As part of Plaintiff's business routine, Ms. Siddell always informs farmers that when grain is delivered, the driver will need a check. Plaintiff's driver accepted Debtor's check in exchange for the grain based on the false impression Debtor created of being able to cover the check. Plaintiff had no apparent reason to not rely on Debtor's misrepresentation since the previous transaction on July 6, 1996, was paid by a check that had cleared without incident. Thus, the August 9, 1996, check was issued to induce reliance by Plaintiff, satisfying the fourth element of sect; 523(a)(2)(A).

The fifth element, the proximate cause element of sect; 523, requires "that the action of the debtor was the act, without which the [plaintiff] would not have suffered the loss complained of." Van Horne, 823 F.2d at 1288-89 (quoting Maier, 38 B.R. at 233). Plaintiff delivered grain to Debtor in the amount of $2,592.84 in exchange for Debtor's check, which was dishonored soon thereafter. Plaintiff lost this value as a proximate result of the false pretense Debtor created. This causal relationship completed satisfies the final element of sect;523(a)(2)(A).

In summary, Plaintiff Buffalo Bay Grain has established all requisite elements of its sect; 523(a)(2)(A) claim by a preponderance of the evidence, as to Matthew J. Schuster. By tendering the check, Mr. Schuster created a false impression that the check was backed by value. Although Mr. Schuster knew

the check would not clear, he did not later attempt to make good on the check, and he never had enough money to cover the check. Mr. Schuster knew that Buffalo Bay Grain would not deliver the grain unless he tendered a check. Consequently, Buffalo Bay Grain lost value as a proximate result of the false pretense Mr. Schuster created.

Plaintiff Buffalo Bay Grain, on the other hand, has not satisfied its burden with respect to Debtor Lisa M. Schuster. Mrs. Schuster did not sign the insufficient funds check and, therefore, did not assist her husband in creating a false impression that the check to Buffalo Bay Grain was backed by value. There is no basis to hold her accountable under sect;523(a)(2)(A).

The Bankruptcy Code is designed to protect the honest debtor. To allow Debtor Matthew Schuster to discharge this claim, would be to reward dishonest conduct and penalize those who became unwilling participants in this conduct.

WHEREFORE, Buffalo Bay Grain's claim against Debtor Matthew J. Schuster is excepted from discharge pursuant to 11 U.S.C. sect;523(a)(2)(A).

FURTHER, Plaintiff Buffalo Bay Grain's claim against Debtor Lisa M. Schuster is dismissed as the requisite elements of proof for non-dischargeability under sect; 523(a)(2)(A) are not established by a preponderance of the evidence.

SO ORDERED this 26th day of January, 1998.

Paul J. Kilburg
U.S. Bankruptcy Judge