

Dated: July 26, 2011
The following is ORDERED:



Jennie D. Latta

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UNITED STATES BANKRUPTCY JUDGE

UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF TENNESSEE
WESTERN DIVISION

In re

BOBBY L. MACK, JR. and REBECCA B. MACK,

Debtors.

Case No. 09-34390-L
Chapter 7

TENNESSEE DEPARTMENT OF TREASURY,
Plaintiff,

v.

BOBBY L. MACK, JR. and REBECCA B. MACK,
Defendants.

Adv. Proc. No. 10-00151

ORDER ON MOTIONS FOR SUMMARY JUDGMENT

BEFORE THE COURT is a motion filed by Defendant Bobby L. Mack, Jr. seeking dismissal on the pleadings with regard to Plaintiff's section 727(a) claim for denial of discharge, and summary judgment with respect to Plaintiff's section 523(a)(2), (4), and (6) claims. Dkt. No. 60. The Plaintiff, Tennessee Department of Treasury, has filed a timely response in which it acknowledges

that it does not object to the entry of the general discharge of the Defendant, Mr. Mack, but that it does object to the entry of summary judgment as to its section 523(a) claims. Dkt. No. 73. The Plaintiff has also filed its own motion for summary judgment against both Mr. and Mrs. Mack. Dkt. No. 75. Mr. Mack has filed a motion to strike the Plaintiff's motion for summary judgment on the basis that it was untimely filed. Mrs. Mack has filed no response, but has recently appeared by her attorney, Henry C. Shelton. Trial on the merits is set for August 8, 2011.

The court has carefully considered the pleadings, affidavits, and briefs filed by the parties, and concludes that summary judgment should be granted for the Defendant, Mr. Mack, and should be denied for Plaintiff, Tennessee Department of Treasury ("Treasury"), successor to Southwest Tennessee Development District. This is a core proceeding. 28 U.S.C. § 157(b)(2)(B)(I).

FACTS

The background facts are these. Southwest Tennessee Development District ("SWTDD") made a loan to Bellinger Academy, a business owned by Mrs. Mack, for the purpose of acquiring office furniture and equipment (the "Loan"). The Loan was guaranteed by Mrs. Mack, but not by Mr. Mack. The Loan proceeds were not used for their intended purpose. The Macks filed a voluntary petition under Chapter 7 of the Bankruptcy Code on December 29, 2009. SWTDD commenced this adversary proceeding by filing its complaint on March 31, 2010. The Tennessee Department of Treasury was later substituted as Plaintiff. Although the Defendants filed a joint answer to the complaint, their counsel, S. Jonathan Garrett, later withdrew when it became apparent that Mrs. Mack did not intend to participate in the defense of this case. Mr. Russell Savory was substituted as counsel for Mr. Mack, and filed Mr. Mack's motion to dismiss and for summary judgment. On March 9, 2011, the court entered its order giving Mrs. Mack two weeks from the date

that Mr. Mack's attorney received notification from the Plaintiff concerning discovery responses that it claimed were inadequate to respond to Plaintiff's discovery requests. Dkt. No. 51. Mrs. Mack has not filed responses, but the Plaintiff has not sought default judgment as to her as they were entitled to do by the court's prior order. At a hearing on June 27, 2011, Ms. Lauren Lamberth, attorney for the Plaintiff announced that it would no longer pursue summary judgment as to Mr. Mack. The court indicated that it had prepared a draft order with respect to the motions and would enter it promptly. The same day, the court received a letter from Mrs. Mack asking the court to assist her in obtaining counsel. The court made some inquiries, and Mrs. Mack has obtained new counsel, Mr. Shelton, who participated in a scheduling conference together with Ms. Lamberth, on July 20, 2011. At that hearing, the court announced that the motion for summary judgment would be denied as to Mrs. Mack for reasons that would be more fully explained in its written order. This order will cover the motions of the Plaintiff and Mr. Mack.

STANDARD FOR GRANTING SUMMARY JUDGMENT

Summary judgment may be granted "if the movant shows that there is no genuine dispute as to any material fact and the movant is entitled to judgment as a matter of law." Fed. R. Civ. P. 56(a), made applicable in adversary proceedings through Fed. R. Bankr. P. 7056 (West 2010-11).

ANALYSIS

Mr. Mack's Motion to Dismiss and for Summary Judgment

Mr. Mack submitted the following undisputed facts in support of his motion, all of which are supported by his affidavit:

1. Bobby L. Mack did not make any false representations to Plaintiff in connection with the Bellinger Academy loan.

2. Bobby L. Mack is not a maker, co-maker, or guarantor of the Bellinger Academy loan.
3. Bobby L. Mack is not a party to the Bellinger Academy Loan Agreement and did not sign it.
4. Bobby L. Mack was never a trustee for or a fiduciary to Plaintiff pursuant to any written agreement.
5. Plaintiff did not lend any funds to Bobby L. Mack.
6. Bobby L. Mack, Jr. has never been an officer, director or shareholder of Bellinger Academy, Inc. and has not possessed or exercised any powers to operate or direct the operations of said corporation.
7. Bobby L. Mack did not write any checks on or order any transfers of funds [sic] from the bank account of Bellinger Academy, Inc.
8. Bobby L. Mack did not willfully or maliciously injure Plaintiff or its property.

Statement of Undisputed Facts, Dkt. No. 60, Ex. 5.

Plaintiff asserts that there are at least three disputed issues of material fact that preclude the entry of summary judgment for Defendant Mr. Mack. First, Plaintiff asserts that there is a dispute as to whether Mr. Mack was a guarantor of the Loan. Second, Plaintiff asserts that there is a dispute as to whether Mr. Mack wrote any checks or transferred any funds from the Bellinger Academy, Inc.'s account at Bank of America. Third, Plaintiff asserts that there is a dispute as to whether Mr. Mack willfully and maliciously injured SWTDD and its property. The court will consider each of these in turn to determine whether they present factual or legal disputes.

Mr. Mack Was Not a Guarantor of the Loan

There is no question that Mr. Mack did not execute a guaranty agreement in connection with the Loan. Instead, Plaintiff asserts that Mr. Mack was a guarantor of the Loan by virtue of his joining in the execution of a deed of trust in favor of SWTDD. Mr. Mack did execute a deed of trust

in favor of SWTDD. Treasury Stmt. Undisputed Facts, Dkt. No. 72, Ex. D. The mere fact that Mr. Mack's interest in property was pledged to secure the Loan, however, does not render Mr. Mack a guarantor of the Loan. *See, e.g., In re Cutaio*, 2007 WL 2713390, *2-3 (Bankr. D. Md. 2007) (Debtors who signed deed of trust but not guaranty have no personal liability for underlying obligation.). The Plaintiff has failed to produce any agreement establishing Mr. Mack's personal liability for the repayment of the loan. Even if it had, that in and of itself would merely establish a debt. It would not render the debt nondischargeable, which is the ultimate objective of the Plaintiff in this lawsuit.

***Even if Mr. Mack Had Access to the Accounts of Bellinger Academy,
Plaintiff has Failed to Articulate A Theory By Which He Would Be Liable to
Plaintiff for his Use or Misuse of Them***

Plaintiff next asserts that Mr. Mack wrote checks and transferred funds from the Bellinger Academy bank account to himself. If this were true, and his transfers were unauthorized, Mr. Mack would be liable to Bellinger Academy. These same facts do not, however, establish his liability to the Plaintiff. Once the Plaintiff disbursed Loan proceeds to Bellinger Academy, it lost ownership of those funds and stood in the relationship of creditor to its debtor, Bellinger Academy. Plaintiff has failed to show that Mr. Mack guaranteed the repayment of Bellinger Academy's loan, and has not advanced any other theory pursuant to which Mr. Mack's misuse of Bellinger Academy's funds would entitle the Plaintiff to look to him for repayment of the Loan.

Mr. Mack Did Not Embezzle Funds of SWTDD

The Plaintiff next asserts that Mr. Mack attended the loan closing, was aware of the purpose of the Loan, and that use of the proceeds was limited to the purchase of specific office furniture and equipment. Plaintiff further asserts that notwithstanding this knowledge, Mr. Mack caused Bellinger

Academy to transfer funds to himself. The Plaintiff concludes from this that Mr. Mack “embezzled at least \$10,200 in checks entrusted to him as the agent of Bellinger Academy.”¹ Embezzlement, for purposes of section 523(a)(4) is “the fraudulent appropriation of property by a person to whom such property has been entrusted or into whose hands it has lawfully come.” *Chapman v. Pomainville (In re Pomainville)*, 254 B.R. 699, 704-05 (Bankr. S.D. Ohio 2000), quoting *Brady v. McAllister (In re Brady)*, 101 F. 3d 1165, 1172-73 (6th Cir. 1996) (other citations omitted.) Embezzlement requires proof that the allegedly misappropriated funds were owned by the plaintiff and not by the debtor. *See Bank of Kentucky v. Ruhe (In re Ruhe)*, 2005 WL 4030037, *1 (Bankr. S.D. Ohio 2005), citing *In re Brady*, 101 F. 3d at 1173. Again, as we have seen, once proceeds of the Loan were disbursed to Bellinger Academy, SWTDD lost its ownership in the funds. It became a creditor of Bellinger Academy. Mrs. Mack was also liable for that debt in the event that Bellinger Academy failed to pay, but Mr. Mack never guaranteed that obligation. The funds were those of Bellinger Academy to use as it saw fit (within the parameters of any loan agreement), but Mr. Mack cannot be said to have embezzled funds from SWTDD. If anything, Mr. Mack may have made unauthorized withdrawals from Bellinger Academy, but the Plaintiff has not presented evidence that would raise a disputed issue of fact concerning this.

¹ Plaintiff’s leading sentence would lead the reader to believe that it intended to assert that Mr. Mack was indebted to it and that that indebtedness is excepted from discharge by 11 U.S.C. § 523(a)(6). The Plaintiff makes no argument along those lines, however, focusing instead on an assertion of embezzlement, which is the subject of 11 U.S.C. § 523(a)(4). As the Plaintiff made no argument that Mr. Mack willfully and maliciously injured it, the court has not addressed this argument except insofar as it has noted that loan proceeds disbursed to a borrower are no longer the property of the lender.

Conclusions Regarding the Motion of Mr. Mack

For the foregoing reasons, the court concludes that Mr. Mack's motion to dismiss the complaint, insofar as it seeks to deny the general discharge of Mr. Mack, should be **GRANTED**, and that Mr. Mack's motion for summary judgment as to Counts I-III of the complaint, raising questions concerning the dischargeability of a particular debt, should likewise be **GRANTED**. In the face of Mr. Mack's motion for summary judgment, the Plaintiff failed to establish that Mr. Mack is indebted to it in any way, or to raise any material disputed fact that would require trial on that issue.

The Plaintiff's Motion for Summary Judgment

The Plaintiff seeks summary judgment as to both Mr. and Mrs. Mack. Only Mr. Mack filed a timely response. The court has previously granted summary judgment for Mr. Mack on the basis that the Plaintiff failed to establish a debt owed to it by Mr. Mack. Its motion for summary judgment against Mr. Mack is therefore **DENIED**.

In its motion for summary judgment as to Mrs. Mack, the Plaintiff alleges that Mrs. Mack:

- (1) knowingly and materially misrepresented to SWTDD how she was going to use the loan proceeds; upon which SWTDD justifiably relied to its detriment (11 U.S.C. § 523(a)(2)(A));
- (2) embezzled from SWTDD (11 U.S.C. § 523(a)(4)); and
- (3) failed to purchase the collateral for SWTDD's loan, instead spending the majority of the proceeds on personal expenditures. (11 U.S.C. §523(a)(6)).

The Plaintiff has filed a Statement of Undisputed Facts supported by a series of affidavits and the deposition of Mrs. Mack. Dkt. No. 72. The Statement provides as follows:

THE LOAN APPLICATION

1. On February 5, 2008, Rebecca B. Mack, as the President and sole owner of Bellinger Academy, Inc., applied for a \$125,000 Small and Minority-Owned Business (“SMOB”) loan from the Southwest Tennessee Development District (“SWTDD”). (Rule 26(a) Disclosures and Joint Pretrial Statement, p. 7.)

2. In her loan application, Ms. Mack itemized a list of furniture and equipment, totaling \$123,939.68, that she wished to buy for Bellinger Academy, Inc. That list is attached hereto as Exhibit A.

3. Prior to applying for a SMOB loan from SWTDD, Ms. Mack obtained a \$50,000 loan for Bellinger Academy, Inc. from the United States Small Business Administration. (Deposition of Rebecca Mack, pp. 60-61).

THE LOAN PURPOSE

4. The stated purpose of the SMOB loan was for the purchase of the office furniture and equipment listed in the Itemized List of Furniture and Equipment contained in the loan application. (Bobby Mack’s Supplemental Response to Request for Admission # 3; Rule 26(a) Disclosures and Joint Pretrial Statement, p 8.)

5. When SWTDD approved the loan application, it issued a Commitment Letter, indicating that the loan purpose was to “finance the purchase of furniture and equipment for Bellinger Academy, Inc. located in the Colonnade Center, 1661 International Drive, Memphis, Tennessee. Borrower will be required to obtain a 5 year lease.” (Commitment Letter dated 4/7/08, attached hereto as Exhibit B; emphasis in original.)

6. The loan agreement, attached hereto as Exhibit C, restricted the use of the loan proceeds to the purchase of the items referred to in Exhibit A. (Bobby Mack’s Supplemental Response to Request for Admission # 3 and # 4.)

THE LOAN'S COLLATERAL

7. The loan was secured, in part, by Bellinger Academy, Inc.'s accounts receivable, equipment, furniture, and supplies; now owned or hereafter acquired; wherever located replacements and substitutions thereof and accessions thereto; and the proceeds and products thereof. (Rule 26(a) Disclosures and Joint Pretrial Statement, pp. 7-8.)

8. The loan was also secured by a Deed of Trust signed by both Mr. and Ms. Mack on their real property located at 1359 Hidden Ridge Lane in Memphis, Shelby County, Tennessee, a copy of which is attached hereto as Exhibit D.

MISUSE OF THE LOAN PROCEEDS

9. The loan closed on May 13, 2008. (Rule 26(a) Disclosures and Joint Pretrial Statement, p. 7.)

10. Both Mr. and Ms. Mack were present at the loan closing. (Affidavit of Joe W. Barker, ¶ 4; Affidavit of Clay McCormack, Esq., ¶ 4.)

11. At the loan closing, Clay McCormack, an attorney for SWTDD, explained the purpose of the loan and that use of the proceeds was limited to the purchase of the office furniture and equipment listed in the Itemized List of Furniture and Equipment, attached hereto as Exhibit A. (Affidavit of Clay McCormack, Esq., ¶ 5.)

12. Exhibit E is a true and correct copy of the Bellinger Academy, Inc.'s bank account records as well as the Macks' bank and credit card records. (Bobby Mack's Supplemental Response to Request for Admission # 5; Deposition of Rebecca Mack, pp. 123-25, 128, 130, 133-36, 139, 142-45, 147, 183.)

13. On May 14, 2008, loan proceeds in the amount of \$119,995.05 were deposited into Bellinger Academy, Inc.'s Bank of America bank account. (Deposition of Rebecca Mack, p. 149; Exhibit E.)

14. Exhibit F is a true and correct copy of summaries of how the Macks spent the loan proceeds prepared by auditors at Treasury

for reasons unrelated to this adversary proceeding. (Affidavit of Stacey Jackson, ¶¶ 2 and 5.)

15. According to the summaries and the Affidavit of Stacey Jackson, Internal Auditor for Treasury, none of the loan proceeds were used appropriately, i.e., for the purchase of the office furniture and equipment listed in the Itemized List of Furniture and Equipment, attached hereto as Exhibit A. Instead, the summaries indicate that the Macks used \$93,605.47 of Bellinger Academy, Inc.'s loan funds for personal expenditures, including \$4,310.00 in cashed checks/ATM, and \$36,575.55 in deposits into their personal bank accounts. (Affidavit of Stacey Jackson, ¶ 6.)

16. The summaries further indicate all of the loan proceeds were spent within seven months and Bellinger Academy, Inc.'s Bank America bank account was subsequently forced closed with a negative balance. (Exhibit F.)

17. On the same day the loan proceeds were deposited, \$6,000.00 was transferred from the Bellinger Academy, Inc.'s Bank of America bank account to the Macks' personal Bank of America bank account via check number 1023, written to Bobby Mack. (Bobby Mack's Supplemental Response to Request for Admission # 8; Deposition of Rebecca Mack, pp. 148-49; Exhibit E.)

18. None of the \$6,000.00 was spent on the office furniture and equipment listed in the Itemized List of Furniture and Equipment, attached hereto as Exhibit A. (Deposition of Rebecca Mack, p. 149.). Instead, once transferred into the Macks' personal Bank of America bank account, the \$6,000.00 was spent on private school tuition, fine crystal, food, mortgage payments and other loan payments. (Affidavit of Stacey Jackson, ¶ 5, Exhibit F.)

19. On or about May 27, 2008, \$1,500.00 was transferred from the Bellinger Academy, Inc.'s Bank of America bank account to the Macks' personal First TN bank account via check number 1027. (Bobby Mack's Supplemental Response to Request for Admission # 11; Deposition of Rebecca Mack, pp. 124-25, 150-51; Exhibit E.)

20. On or about June 9, 2008, \$5,000.00 was transferred from the Bellinger Academy Inc.'s Bank of America bank account to pay the Macks' personal Bank of America credit card. (Bobby Mack's

Supplemental Response to Request for Admission # 12; Deposition of Rebecca Mack, p. 184; Exhibit E.)

21. On or about June 10, 2008, \$3,500.00 was transferred from the Bellinger Academy, Inc's Bank of America bank account to the Macks' personal First TN bank account via check number 1034. (Bobby Mack's Supplemental Response to Request for Admission # 13; Deposition of Rebecca Mack, p. 155; Exhibit E.)

22. On or about June 17, 2008, \$460.00 was transferred from the Bellinger Academy, Inc.'s Bank of America bank account to the Macks' personal Bank of America bank account via check number 1035. (Bobby Mack's Supplemental Response to Request for Admission # 14; Deposition of Rebecca Mack, p. 155; Exhibit E.)

23. On or about June 19, 2008, \$1,000.00 was transferred from the Bellinger Academy, Inc's Bank of America bank account to the Macks' personal First TN bank account via check number 1036. (Bobby Mack's Supplemental Response to Request for Admission # 15; Deposition of Rebecca Mack, pp. 125, 157; Exhibit E.)

24. On or about June 24, 2008, \$600.00 was transferred from the Bellinger Academy, Inc's Bank of America bank account to the Macks' personal First TN bank account via check number 1037. (Bobby Mack's Supplemental Response to Request for Admission # 16; Deposition of Rebecca Mack, pp. 126, 157; Exhibit E.)

25. On or about July 1, 2008, \$1,000.00 was transferred from the Bellinger Academy, Inc's Bank of America bank account to the Macks' personal First TN bank account via check number 1038. (Bobby Mack's Supplemental Response to Request for Admission # 17; Deposition of Rebecca Mack, pp. 126, 160; Exhibit E.)

26. On or about July 15, 2008, \$3,500.00 was transferred from the Bellinger Academy, Inc's Bank of America bank account to the Macks' personal First TN bank account via check number 1046. (Bobby Mack's Supplemental Response to Request for Admission # 19; Deposition of Rebecca Mack, pp. 127, 164; Exhibit E.)

27. On or about July 17, 2008, \$500.00 was transferred from the Bellinger Academy, Inc.'s Bank of America bank account to the Macks' personal Bank of America bank account via check number 1048. (Bobby Mack's Supplemental Response to Request for Admission # 20; Deposition of Rebecca Mack, p. 165; Exhibit E.).

The check was written by and to Mr. Mack even though he was not a signatory on the checking account. (Deposition of Rebecca Mack, p. 165; Exhibit E.)

28. On or about July 17, 2008, \$1000.00 was transferred from the Bellinger Academy, Inc's Bank of America bank account to the Macks' personal First TN bank account via check number 1051. (Bobby Mack's Supplemental Response to Request for Admission # 21; Deposition of Rebecca Mack, pp. 128, 167; Exhibit E.)

29. On or about July 29, 2008, \$1,500.00 was transferred from the Bellinger Academy, Inc's Bank of America bank account to the Macks' personal First TN bank account via check number 1053. (Bobby Mack's Supplemental Response to Request for Admission # 28; Deposition of Rebecca Mack, pp. 129, 168; Exhibit E.)

30. On or about August 6, 2008, Rebecca Mack cashed check number 1059, a \$2,200.00 check written from the Bellinger Academy, Inc.'s Bank of America bank account. (Deposition of Rebecca Mack, pp. 172-73; Exhibit E.)

31. On or about August 15, 2008, \$5,000.00 was transferred from the Bellinger Academy, Inc's Bank of America bank account to the Macks' personal First TN bank account via check number 1058. (Bobby Mack's Supplemental Response to Request for Admission # 32; Deposition of Rebecca Mack, pp. 129, 171; Exhibit E.)

32. On or about August 19, 2008, \$4,000.00 was transferred from the Bellinger Academy, Inc's Bank of America bank account to the Macks' personal First TN bank account via check number 1060. (Bobby Mack's Supplemental Response to Request for Admission # 33; Deposition of Rebecca Mack, pp. 130, 173; Exhibit E.)

33. On or about August 28, 2008, \$3,000.00 was transferred from the Bellinger Academy, Inc's Bank of America bank account to the Macks' personal First TN bank account via check number 1062 written to Mr. Mack. (Bobby Mack's Supplemental Response to Request for Admission # 34; Deposition of Rebecca Mack, pp. 130, 173; Exhibit E.)

34. On or about September 15, 2008, \$4,015.55 was transferred from the Bellinger Academy, Inc.'s Bank of America bank account to the Macks' personal Bank of America bank account via check number 1066. (Bobby Mack's Supplemental Response to

Request for Admission # 35; Deposition of Rebecca Mack, pp. 175-76; Exhibit E.)

35. On or about November 20, 2008, Mr. Mack cashed check number 1077, a \$700.00 check written from the Bellinger Academy, Inc.'s Bank of America bank account. (Bobby Mack's Supplemental Response to Request for Admission # 36; Deposition of Rebecca Mack, pp. 179-80; Exhibit E.)

36. Ms. Mack could not identify any purchases made from the Macks' personal bank accounts for the office furniture and equipment listed in the Itemized List of Furniture and Equipment, attached hereto as Exhibit A. (Deposition of Rebecca Mack, pp. 124-25, 128-29, 133-37, 139, 141-46, 149.)

37. Mr. Mack admits that at least some of the loan proceeds were not used for the loan's stated purpose. (Bobby Mack's Supplemental Response to Request for Admission # 39; Exhibit E.)

38. Between Mr. and Ms. Mack, only a single receipt for office furniture has been produced. That receipt was from Office Depot dated September 16, 2008, in the amount of \$901.09, a copy of which is attached hereto as Exhibit G. The office furniture listed therein was not the office furniture and equipment listed in the Itemized List of Furniture and Equipment, attached hereto as Exhibit A. (See Deposition of Rebecca Mack, p. 56.)

39. Ms. Mack never signed a lease for premises at the Colonnade Center, 1661 International Drive, Memphis, TN, as required by the loan agreement. Instead, in September 2008, Ms. Mack, on behalf of Bellinger Academy, Inc., signed a lease for premises at 751 Walnut Knoll Lane, Cordova, TN 38018. (Lease Agreement, attached hereto as Exhibit H; Rebecca Mack's Response to Request for Admission # 41.)

40. Ms. Mack, on behalf of Bellinger Academy, Inc., was evicted from the Walnut Knoll Lane rental location for failure to pay rent when due. (Affidavit of Terry Pilcher, ¶ 5.)

41. Following eviction from the premises, Terry Pilcher, the maintenance coordinator, conducted the "set out" of the abandoned property. (Affidavit of Terry Pilcher, ¶ 6.)

42. When Mr. Pilcher entered the premises, he found only some desks, chairs, a small television, some teaching software, and

some books. In accordance with customary procedures, he set these items outside the premises. There were no computers, printers, copy machines, or fax machines on the premises. (Affidavit of Terry Pilcher, ¶ 7.)

THE LOAN DEFAULT AND DAMAGES

43. The Promissory Note, attached hereto as Exhibit I, provided for sixty consecutive monthly installments of principal and interest in the amount of \$2,287.99. The promissory note further provided for attorney's fees and costs and penalties in the event of default. (Affidavit of Teresa Sanders, ¶ 4.)

44. During the fall of 2008, the loan payments were not made when due. On or about February 5, 2009, the loan was declared to be in default and notice of the default was mailed to Mr. and Ms. Mack along with a demand for payment of the arrearages in full. (Affidavit of Joe W. Barker, ¶ 8.)

45. Ms. Mack had made only four payments, resulting in a principal balance of \$117,068.36. (Affidavit of Teresa Sanders, ¶ 5.)

46. Interest accruing from the date of the last payment on August 29, 2008, to the bankruptcy filing date, December 29, 2009, is \$1,170.68. (Affidavit of Teresa Sanders, ¶ 6.)

47. Late fees from October 2008 to December 2009 total \$1,716.00. (Affidavit of Teresa Sanders, ¶ 7.)

48. Up until December 29, 2009, when the Macks' bankruptcy was filed, SWTDD incurred \$3,442.25 in attorney's fees and costs in attempt to collect SWTDD's outstanding balance of the loan between Ms. Mack and SWTDD. (Affidavit of Matthew R. West, ¶ 4.)

THE BANKRUPTCY AND ADVERSARY PROCEEDING

49. On December 29, 2009, Debtors filed a Chapter 7 Voluntary Petition.

50. On January 28, 2010, SWTDD filed a claim in the amount of \$127,461.24 (court claim #3). (Rule 26(a) Disclosures and Joint Pretrial Statement, p. 8.)

51. On March 31, 2010, SWTDD timely filed a complaint against Debtors, alleging that the debt owed to SWTDD is nondischargeable pursuant to 11 U.S.C. § 523(a)(2), (4), and (6). (Rule 26(a) Disclosures and Joint Pretrial Statement, p. 8.)

52. Effective September 1, 2010, the debt represented by court claim # 3 was transferred from SWTDD to Treasury. (Rule 26(a) Disclosures and Joint Pretrial Statement, p. 8.)

53. By a consent order dated September 3, 2010, Treasury was substituted for SWTDD as Plaintiff. (Rule 26(a) Disclosures and Joint Pretrial Statement, p. 8.).

Standard of Proof

At trial, the Plaintiff will bear the burden to prove facts excepting Mrs. Mack's debt from discharge by a preponderance of the evidence. *Grogan v. Garner*, 498 U.S. 279, 287 (1991). Exceptions to discharge are strictly construed against the creditor and liberally in favor of the debtor. *In re McCoy*, 269 B.R. 193, 199 (Bankr. W.D. Tenn. 2001), citing *Meyer v. Rigdon*, 36 F.3d 1375 (7th Cir. 1994).

It is important to recall how Mrs. Mack is indebted to the Plaintiff. SWTDD made a loan to Bellinger Academy, which was guaranteed by Mrs. Mack. The Plaintiff is the successor by assignment of the claim of SWTDD. Bellinger Academy is a corporation; thus, it is liable for its own debts. Mrs. Mack was the president and sole shareholder of Bellinger Academy. Bellinger Academy defaulted on its obligation to SWTDD. Mrs. Mack is indebted to the Plaintiff as guarantor of the loan to Bellinger Academy. The Plaintiff asserts that this debt should be excepted from discharge on three bases: material misrepresentation, embezzlement, and willful and malicious injury. The court will consider each of these in turn.

Material Misrepresentation - Section 523(a)(2)(A)

In order to prevail under Count I of the Complaint, Plaintiff must show that:

1. Mrs. Mack obtained money through a material misrepresentation that, at the time, the debtor knew to be false or made with reckless disregard to its truth;
2. Mrs. Mack intended to deceive SWTDD;
3. SWTDD justifiably relied on the false representation; and
4. SWTDD's reliance was the proximate cause of its loss.

See Rembert v. AT&T Universal Card Servs., Inc. (In re Rembert), 141 F.3d 277, 280-81 (6th Cir. 1998).²

First, the Plaintiff must show that Mrs. Mack obtained money by a representation that was false. The record provided by the Plaintiff is inadequate to establish this fact. At the time the loan was closed, the furniture described in the list attached to the loan application had not been purchased by Bellinger Academy, and this fact was known to SWTDD. There was no misrepresentation of fact concerning the purchase of furniture at the time the loan was closed. With respect to the intended use of the Loan proceeds, the Loan Agreement provides:

1.03 Use of Loan Proceeds. The proceeds of the Loan shall be used for financing for the purchase of furniture and equipment for Bellinger Academy, Inc. . . . The Borrower [Bellinger Academy] agrees that it will apply the funds received by it under this Agreement in accordance with the use of loan proceeds specified in the loan application for funds provided pursuant to this loan ("loan application").

² To be sure, a plaintiff may also show actual fraud encompassing 'any deceit, artifice, trick or design involving direct and active operation of the mind, used to circumvent and cheat another.' *Mellon Bank, N.A., v. Vitanovich (In re Vitanovich)*, 259 B.R. 873, 877 (BAP 6th Cir. 2001) quoting *McClellan v. Cantrell*, 217 F.3d 890 (7th Cir. 2000). The Plaintiff in this case, however, relies upon material misrepresentation in its argument.

Pltf's Stmt of Undsptd Facts, Ex. C, ¶ 1.03. The Loan Agreement was signed by Bellinger Academy by its president, Rebecca Mack. The Plaintiff has not shown that Mrs. Mack individually made any representation concerning the use of the Loan proceeds. Moreover, the representation cited from the Loan Agreement is a promise or agreement, not a statement of fact. The paragraph goes on to include another promise of Bellinger Academy concerning the number of employees it would obtain within two years of the agreement, clearly a matter that could not be "represented" at the time of closing because it concerned events that would occur over time. False representations or false pretenses within the meaning of section 523(a)(2)(A) generally encompass statements that falsely purport to depict current or past facts. *In re Morgan*, 415 B.R. 644, 649 (Bankr. E.D. Tenn. 2009). The Loan Agreement further provides under the heading, "Affirmative Covenants," but not under the heading, "Representations and Warranties," that the "Borrower [again, Bellinger Academy] shall apply the proceeds of the Loan solely for the purposes set forth in Section 1.03 of this Agreement." Pltf's Stmt of Undsptd Facts, Ex. C, ¶ 4.05. The agreement to purchase furniture, according to the Loan Agreement, was an affirmative covenant or promise, not a representation. The failure of Bellinger Academy to purchase the furniture was a breach of contract, and an event of default. *See* Pltf's Stmt of Undsptd Facts, Ex. C, ¶ 6.01(c).

The Plaintiff asserts that it was more, however. The Plaintiff asserts that Mrs. Mack misrepresented to SWTDD her *intention* to purchase furniture with the loan proceeds and that this misrepresentation renders her obligation to it nondischargeable. The Plaintiff relies upon proof of what was actually done with the Loan proceeds to establish the fact that Mrs. Mack materially misrepresented to SWTDD how she was going to use the Loan proceeds. The Plaintiff has not pointed to a specific representation by Mrs. Mack in the record. It recites that she applied for a loan

as president of Bellinger Academy; that attached to her loan application was a list of furniture and equipment that she wished to buy for Bellinger Academy; that the stated purpose of the loan was to buy the furniture and equipment; that the Commitment letter indicated that the purpose of the Loan was to purchase the furniture and equipment; and that the loan agreement restricted the use of the loan proceeds. Pltf's Stmt of Undsptd Facts, ¶¶ 1, 2, 4, 5, 6. It may be said that Bellinger Academy's acceptance of the Loan proceeds was itself a non-verbal representation that it would comply with the terms of the Loan Agreement, but the Loan Agreement makes failure to use the proceeds for their intended purpose an event of default. Since the contract provided for this eventuality, and treated it as a breach of contract, not a fraud, it seems inappropriate for the court to supply additional remedies. Moreover, Mrs. Mack indicated in her deposition that she understood that in addition to the purchase of equipment and furniture, the Loan was intended for working capital. Dep. of Rebecca Mack, p. 138-39. Mrs. Mack's deposition makes clear that she undertook numerous activities in furtherance of her dream of establishing a school., and that at least some of these involved use of the loan proceeds.

Second, the Plaintiff must establish that Mrs. Mack intended to deceive it. Here the requirement is that the Plaintiff not only show that Mrs. Mack made a false statement, but that in making that false statement, she intended to deceive SWTDD. The Plaintiff relies upon the same circumstantial proof of the actual use of the Loan proceeds with respect to this element. Specifically, the Plaintiff points to the transfer of \$6,000 to the Macks' joint bank account from the account of Bellinger Academy on the day of the closing as proof that Mrs. Mack knew at the time the Loan was closed that she was going to misuse the Loan proceeds, and thus that she intended to deceive SWTDD. At the closing, funds were disbursed to Bellinger Academy and no requirement

was made that Bellinger Academy provide proof of purchase of the furniture and equipment listed in the Loan application. It is difficult to determine how SWTDD was deceived, but matters of intent generally are not susceptible to decision on summary judgment. *Buckeye Retirement Co., LLC, LTD. v. Swegan (In re Swegan)*, 383 B.R. 646, 655-656 (B.A.P. 6th Cir. 2008).

Third, the Plaintiff must show that SWTDD justifiably relied upon the false representation of Mrs. Mack. Justifiable reliance is a less demanding standard than that of reasonable reliance but requires more than mere reliance in fact. Justifiable reliance is an intermediate standard. *Field v. Mans*, 516 U.S. 59, 72-74 (1995). Under this standard:

[T]he plaintiff is entitled to rely upon representations of fact of such a character as to require some kind of investigation or examination on his part to discover their falsity, and a defendant who has been guilty of conscious misrepresentation cannot offer as a defense the plaintiff's failure to make the investigation or examination to verify the same.

Field v. Mans, 516 U.S. at 72, quoting 1 F. Harper & F. James, Law of Torts § 7.12, pp. 581-83 (1956). The court goes on, however, to indicate that reasonableness continues to play a part in the determination of whether reliance was justified:

[T]he greater the distance between the reliance claimed and the limits of the reasonableness, the greater the doubt about reliance in fact. Naifs may recover, at common law and in bankruptcy, but lots of creditors are not at all naive. The subjectiveness of justifiability cuts both ways, and reasonableness goes to the probability of actual reliance.

Id. at 76. Did SWTDD in fact rely upon any representation of Mrs. Mack concerning the use of the Loan proceeds? The Loan was secured by more than the furniture and equipment to be purchased. Mr. Joe W. Baker, Executive Director of Southwest Tennessee Development District, explains that the Loan was approved because the use of the proceeds was restricted, but acknowledges that the Loan was to be secured in three ways: first, a security agreement in the equipment and furniture

purchased by Bellinger Academy; second, the personal guaranty of Mrs. Mack; and third, a Deed of Trust from both of the Macks on their home. Barker Aff., ¶ 3. The court will need to hear more at trial, but given that this was a commercial loan transaction, the court would have expected SWTDD to have protected itself by requiring proof of purchase of the required furniture and equipment. Instead, SWTDD simply prepared a Security Agreement and UCC-1 financing statement covering “Debtors’ accounts receivable, equipment, furniture, and supplies, now owned or hereafter acquired; wherever located; replacements and substitutions therefore and accessions thereto; and proceeds and products thereof.” Complaint, Exs. C and D. Neither of these documents includes a list of specific property to be purchased with proceeds of the Loan. Had SWTDD requested proof of purchase and Bellinger Academy, through its president, provided proof that was false, this would be a very different case. As it is, the court will need to hear more at trial about SWTDD’s actual reliance upon any representation made by Mrs. Mack.

Fourth, SWTDD will have to show that its loss was proximately caused by its reliance upon Mrs. Mack’s representation. The loss to SWTDD was proximately caused by the failure of Bellinger Academy to repay the loan, and the inadequacy of its collateral. The furniture and equipment to be purchased by Bellinger Academy was only one part of SWTDD’s collateral. This case is distinguishable from the two cases relied upon by the Plaintiff, *In re McCoy*, 269 B.R. 193,199 (Bankr. W.D. Tenn. 2001), and *In re Eccles*, 393 B.R. 845, 851 (Bankr. W.D. Mo. 2008), *aff’d*, 407 B.R. 338 (BAP 8th Cir. 2009), in that in those cases, the items to be purchased were the only collateral for the subject loans. The failure of the debtors in those cases to purchase the intended items resulted in there being no collateral for the loans. The fact that there was additional collateral

in this case makes it harder for the court to say that the failure of Bellinger Academy to use the Loan proceeds in the way intended was the *proximate* cause of SWTDD's losses.

There are genuine disputes concerning Mrs. Mack's intention with respect to the Loan proceeds that prevent the entry of summary judgment for the Plaintiff.

Embezzlement - Section 523(a)(4)

In Count II of the Complaint, the Plaintiff seeks a declaration that Mrs. Mack's debt to it should be excepted from discharge on the basis that it resulted from embezzlement. Embezzlement, for purposes of section 523(a)(4) is "the fraudulent appropriation of property by a person to whom such property has been entrusted or into whose hands it has lawfully come." *Chapman v. Pomainville (In re Pomainville)*, 254 B.R. 699, 704-05 (Bankr. S.D. Ohio 2000), quoting *Brady v. McAllister (In re Brady)*, 101 F.3d 1165, 1172-73 (6th Cir. 1996) (abrogated on other grounds as explained in *Nat'l Dev. Servs. v. Denbleyker (in re Denbleyker)*, 251 B.R. 891 (Bankr. D. Colo. 2000) (other citations omitted). Embezzlement requires proof that the allegedly misappropriated funds were owned by the plaintiff and not by the debtor. *See Bank of Kentucky v. Ruhe (In re Ruhe)*, 2005 WL 4030037 (Bankr. S.D. Ohio, citing *Brady*, 101 F.3d at 1173. Once proceeds of the Loan were disbursed to Bellinger Academy, SWTDD lost its ownership in the funds. It became a creditor of Bellinger Academy. Mrs. Mack was also liable for that debt as a guarantor. The funds were those of Bellinger Academy to use within the parameters of the Loan Agreement. Mr. and Mrs. Mack may have made unauthorized withdrawals from Bellinger Academy, but these were the funds of Bellinger Academy, not SWTDD. It does not appear that the Plaintiff is entitled to judgment on the issue of embezzlement, but Mrs. Mack did not seek summary judgment on any issue herself so the court will reserve judgment on this issue for trial.

Willful and Malicious Injury - Section 523(a)(6)

Finally, in Count III of the Complaint, the Plaintiff seeks a declaration that Mrs. Mack's debt to it should be excepted from discharge on the basis that it resulted from willful and malicious injury to the property of SWTDD. In order to prevail, the Plaintiff must show an injury that was both willful and malicious. *Markowitz v. Campbell (In re Markowitz)*, 190 F.3d 455, 463 (6th Cir. 1999). It is not enough that the defendant's act was intentional. The plaintiff must show that the injury to its property was intended or was substantially certain to occur. *Kawaauhau v. Geiger*, 523 U.S. 57, 61 (1998); *Markowitz*, 190 F.3d at 464. Prior to the decision in *Geiger*, the Sixth Circuit defined an act as malicious if it were undertaken "in conscious disregard of one's duties or without just cause or excuse; it does not require ill will or specific intent to do harm." *Wheeler v. Laudani*, 783 F.2d 610, 615 (6th Cir. 1986). The Sixth Circuit Bankruptcy Appellate Panel has ruled that that formulation was overruled by *Geiger*. *In re Bullock-Williams*, 220 B.R. 345, 347 (BAP 6th Cir. 1998). The BAP has said that in order to establish that a debt should be excepted from discharge under section 523(a)(6), a plaintiff must show more than a 'knowing breach of contract.' *Id.* As the Supreme Court indicated in *Geiger*, the language of section 523(a)(6) is indicated to encompass intentional torts.

The mere failure to repay a loan, without more, will never fall within this exception. The Plaintiff asserts that the misuse of the Loan proceeds provides proof of that something more. The court is convinced from its review of the deposition of Mrs. Mack, however, that there is at least a genuine issue for trial as to her intention with respect to the use and repayment of the Loan that requires a trial. Mrs. Mack clearly took steps after receiving the loan proceeds that were consistent with an intent to establish a school and inconsistent with an intent to harm the Plaintiff.

CONCLUSIONS

For the foregoing reasons, the motion of Bobby L. Mack, Jr. for summary judgment against the Tennessee Department of Treasury shall be **GRANTED**. The motion of Tennessee Department of Treasury for summary judgment against Bobby L. Mack, Jr. and Rebecca B. Mack shall be **DENIED**. The court will enter judgment for Bobby L. Mack, Jr., there being no just reason for delay. *See* Federal Rule of Civil Procedure 54(b) made applicable in bankruptcy proceedings by Federal Rule of Bankruptcy Procedure 7054(a).

cc: Debtors/Defendants
Attorneys for Debtors/Defendants
Plaintiff
Attorney for Plaintiff
Chapter 7 Case Trustee