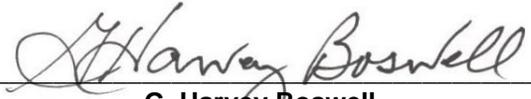




Dated: April 14, 2004
The following is SO ORDERED.


G. Harvey Boswell
UNITED STATES BANKRUPTCY JUDGE

UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF TENNESSEE
EASTERN DIVISION

In re

TOM D. CRISWELL AND LOU ANN CRISWELL,

Debtors.

FIRST CITIZENS NATIONAL BANK,

Plaintiff,

v.

TOM D. CRISWELL AND LOU ANN CRISWELL,

Defendants.

Case No. 03-11856

Chapter 7

Adv. Pro. No. 03-5272

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

The debtors in this case, Tom and Lou Ann Criswell, filed their chapter 13 petition on April 14, 2003. Their case was converted to chapter 7 on May 20, 2003, and was discharged on September 26, 2003. Pursuant to the terms of the discharge order, the Criswell's discharge was reserved as to First Citizens National Bank ("First Citizens" or "Bank").

Prior to filing for bankruptcy relief, the debtors obtained a loan from First Citizens in the principal amount of \$55,000. The loan was secured by the debtors' principle residence in Newbern, Tennessee. At issue in this adversary proceeding is for what purpose the proceeds of this loan were to be used. The debtors contend that they thought the proceeds could be used for improvements to the

Newbern property and for living expenses. The Bank contends that the proceeds were to be used strictly for home improvements.

Although the debtors did make some minor repairs to the property before defaulting on the loan, the majority of the proceeds were not spent on improving the property. First Citizens alleges that by failing to use the money to make the home improvements, the debtors willfully and maliciously harmed the bank's security interest in the Newbern property. As a result, First Citizens contends that the balance of the note should be found non-dischargeable under 11 U.S.C. § 523(a)(6).

The Court conducted a trial on the Plaintiff's Complaint to Determine Dischargeability on February 11, 2004. FED. R. BANKR. P. 7001 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

The debtors applied for the loan at issue in this case on April 23, 2002. In so doing, they met with Rob Kerr, a loan officer at First Citizens. The debtors provided Kerr with the information necessary to complete the Uniform Residential Loan Application (Trial Exhibit 1). According to both Tom Criswell's and Rob Kerr's testimony, Kerr filled in the information on the application as he was talking to the debtors. Tom Criswell admitted that the signatures on the application are his and his wife's. He also admitted that he did not read the application closely before signing it.

At the time of applying for the loan, the debtors originally sought to borrow \$40,000.00. Before the loan was disbursed in August 2002,¹ the debtors had increased the loan request to \$55,000.00. On page 1 of the loan application, under "amount," there is a line through the \$40,000.00 figure and "55,000.00" is written above it. There is also a handwritten note from Rob Kerr on page 4 of the application indicating the increase in the loan amount.

Under section II of the loan application, the purpose of the loan is listed as "home improvements" with the subject property being the Newbern house and lot. The debtors proposed to give the Bank a lien on the property as collateral for the loan. According to section VI of the application, the house was lien free at the time of entering into the agreement with the Bank.

¹Tom Criswell inherited the house and lot in Newbern from his father; however, at the time of applying for the loan, the title to the property was still in his father's name. As a result, the loan was not disbursed until the title was transferred to Tom Criswell in August 2002.

In section VII of the application, "Details of the Transaction," the following notations were made:

Alterations, improvements, repairs \$40,000.00
Estimated closing costs \$809.62
Total costs \$40,809.62
Loan amount \$40,809.62

Rob Kerr testified that although the amount on page 1 of the application was changed to \$55,000.00 when the loan amount was increased, the figures in this section were not updated to reflect the increased amount. The Court will presume that the increased loan amount applied to this section as well with the \$40,000.00 figure being increased to \$55,000.00 and the "total costs" and "loan amount" being increased to \$55,809.62.

Tom Criswell testified that at the time of applying for the loan, he had just returned to work with the State of Tennessee after being on sick leave for eight months. Criswell suffers from hepatitis C and liver cancer and had been undergoing chemotherapy in 2001 and 2002. In March 2002, Criswell's doctor had released him to go back to work. Criswell returned to his job as CFO with the state's Department of Finance and Administration in Arlington, Tennessee. According to the loan application, he also had a private CPA practice in which he earned \$2,083.00 per month. Criswell earned \$5,000.00/month with the state. At the time of applying for the loan as well as at the time of the trial, Lou Ann Criswell did not work outside the home.

The loan was eventually disbursed in August 2002. The debtors signed the promissory note on August 7, 2002, in the amount of \$55,875.19. Trial Exhibit 2. The debtors also signed a deed of trust in favor of the Bank on that same day. Trial Exhibit 3. The deed was registered on August 8, 2002, in Dyer County. Trial Exhibit 3.

In conjunction with the loan closing, the Bank prepared a U.S. Department of Housing and Urban Development Settlement Statement. A total of \$875.19 was deducted from the loan proceeds to pay taxes and fees. An additional \$10,163.12 was disbursed to First Citizens to pay off a bridge loan the debtors had obtained while waiting for the disbursement of the \$55,000.00 loan. The remaining \$44,462.29 in loan proceeds was disbursed to the debtors.

Both Rob Kerr and Paul Newell, loan officers at the Bank, testified that they had spoken with the debtors about the purpose of the loan. According to Kerr and Newell, the debtors never mentioned using the proceeds for anything other than home improvements to the Newbern property. Newell specifically testified that his approval of the Criswells' loan was based on the understanding that the proceeds would be used to improve the debtor's house.

According to his trial testimony, Tom Criswell “felt obligated” to use some of the loan proceeds for home improvements, but also believed that he was at liberty to use a portion of the proceeds for living expenses and to catch up bills he had fallen behind on while on sick leave. Lou Ann Criswell was not present at the trial in this matter because she was ill; however, her December 5th 2004 exam was admitted into evidence. Trial Exhibit 8. When asked during this exam if she thought she and her husband had the liberty to use the loan proceeds for anything other than home improvements, Lou Ann Criswell replied “No, I guess not.”

Some of the home improvements Tom Criswell hoped to make with the loan proceeds included replacing the flooring throughout the house, installing new kitchen cabinets, adding a deck, enlarging the living room and adding a carport. Criswell got estimates from two contractors for this work. One of the contractors told Criswell that if he contracted the work out himself, the improvements would cost between \$25,000 and \$30,000. If Criswell hired a contractor, he was told to expect to add at least 10% to the estimate. Criswell testified that he did not hire either of the contractors he got quotes from because one of the contractors was busy and could not do the repairs. When asked why he did not hire the other contractor, Criswell stated that he and his family would have to move out of the house before some of the repairs could be made and they were not able to do that “just then.”

Although he did not go forward with the improvements for which he got estimates, Tom Criswell did make some minor renovations. He installed a new kitchen sink which cost \$175.00. He replaced some rotted eave boards at a cost of \$300.00 to \$500.00. He had plumbing work done on three separate occasions which cost \$50.00, \$130.00 and \$200.00 respectively. He purchased and installed a ceiling fan which cost between \$200.00 and \$225.00. He also had some dirt hauling work done to remedy a water drainage problem from the neighboring property. This work cost \$500.00.

In addition to these repairs, Criswell purchased a set of french doors which cost between \$1000.00 and \$1300.00, new flooring for the house at a cost of \$3500.00 and tiles at a cost of \$250.00. Criswell stored these items in a building behind the house in Newbern. Before he could install the supplies, however, they were stolen. Neither Criswell nor his wife reported the theft to the police or their insurance company. The debtor did not present any receipts or other paperwork evidencing these purchases.

Sometime after receiving the loan proceeds in August 2002, the debtors defaulted on the note. As a result, the Bank foreclosed on the property. At the time of foreclosing, the Bank was granted access to the house and took photographs of the interior. Trial Exhibit 7. With the exception of the new kitchen sink and the ceiling fan, nothing appears to have been done to update or improve the house. The kitchen cabinets and appliances look to be original to the house when it was built in 1967. The bathroom looks

not only to be original, but badly in need of repair. The Court was unable to tell if any other portions of the house had been updated. In every one of the photographs submitted as an exhibit, it looks as if a tornado had recently struck the interior of the house. Food, toys, clothing, empty boxes, and trash were strewn in every room of the house with no apparent rhyme or reason.

After the Bank foreclosed on the property, the house was put up for auction. The Bank was the high bidder at the sale with a credit bid of \$45,000.00. According to the testimony of two bank officials, the debtors were given credit for the entire amount of the bid. The principal amount due after the credit is \$10,206.51. From the day of the sale to the day of the trial, \$359.04 in interest has accumulated on the outstanding principal. The Bank previously charged off \$2,801.00 in interest. There is a standard late charge on the account of \$64.20. The Bank has also incurred \$380.00 in court reporter fees and an undisclosed amount in attorney's fees and filing fees in bringing this action.

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. *Meyers v. I.R.S. (In re Meyers)*, 196 F.3d 622 (6th Cir. 1999).

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:

. . . 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.

J & A Brelage, Inc., v. Jones (In re Jones), 276 B.R. 797, 802 (Bankr. N.D. Ohio 2001) (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 debtors signed an application which stated on its face that the sole purpose of the loan was for "home improvements." Trial Exhibit 1, Section II. The application further specified that the entire loan amount was to be used for "alterations, improvements, repairs" to the Newbern house. Trial Exhibit 1, Section VII. Rob Kerr testified that he spoke with the debtors about the purpose of the loan and it was clear that all of the loan proceeds were to be used for home improvements. Paul Newell also testified that it was understood among all the parties that the sole purpose of the loan was to improve the Newbern house.

In addition to the loan application language and the bank officials' testimony regarding the parties' understanding, the debtors also admitted that they understood what the loan proceeds were to be used for. Lou Ann Criswell stated in her 2004 exam that she thought all of the proceeds were to be used for improving the house. Tom Criswell testified that he "felt obligated" to use at least some of the money for home improvements. He also testified that he got estimates for the improvements he intended to make with the loan proceeds. The low end of these estimates was \$25,000.00.

The debtors received \$44,462.29 in loan proceeds from First Citizens in August 2002. Of this, the debtors spent \$1,780.00 on materials and labor for the house. The remaining 95.99% of the money was apparently spent on living expenses.² Given the fact that both debtors admitted knowing that at least a portion of the loan proceeds were to be used on home improvements, they acted in a willful manner when they commenced spending almost 96% of the proceeds for expenses other than home improvements. Their use of the vast majority of the proceeds in this manner also leads the Court to conclude that the debtors acted in conscious disregard of their duties under the note. When they signed the loan application for home improvements, they had an obligation to use the loan proceeds for that purpose. The debtors knew why the bank loaned them the money and that the house secured the loan. When they made no effort to use the proceeds to improve the house, they knowingly injured the Bank's security interest.

As a result of these conclusions, the Court finds that the Bank is entitled to a non-dischargeable judgment against the debtors in the amount of \$12,030.75. The Court determined this amount by adding the outstanding principal, interest, late charges and court reporter fees. The Court then subtracted the \$1,780.00 the debtors spent on the house from this amount. The Court also finds that the Bank is entitled to recover their attorney's fees in this matter. *In re Martin*, 761 F.2d 1163, 1168 (6th Cir. 1985).

² Tom Criswell also testified that he spent between \$1,000.00 and \$1,300.00 on a set of french doors, \$3,500.00 on flooring for the house and \$250.00 on tiles for the house. Before any of these items could be installed in the house, however, the debtors claim they were stolen. Because the debtors did not report the theft to the police, file a claim with their insurance company, or presents any receipts for these alleged purchases, the Court does not find there is sufficient evidence to include these expenses in the total of money actually spent on the house.

III. ORDER

It is therefore **ORDERED** that First Citizens National Bank is awarded a non-dischargeable judgment against the debtors in the amount of \$12,030.75 plus First Citizens National Bank's attorney's fees. The attorney for First Citizens National Bank shall have twenty days from entry of this order to file an application for fees. The Court will set the application for a hearing and give the debtors an opportunity to file an objection to the application.

Mailing Information

Gerald Ketchum, Attorney for Debtor

Mark D. Johnston, Attorney for First Citizens National Bank