

**UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF TENNESSEE
EASTERN DIVISION**

In re

**DAVID SHERWOOD AND PATRICIA BREWTON McADOO,
Debtors.**

Case No. 02-12101

Chapter 7

**FIRST CITIZENS NATIONAL BANK,
Plaintiff,**

v.

Adv. Pro. No. 02-5272

**DAVID SHERWOOD AND PATRICIA BREWTON McADOO,
Defendants.**

**MEMORANDUM OPINION AND ORDER RE
PLAINTIFF'S COMPLAINT TO DETERMINE DISCHARGEABILITY**

The Court conducted a hearing on the Plaintiff's Complaint to Determine Dischargeability on April 2, 2003. FED. R. BANKR. P. 9014 Resolution of this matter is a core proceeding. 28 U.S.C. § 157(b)(2). The Court has reviewed the testimony from the hearing and the record as a whole. This Memorandum Opinion and Order shall serve as the Court's findings of facts and conclusions of law. FED. R. BANKR. P. 7052.

I. FINDINGS OF FACT

At issue in this case is a promissory note executed on April 15, 1996. On that date, the debtors obtained a line of credit with First Citizens National Bank, (hereinafter "Bank") in the amount of \$215,100.00. According to the terms of the agreement, the debtor David McAdoo, (hereinafter David McAdoo will be referred to as the "debtor" or "McAdoo"), was to use this line of credit to construct town homes on eight lots he owned in Union City, Tennessee. *See*, TRIAL EXHIBIT 1. The Bank took a security interest in the lots as collateral for the loan. *See*, TRIAL EXHIBIT 1 and TRIAL EXHIBIT 2. The original expiration date of the loan was April 15, 1997; however, the loan was renewed several times eventually expiring on January 26, 2002. *See*, TRIAL EXHIBIT 1.

Over the next few years, McAdoo developed and sold town homes on lots 1, 2, 3, 4, 5, 6, and 7.¹ Both McAdoo and Sherry Brown, vice-president at the bank, (hereinafter referred to as "Brown"), testified that once a lot and town home was sold, the normal course of dealing for the parties would be

¹There is some controversy regarding the sale of lot 6 which will be discussed infra.

that the proceeds were applied to the note at the bank, the lien was released and a warranty deed was prepared. John L. Warner, an attorney in Union City, prepared all of the warranty deeds for these conveyances.² McAdoo sold lots 1 and 2 to the “Mickey J. Smith and Pamela B. Smith Family Trust” on February 10, 1998 for the amount of \$115,000.00. On September 28, 1998, McAdoo sold lot 3 to Patricia Ann Christian for \$70,090.00. McAdoo sold Lot 4 to Dorris W. Elkins on March 12, 1999 for \$25,000.00. On May 4, 1999, McAdoo sold lot 5 to Jerry Wayne Bivins, Jr. & Mary Beth Bivins for \$12,000.00. On December 7, 1999, McAdoo sold lot 6 to William H. Cruce and Teresa Parementer for \$78,500.00. Finally, McAdoo sold lot 7 to Eunia Mae Harris on June 29, 2000, for \$74,150.00. All of the deeds were timely recorded at the Obion County Register’s office. *See*, TRIAL EXHIBIT 4.

The parties are in agreement as to the disposition of lots 1, 2, 3, 4, 5, and 7. Brown signed a “Partial Release of Deed of Trust” in her capacity as vice president of the bank for each of these lots and both Brown and McAdoo testified that the proceeds of these sales were remitted to the bank. *See*, TRIAL EXHIBIT 5; however, the parties disagree about the disposition of lot 6. The debtor testified that he signed all of the necessary paperwork at Warner’s office as he had done in the case of the other lots. The debtor also testified that he remitted the proceeds from the sale of lot 6 to the bank. The bank, on the other hand, alleges that the debtor sold lot 6 out of trust without remitting any of the proceeds to the bank. Although he had copies of the “Partial Release of Deed of Trust” for lots 1, 2, 3, 4, 5, and 7, the debtor did not produce a copy of the release for lot 6. Also, the debtor did not submit any kind of receipt or cancelled check that proved he had remitted the \$78,500.00 in proceeds from the sale of lot 6 to the bank. Brown testified that the bank did not learn of the sale of lot 6 until after McAdoo had filed his bankruptcy case and the bank had begun foreclosure proceedings on lots 6 and 8. The title company for lot 6 contacted the bank after the foreclosure proceedings had been initiated and eventually paid the bank \$78,500.00 to release the title. The bank applied this money to McAdoo’s debt.

After the sale of lot 7 in June 2000, the debtor made three more draws on the line of credit. He withdrew \$20,000 on July 27, 2000, \$25,000 on August 22, 2000, and \$28,500 on January 2, 2001. Brown testified that at the time these draws were made, the bank assumed that the debtor was using the money to build town homes on lots 6 and/or 8. When the bank began foreclosure proceedings on lots 6 and 8 after the debtor had filed for chapter 7 relief, the bank discovered that lot 6 had previously been sold and that lot 8 was unimproved. McAdoo testified that he used some, but not all, of the \$73,500 he withdrew after the sale of lot 7 to make small improvements to lot 8. According to his testimony, he graded the lot, concreted a drainage ditch and built a fence. McAdoo did not submit any evidence of

²The court used the date on the individual warranty deeds to determine the “sold” dates for lots 1 - 7. *See*, TRIAL EXHIBIT 4.

these improvements. Brown testified that lot 8 was eventually sold as a vacant lot for \$10,000.00. The bank applied these proceeds to McAdoo's note.

While McAdoo was involved in building the town homes in Union City, he also was working on other construction jobs. According to his testimony, he averaged fifteen reasonable-sized jobs and twenty to twenty-five smaller jobs a year. The construction of one town home was considered one job. McAdoo did both residential and commercial work. Some of the other jobs he worked on during this time were state jobs which were completed without loans. In situations such as these, McAdoo testified that he would make arrangements with suppliers to pay when he received money from the state every sixty to ninety days. He also testified that much of the labor on the state jobs was subcontracted out and he would pay the subcontractors like he did the suppliers.

McAdoo testified that he had been in the construction business in Northwest Tennessee for several years prior to entering into the security agreement with the bank. McAdoo also testified that he always understood that the line of credit was to be used to build the town homes on the Union City lots. When questioned about the money he withdrew after lot 7 was sold, McAdoo was insistent that he never intended to injure the bank's security interest in lot 8. He went on to state that, aside from the small improvements allegedly made to lot 8, he could not remember where or how he spent the money he withdrew on July 27, 2000, August 22, 2000, and January 2, 2001. On direct examination, the debtor claimed that he was having severe problems with his business in late 2000 and early 2001. People were backing out of deals, employees were walking off the job and, as a result, McAdoo was way behind schedule.

On direct examination by his attorney, the debtor testified that he had made several payments to the bank which had never been credited to his account. McAdoo submitted copies of six checks he allegedly deposited at the bank over the course of two years. *See*, TRIAL EXHIBIT 6. These checks total \$83,142.01. McAdoo's copies of the checks are copies of the front of the check only. The backs were not copied and there were no markings on the front to show if they had ever been handled by the bank. Additionally, McAdoo did not produce receipts of these deposits. The bank has no record of these deposits ever being made.

II. CONCLUSIONS OF LAW

Section 523(a)(6) of the Bankruptcy Code states:

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

. . .

(6) for willful and malicious injury by the debtor to another entity or to the property of another entity.

11 U.S.C. § 523(a)(6). A creditor seeking to have a debt declared non-dischargeable under this section must prove § 523(a)(6)'s elements by a preponderance of the evidence. *Grogan v. Garner*, 498 U.S. 279, 291 (1991). Once a creditor establishes a prima facie case, the burden shifts to the debtor to present credible evidence that a defense to the liability exists. *Sears Roebuck & Co., v. Miller (In re Miller)*, 70 B.R. 55, 56 (Bankr. S.D. Ohio 1987). Exceptions to discharge are to be strictly construed against the creditor and liberally in favor of the debtor "with the benefit of any doubt going to the debtor." *Manufacturer's Hanover Trust Co. v. Ward (In re Ward)*, 857 F.2d 1082, 1083 (6th Cir. 1988).

Until recently, the Sixth Circuit's standard for § 523(a)(6)'s "willful" requirement was rather lenient. As long as a debtor could be shown to have intentionally committed an act which led to an injury, he would be found to have acted "willfully" under § 523(a)(6), regardless of whether or not he actually intended the injury. *Perkins v. Scharffe*, 817 F.2d 392, 394. Perkins was overruled in 1998 by the U.S. Supreme Court case of *Kawaauha v. Geiger*, 523 U.S. 57, 18 S.Ct. 974, 140 L.Ed.2d 90 (1998). In *Geiger*, the Supreme Court held that only acts done with the intent to cause the actual injury will rise to the level of a "willful and malicious injury" as used in § 523(a)(6). *Id.* In light of the Supreme Court's ruling in *Geiger*, the Sixth Circuit amended its definition of "willful" as used in § 523(a)(6):

[W]e now hold that unless "the actor desires to cause consequences of his act, or . . . believes that the consequences are substantially certain to result from it," he has not committed a "willful and malicious injury" as defined under § 523(a)(6).

Markowitz v. Campbell (In re Markowitz), 190 F.3d 455, 464 (6th Cir. 1999).

In addition to requiring a creditor to prove that a debtor acted willfully, § 523(a)(6) also requires the creditor to show that the debtor acted maliciously. 11 U.S.C. § 523(a)(6). "Under § 523(a)(6), a person is deemed to have acted maliciously when that person acts in conscious disregard of his duties or without just cause or excuse." *Gonzalez v. Moffitt (In re Moffitt)*, 252 B.R. 916, 923 (B.A.P. 6th Cir. 2000) (citations omitted); *River View Land Co., Inc., v. Bucak (In re Bucak)*, 278 B.R. 488, 493 (Bankr. W.D. Tenn. 2002) (citations omitted) ("The definition of 'malicious,' for section 523(a)(6) purposes, is proven when a creditor shows that a debtor acted in conscious disregard of the rights of others, without just cause or excuse.").

As with § 523(a)(2)(A)'s requirement of establishing fraudulent intent, proving that a debtor acted willfully and maliciously under § 523(a)(6) can be difficult. Debtors will rarely, if ever, admit to acting in a willful or malicious manner. As a result, a creditor may establish that a debtor acted "willfully" by presenting circumstantial evidence. *J & A Brelage, Inc., v. Jones (In re Jones)*, 276 B.R. 797, 802 (Bankr. N.D. Ohio 2001):

. . . the "willful" requirement of § 523(a)(6) may be indirectly established by the creditor demonstrating the existence of two facts: (1) the debtor knew of the creditor's lien rights; and (2) the debtor knew that his conduct would cause injury to those rights.

. . .
It therefore follows that, for purposes of determining whether a debtor knew his actions would injure the creditor's lien rights, a rebuttable presumption will arise when the debtor, despite having knowledge as to the implications of the security agreement, took no action to protect the creditor's interest therein.

Jones, 276 B.R. at 802 (citations omitted); *see also*, *O'Brien v. Sintobin (In re Sintobin)*, 253 B.R. 826, 831 (Bankr. N.D. Ohio 2000); *Rizzo v. Passialis (In re Passialis)*, 292 B.R. 346, 353 (Bankr. N.D. Ill. 2003).

In the case at bar, the bank has alleged that McAdoo willfully and maliciously injured its security interest in lot 8 when he did not use the money he withdrew in late 2000 and early 2001 to improve the lot. The promissory note states on its face that the purpose of the loan was to construct town homes on the Union City lots. McAdoo testified at the trial that he understood that the money was to be used to construct the town homes. McAdoo also testified that he had been in the construction business for a number of years at the time he entered into the loan agreement with the bank. When the debtor sold lots 1, 2, 3, 4, 5, and 7, he secured a release of lien from the bank and remitted the proceeds to the bank. This behavior demonstrates to the Court that the debtor was fully aware that the bank had a security interest in the lots and town homes.

After reviewing all of the evidence presented at the trial along with the fact that the debtor made three significant withdrawals over the course of four to five months, the Court finds that the debtor did willfully and maliciously injure the bank's security interest. The moment the debtor spent the first dollar of the July 2000 withdrawal on something other than improving lot 8, he was aware that he was harming the bank's interest. When he made the other two withdrawals in August and January, he destroyed any chance of successfully defending his actions.

III. ORDER

It is therefore **ORDERED** that First Citizens National Bank is awarded a non-dischargeable judgment against the debtors in the amount of \$73,500.00.

IT IS SO ORDERED,

BY THE COURT,

**G. Harvey Boswell
United States Bankruptcy Judge**

Date: June 24, 2003