In the United States Bankruptcy Court

for the Southern District of Iowa

ROGER THIELEN
Debtor(s).

Bankruptcy No. 03-02814
Chapter 7

PHIL THIELEN and
MARY JO THIELEN
Plaintiff(s)

vs.

ROGER THIELEN
Defendant(s)

Adversary No. 03-30135-wle,

ORDER RE: COMPLAINT TO DETERMINE DISCHARGEABILITY

Procedural History

Plaintiffs Phil Thielen and Mary Jo Thielen filed their complaint on August 25, 2003, seeking a determination that debt owed them by Roger Thielen is nondischargeable under 11 U.S.C. §§ 523(a)(2)(A), 523(a)(4) and 523(a)(6). Final trial was held June 8, 2004 before the United States Bankruptcy Court for the Southern District of Iowa. James B. Cavanagh appeared as attorney for plaintiffs. Attorney C.R. Hannan represented defendant Roger Thielen.

At the close of evidence, the court granted defendant's motion for judgment as a matter of law on the claim under § 523(a)(4) for plaintiffs' failure to offer evidence of a fiduciary relationship. The matter was taken under advisement as to the remaining claims. On or about August 1, 2005, the matter was assigned to the undersigned for decision.

On September 19, 2005, this court held a status conference during which the parties agreed that the court could determine the proceeding based on the trial record. The parties were provided additional time to submit supplemental briefs. The court will base its decision on the pleadings, including the amended complaint (Doc. 15) and amended answer (Docs. 17, 28), the parties' trial stipulation (Doc. 31), and the trial transcript and exhibits. The court will also consider the parties' briefs (Docs. 33, 37, 39, 54).

The court has jurisdiction over this matter under 28 U.S.C. §§ 1334(b) and 157(a) and the District Court's order of reference. This is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(I).

Findings of Fact

Roger Thielen and Phil Thielen are brothers. In 2000, Roger was the sole shareholder, officer and director of Atlantic Supply Co. ("Atlantic Supply"), a corporation that operated a business in Atlantic, Iowa. The corporation, formed in about 1989, is no longer in business. In 2000, Atlantic Supply sold and serviced office supplies and business equipment. It operated in a building owned by RJT Properties ("RJT"). RJT was a limited liability company owned by Roger and his wife. Atlantic Supply's lease payment was $1,365 per month.

Mid-America Tribune was a corporation owned by Roger's son Ryan. Mid--America's articles of incorporation were filed with the Iowa Secretary of State on January 4, 2001. Ryan was 20 years old at that time.

In about 1999, Roger became interested in establishing a newspaper printing operation in Atlantic. Sometime in 2000, he began to inquire about financing for the purchase of printing equipment. As of early October 2000, Roger had not obtained financing. First Whitney Bank & Trust in Atlantic had turned him down. Roger had obtained information from two leasing companies but had not submitted an application to either firm.

Beginning in September or October of 2000, Roger had discussions with plaintiffs about financing the equipment. Phil testified that in early October of that year, Roger said he had a lease arrangement in place and wanted to know if plaintiffs would co--sign or guarantee the lease agreement (Tr. 113:16--20). Phil said that Roger later indicated that he would prefer to purchase the equipment.

On October 12, 2000, Roger sent a fax letter to plaintiffs stating in relevant part:

> 3.) On a lease of 1,131,000.00 total payments are 1,318,312.00. Of this 36 months is for approx. 205,272.00 market value[.] 60 months is for 925,728.00.

Exhibit 2. The phrase "25% Buyout" was written next to "60 months." The fax stated further:

> 4.) I should have the new bid with the stitcher/trimmer w/a 20 bin collator = Total should be just a little above 1,250,000.00.
> 5.) Phil -- how long does it take to do the inside concrete work and how long does it have to cure.
> 6.) If you two are willing to do this it will be to my advantage to not lease any of it as the equip. will be worth way more than letting it go back.
> 7.) If you two are willing to do this Xpedx needs 35% of total to get started -- once the equip. is here they need 50% with the remainder due after it is installed and running correctly.
> 8.) They also need a letter from my (yours) bank stating that I'm good for the money.

Id. At the bottom of the letter were written these calculations:

> 35% of 1,250,000 = 437,500
>
> 50% " " = 625,000

Xpedx was a supplier for Atlantic Supply. It has an office in Ankeny, Iowa. Xpedx is also a manufacturer's representative for the type of printing equipment that Roger wished to purchase. It made several proposals to Roger for the purchase of equipment.

Phil Thielen is retired from Peter Kiewit & Sons and now has his own construction company in Omaha. He was aware that the printing business would require remodeling of the building where Atlantic Supply was located. Phil helped Roger estimate remodeling costs and discussed other costs the printing business would require. Phil encouraged Roger to negotiate for the best price on the equipment.

Plaintiffs were specific in their discussions with Roger that they would lend money only for the cost of the equipment (Tr. 121). Phil wanted to know how the operating expenses of the printing business would be paid (Tr. 36--37). Roger told Phil that "as far as Atlantic Supply Company was concerned it was fine; everything was fine." (Tr. 37:2--19.)

At 9:19 a.m. on October 18, 2000, Lynn Worley, an Xpedx employee, faxed a letter to Roger Thielen with the following price quotes:

CreoScitex Lotem 400V	$ 180,000.00
CreoScitex 43 Wide	$ 10,000.00
Rosback 6 Station Collator	$ 168,100.00
Ryobi 684	$ 650,000.00
IR Dryer	$ 10,000.00

Auto Blanket Cleaner	$ 22,750.00
Baumcut 31.5"	$ 24,995.00
20 Bin Standard Collator w/stitch and trim	$ 92,000.00
Total	$11,157,845.00

Exhibit 6. At 9:20 a.m., one minute later, Worley sent Roger a second fax letter furnishing the "newest quote for the equipment you will need." The letter gave the following prices for the same items of equipment listed in the earlier letter:

CreoScitex Lotem 400V	$180,000
CreoScitex 43 Wide	14,000
Rosback 6 Station Collator	183,100
Ryobi 684	689,000
IR Dryer	12,000
Auto Blanket Cleaner	28,750
Baumcut 31.5"	24,995
20 Bin Standard Collator w/stitch and trim	121,000
Total	$1,252,845

Exhibit 4. Worley told Roger that the lower price quote included manufacturers' incentives. Worley sent the higher price quote to demonstrate that Xpedx was getting him a good price. Roger knew that Xpedx required a down payment of 25% of the total purchase price (Tr. 62).

On October 19, 2000, Roger sent plaintiffs a fax letter that stated in relevant part:

> With this letter I am also faxing a copy of Equipment and price list for each piece.
>
> . . .
>
> 2.) Xpedx would like a copy of a letter from both you
>
> and your bank saying that you are lending me the money
>
> and that your [sic] good for it. Xpedx would rather you transferred the money to me and then I pay them (I will give you a copy of the check so you know that it has been paid.) Kevin Garrett my CPA would prefer it that way also -- however both of them said that it did not have to be done like that. (IE) We could have loan agreements and then pay Xpedx.
>
> . . .
>
> 4.) It would be nice if we could transfer the money this morning so I can get this done in Des Moines this afternoon. That way I can be in Omaha Tomorrow.
>
> 5.) They will accept 30% instead of 35%[;] the amount would be 375,853.50.

Exhibit 3. Roger included with his letter to plaintiffs a copy of the price list that showed the higher prices totaling $1,252,845.

Plaintiffs agreed to lend the purchase money for the equipment. They confirmed with Xpedx that they were financing the purchase and supplied a letter of reference from Gateway Community Bank. Exhibits 7, 8. Mary Jo Thielen obtained a cashier's check for $375,853.50 from Gateway Bank. On the evening of October 19, 2000, Roger came to plaintiffs'

home in Omaha and received the cashier's check. Plaintiffs asked Roger to provide them with a copy of his check to verify that he had given the money to Xpedx. Roger agreed to do so.

The next day, Roger deposited the Gateway check into Atlantic Supply's account at First Whitney Bank and obtained a cashier's check payable to Xpedx in the amount of $289,461.25. This amount represented the required 25% down payment on the $1,157,845 purchase price. Xpedx confirmed these terms in a letter agreement dated November 6, 2000. Exhibit 13. The agreement also acknowledged receipt of the down payment. Roger did not disclose the actual terms of the purchase agreement to plaintiffs.

On the same day, October 20, 2000, Roger filled out an Atlantic Supply check form showing Xpedx as the payee of the sum of $375,853.50. Roger provided plaintiffs with a copy of the check. He did not deliver the check to Xpedx.

At the time plaintiffs agreed to finance the purchase of the printing equipment, Atlantic Supply was in very poor financial condition. On September 27, 2000, its business checking account was overdrawn by $2,238.20. Exhibit 14. The next day, at least $4,000 of loan proceeds were added to the account. On October 11, the account was charged a fee for return of an insufficient funds check. On October 12, additional loan proceeds of $7,000 were deposited into the account. On October 19, the day before the deposit of the funds from plaintiffs, Atlantic Supply's bank account had a balance of $1,553.26. On that day, Atlantic Supply was delinquent on loans owed to First Whitney Bank, on lease payments owed to RJT Properties, and on real property taxes owed to the Cass County Treasurer.

Roger Thielen obtained from plaintiffs $86,392.25 in excess of the amount needed for the down payment to Xpedx. On the same day that he deposited the funds into Atlantic Supply's account, Roger wrote checks to First Whitney Bank in the amounts of $14,056.90 and $11,952.00. Exhibit 14.

Between October 21 and January 24, 2001, Roger continued to use the excess loan proceeds for personal purposes, business loans, and general operating expenses. The money was used to pay delinquent real estate taxes and lease payments. An accountant was paid $4,206. Deter Motor Co. received $2,056. Roger wrote checks to himself and his son Ryan totaling more than $16,000. Exhibits 14, 16, 17, 18. In the same three--month time period, deposits into the account totaled approximately $22,665. On January 24, 2001, the balance in the account was $1,071.12. Exhibit 18.

On December 30, 2000, Roger Thielen and Atlantic Supply executed a promissory note to plaintiffs for the amount of $1,252,845.00. On the same date, they granted plaintiffs a security interest in the equipment being purchased from Xpedx. Exhibits 20, 21. A financing statement covering the equipment was filed with the Iowa Secretary of State on January 22, 2001. Exhibit D.

In about December 2000, plaintiffs discovered that the Internal Revenue Service had filed a tax lien for Atlantic Supply's unpaid employment taxes. Quarterly 941 taxes were unpaid for each quarter of 1997, 1998, and 1999 and the first quarter of 2000. Unemployment taxes were unpaid for tax years 1997, 1998 and 1999. The amount owed was at least $76,000. Exhibit 25.

In early 2001, plaintiffs requested information from Xpedx. On March 12, 2001, they received from Xpedx a copy of the November 6, 2000 purchase agreement letter showing the actual cost and terms of the equipment purchase. Plaintiffs decided that they would not loan the balance of the purchase price. Neither Roger nor Atlantic Supply had the financial ability to complete the purchase transaction. On March 21, 2001, the equipment order was cancelled. Exhibit 22.

The several items of equipment in the purchase agreement with Xpedx were to be manufactured by various firms in different locations. One of the items was a collator manufactured in England by Setmaster and sold through Rosback Company (the "Rosback collator"). Plaintiffs were not able to cancel the order for the Rosback collator.

In April 2001, Roger and Atlantic Supply assigned to plaintiffs the rights in the equipment purchased from Xpedx. Plaintiffs were authorized to negotiate directly with Xpedx to terminate the purchase agreement, to resell any of the equipment, and to obtain reimbursement of the down payment. Exhibit G.

On April 20, 2001, Phil Thielen and Mary Jo Thielen, Roger Thielen and Atlantic Supply, and Xpedx entered into a settlement agreement and release. The agreement determined the disposition of the $289,461.25 received by Xpedx as a

down payment. Exhibit I at 1. Of that amount, Xpedx retained $159,254.00 as payment in full for the Rosback collator. Xpedx retained another $94,500.00 as payment for other expenses. Plaintiffs received return of $35,707.25. Id., ¶ 2. Roger Thielen and Atlantic Supply agreed they would not receive any portion of the down payment.

The settlement agreement dealt also with disposition of certain equipment. Xpedx agreed to direct Rosback Company to deliver the collator to a location to be determined by plaintiffs and Rosback for resale to a third party. Id., ¶ 4. Pursuant to the agreement, Xpedx released plaintiffs, Roger Thielen, and Atlantic Supply from all claims. In exchange, plaintiffs, Roger, and Atlantic Supply each released Xpedx from all claims. Id., ¶ 5. The agreement did not release Roger or Atlantic Supply from plaintiffs' claims.

After the settlement agreement was executed, plaintiffs decided to leave the collator in England, with the understanding that Rosback Company would attempt to sell it (Tr. 172--173). After approximately a year, Rosback had not sold the collator. No one made an offer to buy the equipment. Plaintiffs then talked with a third party in the United States who could have made use of the equipment (Tr. 167--168). Plaintiffs asked Setmaster to ship the collator to the United States. Phil testified that the firm "couldn't deliver it." (Tr. 168:5.) In June 2002, plaintiffs traveled to England to view the collator. The equipment had been "cannibalized" for parts (Tr. 170:5--11). Plaintiffs brought an action against Rosback. In June 2004, the matter had not been resolved and plaintiffs had received nothing from Rosback. Counsel for plaintiffs recites in his brief (Doc. 54 at 12) that the situation has not changed as of October 2005.

Sometime in 1996, plaintiffs loaned Roger $40,000 to purchase inventory to expand his business (Tr. 163:8--19). Shortly thereafter, Roger was in a serious motor vehicle accident. His injuries impaired his ability to operate his business. Plaintiffs loaned another $38,000 to help him out (Tr. 164:4--9). Thereafter, it appeared to plaintiffs that the business was "on track." In February 1998, plaintiffs obtained a promissory note from Roger for $78,000. Exhibit H.

Phil expected that Roger would pay down the 1998 note with earnings from consulting work for Total Mailing Systems, Inc. ("TMS"), a commercial tenant of Phil. Roger worked for TMS for six to eight weeks between September and November, 2000 (Tr. 91--92). On November 5, 2000, Roger prepared an invoice from Atlantic Supply to TMS for the following items:

Sales consulting fee	$2,750.00
Mileage	268.00
Tax	150.90
Total	$3,168.90

Exhibit 28. TMS paid the invoice on December 8, 2000. Id. Roger made no payments on the $78,000 note.

On November 20, 2002, Phil Thielen brought an action against Roger Thielen in the Nebraska District Court for Douglas County. The action, as amended, sought judgment on two claims: (1) $78,000 owing on the 1998 note and (2) $340,146.25 based on the money advanced in 2000 less the refund from Xpedx. Exhibit U.

On May 14, 2003, following a hearing on the previous day, the Nebraska District Court granted default judgment against Roger Thielen for $521,679.95. Exhibit V. At 6:56 a.m. on the same date, Roger filed a Chapter 7 bankruptcy petition in the United States Bankruptcy Court for the Southern District of Iowa.

Discussion

Plaintiffs ask the court to determine that the debt for the down payment to purchase the printing equipment, in the principal amount of $340,146.25, is nondischargeable under 11 U.S.C. §§ 523(a)(2)(A) and 523(a)(6). Plaintiffs bear the burden of proof by a preponderance of the evidence. Grogan v. Garner, 498 U.S. 279, 111 S.Ct. 654 (1991); Clauss v. Church (In re Church), 328 B.R. 544, 547 (B.A.P. 8th Cir. 2005).

The court first addresses the claim under § 523(a)(6) that the debt is for "willful and malicious injury." In the context of

a dischargeability proceeding, the term "willful" means deliberate or intentional. Johnson v. Logue (In re Logue), 294 B.R. 59, 62--63 (B.A.P. 8th Cir. 2003)(citing Kawaauhau v. Geiger, 523 U.S. 57, 118 S.Ct. 974 (1998)).

> The injury, and not merely the act leading to the injury, must be deliberate or intentional. Malice requires conduct which is targeted at the creditor, at least in the sense that the conduct is certain or almost certain to cause financial harm. . . . Malice requires conduct more culpable than that which is in reckless disregard of the creditor's economic interests and expectancies. The debtor's knowledge that he or she is violating the creditor's legal rights is insufficient to establish malice absent some additional aggravated circumstances.

In re Logue, 294 B.R. at 63 (citations omitted).

For their claim under § 523(a)(6), plaintiffs state that Roger Thielen intentionally provided false information and concealed material facts. They contend that Roger knew at the time he borrowed money from plaintiffs that neither he nor Atlantic Supply had the ability to repay the loan. Plaintiffs argue that Roger's actions constituted malice, because they made it certain or almost certain that plaintiffs would suffer financial harm by making the loan. (Doc. 54 at 23--25.)

The conduct that plaintiffs complain of is the identical conduct that forms the basis for their claim under § 523(a)(2)(A). Exceptions to discharge should be construed narrowly, and the subsections of § 523 should not be interpreted so as to make others superfluous. Berkson v. Gulevsky (In re Gulevsky, 362 F.3d 961, 963 (7th Cir. 2004). Even assuming that plaintiffs have stated a claim distinct from their claim for false representation, the court finds that they have not proved malice. In Barclays American/Business Credit, Inc. v. Long (In re Long), 774 F.2d 875 (8th Cir. 1985), the debtor diverted cash collateral to a new bank account and used the money to pay attorney fees and other expenses in an effort to keep his company in business. The debtor knowingly breached his security agreement, but his conduct did not establish an intent to harm the creditor. Id. at 882. In In re Logue, 294 B.R. 59 (B.A.P. 8th Cir. 2003), the debtor sold cattle at an auction other than the auction designated by a sales restriction in the security agreement. He used the proceeds to feed and maintain his remaining herd. Where a debtor has used the proceeds of collateral in an attempt, albeit an unsuccessful one, to keep a business afloat, malice may not necessarily be inferred from the debtor's breach of the security agreement. Id. at 63 (citing First National Bank of Fayetteville v. Phillips (In re Phillips), 882 F.2d 302, 305 (8th Cir. 1989); In re Long, 774 F.2d at 882).

In the Thielens' case, Roger used most of the additional money obtained from plaintiffs to pay business expenses, including delinquent loan obligations and real estate taxes. This use tends to negate an inference of malice. Plaintiffs have established that he acted intentionally. They have not shown, however, that his conduct was targeted at plaintiffs with an intention to harm them.

False Representation

In order to prevail under § 523(a)(2)(A), a creditor must prove the following: (1) the debtor made a false representation; (2) at the time made, the debtor knew it to be false; (3) the representation was made with the intention and purpose of deceiving the creditor; (4) the creditor relied on the representation; and (5) the creditor sustained the alleged injury as a proximate result of the representation. In re Church, 328 B.R. at 547. A creditor's reliance must be justifiable. Id. (citing Field v. Mans, 516 U.S. 59, 116 S.Ct. 437 (1995)).

Plaintiffs allege that Roger Thielen made the following false representations:

> (1) that he had entered into an agreement with a leasing company before approaching plaintiffs for financing;
>
> (2) that the purchase price of the equipment was $1,252,845;
>
> (3) that the required down payment was 30 percent of the purchase price;
>
> (4) that he had paid the $375,853.50 down payment to Xpedx; and
>
> (5) that Atlantic Supply had the ability to cover operating expenses for the new printing operation.

Roger spoke with two leasing companies about leasing printing equipment. He made reference to specific lease terms in his October 12 letter to plaintiffs. Phil's belief that a leasing company had agreed to lease the equipment to Roger may be relevant to the element of reliance, which will be discussed below. However, it is not necessary to this decision to find whether Roger falsely stated that he had entered into a leasing agreement.

Roger admits that he knowingly made false representations as to the purchase price and the amount of the down payment required by Xpedx. (Tr. 62--63; see Exhibit 3.) He admits knowingly making the false statement that he paid $375,853.50 to Xpedx. (Tr. 63--65.) Roger's concealment of the amount actually paid to Xpedx shows that he made the false statements as to the purchase price and down payment with the intent to deceive.

Roger makes two arguments that concealment of the actual purchase price was consistent with standard business dealings and not indicative of fraudulent intent. First, he says that he purchased the printing equipment for resale to his son's corporation, Mid-America Tribune, and that he did not have to disclose how much profit he was making on the deal. This claim of a valid business motive does not make any sense. Plaintiffs entered into an agreement with Roger and Atlantic Supply. The Mid-America Tribune entity was not even in existence until January 2001. Moreover, a vendor would not make a "profit" by borrowing more money than needed to purchase goods. The vendor would add a profit margin in a subsequent sale to the ultimate user of goods. Roger illustrated the concept himself, using Atlantic Supply's sale of goods as an example (Tr. 85).

Roger's second argument is that a debtor need not disclose manufacturers' incentives to a purchase money lender. For this proposition, Roger cites Greyhound Financial Corn. v. Rosenberger (Matter of Rosenberger), Adv. No. 90-240 (Bankr. S.D. Iowa Sept. 9, 1993) (Hill, J.). In that case, Greyhound agreed to purchase 14 semi--tractors from Freightliner for lease to debtor's corporation. Greyhound independently valued the tractors and verified the purchase price of $1,099,000 directly with Freightliner. Debtor made a side deal with Freightliner to add equipment to the tractors in exchange for a rebate of $210,000. The rebate was paid directly to debtor.

The Rosenberger case does not support Roger's argument. Judge Hill ultimately held the debt dischargeable, because Greyhound failed to show the elements of reliance and damages. The court found, however, that debtor's failure to disclose the rebate was a false representation knowingly made with the intention and purpose of deceiving Greyhound. Id., slip op. at 4. This court finds that Roger's concealment of the manufacturers' incentives was an intentional falsehood made for the purpose of deceiving the plaintiffs. Roger knew that plaintiffs believed they were lending only the purchase price of the equipment. His concealment of the actual price was a device to obtain money for other purposes without the plaintiffs' knowledge.

The court finds also that Roger knowingly made a false statement by representing that Atlantic Supply had the ability to pay the operating expenses of the printing business. Roger knew that Phil was concerned about how the expenses of the new business would be paid. Roger knew that these expenses were the responsibility of Atlantic Supply (Tr. 39:2-9). Roger said he told Phil in this context that "as far as Atlantic Supply Company was concerned it was fine; everything was fine." (Tr. 37:2--19.) Roger knew at the time he made this representation that it was false. Roger made the statement when Atlantic Supply was delinquent on office lease payments, bank loan payments, and real estate taxes. The company had not paid employment taxes for three years, and the IRS had filed a tax lien. Roger said he was justified in telling Phil that Atlantic Supply would be able to pay the added expenses of the printing operation, because he was owed $11,000 for his work regarding TMS. (Tr. 111:11--15.) There was no evidence to support this claim that he expected his work for TMS to be a source of substantial income.

Roger did not tell plaintiffs that Atlantic Supply was in default on bank loans or that it was delinquent on taxes and other obligations. (Tr. 32, 33, 60, 61.) Failure to disclose these material facts also constituted a false representation. See Merchants National Bank of Winona v. Moen (In re Moen), 238 B.R. 785, 791 (B.A.P. 8th Cir. 1999) (citing cases). Phil testified that Roger "stonewalled" plaintiffs when they attempted to obtain financial information from him (Tr. 200:3--18). This testimony supports the conclusion that Roger's failure to disclose Atlantic Supply's delinquencies and tax problems was made with the intention and purpose of deceiving plaintiffs.

Roger contends that plaintiffs acted unreasonably in advancing more than $375,000 without obtaining financial information or doing a lien search, especially considering that he had failed to repay a prior loan of $78,000. The

Supreme Court has expressly held, however, that a plaintiff need not demonstrate reasonable reliance in order to prevail under § 523(a)(2)(A). The standard of proof is the less demanding one of justifiable reliance. Field v. Mans, 516 U.S. 59, 61, 116 S.Ct. 437, 439 (1995). The Bankruptcy Panel for the Eighth Circuit described the standard as follows:

> Justification is a matter of the qualities and characteristics of the particular plaintiff and the circumstances of the particular case. A person is required to use his senses, and cannot recover if he blindly relies upon a misrepresentation the falsity of which would be patent to him if he had utilized his opportunity to make a cursory examination or investigation. It is only where, under the circumstances, the facts should be apparent to one of his knowledge and intelligence from a cursory glance, or he has discovered something which should serve as a warning that he is being deceived, that he is required to make an investigation of his own. The matter seems to turn upon an individual standard of the plaintiff's own capacity and the knowledge which he has, or which may fairly be charged against him from the facts within his observation in light of his individual case.

Waring v. Austin (In re Austin), 317 B.R. 525, 530-31 (B.A.P. 8th Cir. 2004) (quoting Field v. Mans, 516 U.S. at 71--21, 116 S.Ct. at 444).

Applying this standard to the case at hand, the court concludes that plaintiffs have shown justifiable reliance on the false representations made by Roger. Phil Thielen is apparently a successful businessman, but plaintiffs are not commercial lenders. The transaction was between brothers. There was no evidence to suggest that the family relationship gave plaintiffs special knowledge to warn them that they were being deceived. Also, Phil believed that a leasing company had already agreed to lease the equipment to Roger and Atlantic Supply, an indication that the leasing company was comfortable with Roger's ability to pay. Plaintiffs agreed to finance only the purchase price of the equipment. They relied on Roger's representation of the purchase price, believing they would be lending on a secured basis. They requested confirmation that the down payment had been paid to Xpedx. Plaintiffs expected there would be some months' delay in delivery of the equipment after placing the purchase order. Because of time pressure, plaintiffs advanced money for the down payment prior to obtaining documents necessary to create and perfect a security interest. There was no evidence that plaintiffs were alerted to the existence of an IRS lien. They likely believed they would have the usual first lien position of a purchase money lender.

The final issue is damages. Roger admits that he received $375,853.50 from plaintiffs and that plaintiffs have recovered only $35,707.25. Nevertheless, he contends that plaintiffs have failed to prove damages in the amount of the difference, $340,146.25. He makes two arguments: (1) plaintiffs should be required to give him credit for the value of the Rosback collator, or (2) plaintiffs should be denied a deficiency as to the collator, because their failure to sell the equipment is a failure to dispose of the collateral in a commercially reasonable manner. The price of the collator under the purchase agreement was $168,100. Xpedx accepted $159,254 as payment in full for that piece of equipment.

In support of his contention that he was not given credit for the value of the Rosback collator, Roger offered into evidence the judgment entered against him in the Nebraska District Court for Douglas County. The judgment was entered in favor of plaintiffs in the principal amount of $340,146.25 on the December 30, 2000 note. Exhibit V.

A default judgment is a valid, final judgment, which may operate as the basis for claim preclusion. Lynch v. Lynch, 94 N.W.2d 105, 110 (Iowa 1959). The issue in this proceeding is whether plaintiffs suffered damages as a proximate result of Roger's false representations. "Once it is established that specific money or property has been obtained by fraud . . . any debt arising therefrom is excepted from discharge." Cohen v. de la Cruz, 523 U.S. 213, 218, 118 S.Ct. 1212, 1216 (1998). It seems that Roger's arguments are a collateral attack on the judgment.

However, there appears to be some confusion as to the status of the judgment at the time of the bankruptcy. Among the many facts alleged in paragraph 15 of their amended complaint in this adversary proceeding, plaintiffs assert that they obtained a judgment against Roger on May 13, 2003. They contend that of the judgment, the amount of $340,146.25 was obtained by Roger's fraud. In his Answer to Amended Complaint (Doc. 17), Roger denied all the allegations of paragraph 15. No mention of the judgment is contained in the Stipulated Final Pretrial Order (Doc. 31). Nonetheless, in his Trial Memorandum, Roger states that Roger's debt to plaintiffs "was ultimately reduced to judgment on May 14, 2003, the next day Roger filed his Chapter 7 petition." (Doc. 33, p. 2, lines 9--10.)

The evidence contradicts Roger's belief. The judgment (Exhibit V) indicates that the state court held hearing on plaintiffs' motion for summary judgment on May 13, 2003. However, it appears from the exhibit that the presiding judge did not execute the judgment until May 14, 2003, and it was not entered on the court's docket until May 15. I take judicial notice of the bankruptcy court docket and find that the bankruptcy case was filed at 6:56 a.m. on May 14, 2003. I am unable to determine when the state court judge executed the judgment. If it was after the filing of the bankruptcy case, the issuance of the judgment was void under 11 U.S.C. § 362. Matter of Vanzandt, 326 B.R. 737, 744 & n.9 (Bankr. S.D. Iowa 2004) (citing LaBarge v. Vierkant (In re Vierkant), 240 B.R. 317 (B.A.P. 8th Cir. 1999)). If the state court judge executed the judgment prior to the filing of the bankruptcy petition, I would conclude that the later entry of the judgment on the docket did not violate the automatic stay. In re Capgro Leasing Associates, 169 B.R. 305, 315 (Bankr. E.D.N.Y. 1994).

The burden was on plaintiffs to prove a valid final judgment in state court if they desired to rely on any preclusive effects of the judgment in this adversary proceeding. They have failed to meet their burden.

Assuming that Roger is not precluded from challenging the amount of damages, his arguments are without merit. The Rosback collator was a custom--manufactured, specialized piece of equipment. See Exhibit R. Plaintiffs did not take on the newspaper printing business, nor did they take possession of the collator. They agreed that the seller could retain possession of the equipment and try to resell it. This decision seems reasonable, in that the equipment was overseas and in the hands of a firm that, presumably, had the contacts and expertise to find a buyer. No offers were made on the equipment. Plaintiffs then attempted to have the collator shipped to a potential buyer in the United States. They traveled to England to view the equipment. They discovered the equipment had been stripped of parts. Additionally, Phil suffered physical impairment for some months at the end of 2001 into 2002 from Guillain-Barre Syndrome, a disorder of the nervous system (Tr. 174--175).

The evidence indicates that sale was prevented by actions outside of plaintiffs' control. Roger has not proven that plaintiffs failed to dispose of the collator in a commercially reasonable manner. Roger's entire obligation on the December 30, 2000 note should be held nondischargeable.

Roger still contends that he should receive a credit on plaintiffs' claim to the extent of any recovery by plaintiffs in any future disposition of the collator or from plaintiffs' recovery, if any, against the manufacturer. Plaintiffs have not asked the bankruptcy court to enter a money judgment against Roger, perhaps believing that they have a valid final judgment from state court. If they do, the issue of the credit may be precluded by that judgment. If they do not, the plaintiffs and Roger might ask to present that issue to the state court for determination in its final judgment or in any proceedings auxiliary to judgment. I conclude in this proceeding that Roger's discharge does not discharge his debt to plaintiffs for the money loaned him on October 19, 2000. The present principal balance of this loan is $340,146.25. This debt is excepted from discharge under 11 U.S.C. § 523(a)(2)(A).

IT IS ORDERED that the claims of Phil Thielen and Mary Jo Thielen against Roger Thielen pursuant to 11 U.S.C. § 523(a)(4) and 523(a)(6) are dismissed.

IT IS FURTHER ORDERED that Roger Thielen's debt to Phil Thielen and Mary Jo Thielen in the principal amount of $340,146.25 is excepted from the Chapter 7 discharge of Roger Thielen pursuant to 11 U.S.C. § 523(a)(2)(A).

DATED AND ENTERED January 27, 2006.

William L. Edmonds
U.S. Bankruptcy Judge