In the United States Bankruptcy Court

for the Northern District of Iowa

JAMES ROGER SCHLITTER *Debtor(s).*	Bankruptcy No. 98-00597-D Chapter 7
GEORGE AND DEBRA DAVIS dba Jim's Antiques *Plaintiff(s)* vs. JAMES ROGER SCHLITTER *Defendant(s)*	Adversary No. 98-9072-D

ORDER

On April 22, 1999, the above-captioned matter came on for hearing pursuant to assignment. Plaintiffs George and Debra Davis appeared in person with their attorney, Darin Harmon. Debtor/Defendant James Roger Schlitter appeared in person with his attorney, W. Richard White. Evidence was presented after which the Court took the matter under advisement. The time for submitting briefs is now past and the matter is ready for resolution. This is a core proceeding pursuant to 28 U.S.C. §157 (b)(2)(I).

STATEMENT OF THE CASE

This adversary proceeding is brought pursuant to 11 U.S.C. §523(a)(2)(A). Plaintiffs allege that Debtor/Defendant engaged in fraud by tendering a check without sufficient funds in his checking account. Plaintiffs seek a determination that the debt owed to them by Debtor be declared nondischargeable pursuant to §523(a)(2)(A). Defendant denies these allegations.

FINDINGS OF FACT

George and Debra Davis reside in Lawrence, Kansas and operate an antique business known as Clockhouse Antiques. At all relevant times, Debtor/Defendant James Schlitter operated a similar business known as Jim's Antiques. The nature of these businesses is such that the owners travel to various locations and sell various products at shows set up for that purpose. Mr. and Mrs. Davis met Mr. Schlitter at a promotional sales event in Minneapolis, Minnesota on April 24, 1996. On that date, Debtor purchased 19 antique toy wagons from Mr. and Mrs. Davis and paid them with a check in the amount of $2,300. Upon completion of the transaction, the wagons were given to Debtor. Debtor testified that he sold two or three of the wagons in Minneapolis but took the remainder home. They were subsequently sold at other shows.

Plaintiffs deposited the check and it was twice returned for non-sufficient funds. They testified that they called Mr. Schlitter many times and he invariably promised that he would take care of it. They testified that they last saw him at a show in Rochester, Minnesota where he personally stated that he would take care of the check but none of the funds have ever been paid.

Mr. Schlitter testified that he started in business in 1984 and continued the antique business until approximately Christmas of 1996. The check was drawn on the Luana Bank. He testified that he did not know that the check would not clear when presented. He testified that when he wrote the check he thought there was enough money to cover it. When he discovered that there was not enough funds to cover the check, he had discussions with the Plaintiffs and thought he would obtain sufficient funds to make it good. However, business had begun to slow down. In April of 1996, he still thought the business would work out but by Christmas of 1996, he had back problems and insufficient funds to pay his bills nor any way to refinance his obligations. At that time, he went out of business.

The Bank records for Mr. Schlitter were received into evidence. During the period preceding and subsequent to the writing of this check, many checks were drawn by Mr. Schlitter which were returned for non-sufficient funds. Mr. Schlitter testified that he was convicted in Iowa District Court of a felony involving non-sufficient funds checks. Debtor has not paid any of the outstanding balance nor has he returned any of the wagons which Plaintiffs sold to him. There is no issue concerning value received. Debtor does not contest that he received value equal to the amount of the check and the check was in the amount of $2,300. Thus, the total amount remains due and owing as of the time of trial.

CONCLUSIONS OF LAW

Plaintiffs bear the burden to prove the elements of its claim under 11 U.S.C. §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 § 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. §523(a)(2)(A) (1993). 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 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 "§ 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 § 523(a)(2)(A).

Because the first and second elements under § 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 § 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 §523(a)(2)(A)). The Anderson court determined that Williams is not binding precedent in a §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 §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 a check in the amount of $2,300 to Plaintiffs. It is the conclusion of this Court that, at that time, Debtor knew there were insufficient funds in the account to cover this check when presented for payment. In making this determination, the Court relies upon the Bank records which conclusively establish that during this time, Debtor had numerous checks returned for non-sufficient funds. Debtor testified that there were periods of time when he had deposited funds and felt that this check would clear. However, this Court must conclude that, at the time the check was drawn, Debtor falsely represented that the check would be paid when presented and Debtor knew at the time that this was false. In making this determination, the Court evaluates all of the underlying circumstances presented in this testimony and assesses the demeanor of the witnesses. In re Levitsky, 137 B.R. 288, 291 (E.D. Wis. 1992); In re Holzapfel's Sons, Inc., 249 F.2d 861, 864 (7th Cir. 1957). Additionally, in this case, Debtor admitted that he was convicted of a felony involving dishonest or false statement. Such evidence is admissible under the Federal Rules of Evidence for the purposes of attacking the credibility of a witness. Fed.R.Evid. 609(a). Evidence of such a prior conviction may be used to help the trier of fact decide whether to believe that witness and how much weight to give his or her testimony. Based upon the entire record presented to the Court, the preponderance of credible evidence convinces this Court that Debtor, in tendering the check to the Plaintiffs, created a false impression that the check was backed by value. This conclusion satisfies both the first and second elements of §523(a)(2)(A).

The third element requires that Debtor intended to deceive Plaintiffs. 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 § 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). Debtor 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. SeeEdwards, 143 B.R. at 54 (listing the above factors).

It is the conclusion of this Court, based upon the check registry and all of the facts and circumstances of this case, that Debtor knew that the check would not clear the Bank when presented. Though Debtor later promised to make good on the check, he never took any affirmative action to do so. At no time did he make even partial payment. Based upon the deficiencies in Debtor's checking account, this Court concludes that Debtor never had sufficient funds in his checking account to cover this check. Based upon these conclusions, Plaintiffs have satisfied the requirement that Debtor intended to deceive them.

The fourth element requires that Plaintiffs must have relied upon Debtor's misrepresentations or false pretenses. SeeIn re Maier, 38 B.R. 231, 233 (Bankr. D. Minn. 1984). The evidence does not present any reason why Plaintiffs should not have relied on Debtor's misrepresentation. It is apparent that Plaintiffs did rely upon the representations made by Debtor as they accepted payment for the 19 antique wagons and turned over possession of those wagons immediately to Debtor who then had the opportunity to resell them. Thus, the April 24, 1996 check was issued by Debtor to induce reliance by Plaintiffs, thereby satisfying the fourth element of §523(a)(2)(A).

The fifth element is the proximate cause element of §523. This element requires "that the action of the debtor was the act, without which the [plaintiff] would not have suffered the loss complained of." In re Van Horne, 823 F.2d 1285, 1288-89 (8th Cir. 1987)(quoting Maier, 38 B.R. at 233). Plaintiffs delivered the wagons to Debtor with a value of $2,300 in exchange for Debtor's check which was dishonored thereafter. The wagons have been disposed of and Plaintiffs, therefore, lost the sum of $2,300 as a proximate result of the false pretense Debtor created. The causal relationship satisfies the final element of §523(a)(2)(A).

In summary, Plaintiffs, George and Debra Davis, have established all of the requisite elements of their §523(a)(2)(A) claim by a preponderance of evidence against Debtor/Defendant James Roger Schlitter. By tendering the check, Mr. Schlitter created a false impression that the check was backed by value. Although Mr. Schlitter knew that the check would not clear, he did not later attempt to make good on the check, and he never had sufficient funds in his checking account to cover this check. Plaintiffs justifiably relied upon the representations by Mr. Schlitter and, thereby, Plaintiffs lost value as a proximate result of the false representations made by Mr. Schlitter. Based upon all of these conclusions, the claim by Plaintiffs against Debtor James Schlitter is excepted from discharge. In addition to the dischargeability issue, Plaintiffs seek attorney's fees.

ATTORNEY'S FEES

The Court has determined that this claim is nondischargeable. The Court could make the determination that the claim is nondischargeable and allow Plaintiffs' claim to be liquidated by them in an appropriate State court action, though this Court is not required to do so. In re Lyngholm, 24 F.3d 89, 92 (10th Cir. 1994). Disputed claims "may be resolved by the bankruptcy court under §502 (b), and §502(c)(1) which contemplates it will resolve claim matters that 'would unduly delay the administration of the case.'" Id. This matter is properly before the Court on a dischargeability claim. Defendant has not objected to the Court's determination of the merits of the claim in this matter and as such, this Court determines that it should be completely resolved in this action. As this Court will enter a judgment in the amount of $2,300 in favor of Plaintiffs and against Debtor, the Court, therefore, will consider the issue of attorney's fees by applying State law.

The "American Rule" applies in bankruptcy cases and requires either a statutory or a contractual basis for an award of attorney fees for a prevailing party. TranSouth Fin. Corp. v. Johnson, 931 F.2d 1505, 1507 (11th Cir. 1991); In re Gagle, 230 B.R. 174, 184 (Bankr. D. Utah 1999). The Eighth Circuit recently recognized that attorney fees are properly included in a nondischargeable debt under §523(a)(2)(A) where provided for by contract. In re Alport, 144 F.3d 1163, 1168 (8th Cir. 1998). It has long been the rule that state statutes providing for attorney fees may be enforced in federal court by including such fees in judgment. Associated Mfrs. Corp. v. De Jong, 64 F.2d 64, 68 (8th Cir. 1933).

Creditors here request attorney fees pursuant to Iowa Code sec. 625.22. This statute states a plaintiff in an action to recover payment on a dishonored check or draft may recover a reasonable attorney's fee. Creditors' complaint requests a judgment of $2,300, the amount of the dishonored check they received from Debtor, plus interest, costs and reasonable attorney's fees, and that the debt be declared nondischargeable. Based on that request for judgment, the Court concludes this is an action to recover payment on a dishonored check under sec. 625.22 as well as an action to determine dischargeability of a debt.

Iowa courts have significant discretion when awarding attorney fees in actions to recover payment on dishonored checks under sec. 625.22. Golden Circle Air, Inc. v. Sperry, 543 N.W.2d 629, 633 (Iowa App. 1995). The Court may consider time spent, the nature and extent of service, amount involved, difficulty of handling and importance of issues, responsibility assumed and results obtained. 3 S Inc. v. Zarek, 504 N.W.2d 153, 156 (Iowa App. 1993). The affidavit required by sec. 625.24 is a prerequisite to an award of attorney fees. Moser v. Thorp Sales Corp., 334 N.W.2d 715, 719 (Iowa 1983). That affidavit must state there is no agreement between the attorney and the client for any division or sharing of the attorney fee requested. Iowa Code §625.24.

Creditors offered Exhibits 16 and 17 showing accountings for attorney fees. Attorney Jeff Paulsen has billed $1,442 in attorney fees. He represented Creditors until March 22, 1999 when he withdrew in light of Creditors' employment of Attorney Darin Harmon. Mr. Harmon's statement for services totals $1,171.50 for his employment in this case by Creditors. Neither attorney has filed an affidavit as required under sec. 625.24.

The Court concludes that attorney fees may be included in the judgment pursuant to sec. 625.22. Attorneys Poulson and Harmon are directed to file their affidavit in compliance with sec. 625.24 within ten days of the date of this order. When the affidavits are received, the Court will enter an appropriate supplemental judgment entry order.

WHEREFORE, the claim of Plaintiffs George and Debra Davis against Debtor/Defendant James Roger Schlitter is excepted from discharge pursuant to 11 U.S.C. §523(a)(2)(A).

FURTHER, judgment is entered in favor of Plaintiffs George and Debra Davis and against Debtor/Defendant James Roger Schlitter in the amount of $2,300.

FURTHER, respective counsel for Plaintiffs are to submit an affidavit of attorney's fees within ten days of the date of this order in compliance with Iowa Code sec.625.22.

FURTHER, upon receipt of the affidavit of attorney's fees, the Court will enter a supplemental judgment respecting costs and attorney's fees.

SO ORDERED this 14th day of May, 1999.

Paul J. Kilburg

U.S. Bankruptcy Judge