

UNITED STATES BANKRUPTCY COURT  
WESTERN DISTRICT OF TENNESSEE  
EASTERN DIVISION

IN RE:

DAVID JON WOOLF and  
TAMMY ANN WOOLF,  
DEBTORS.

Case No. 91-10972-K (WHB)  
Chapter 7

CITY STATE BANK,  
PLAINTIFF,

V.

Adversary No. 91-0261

DAVID JON WOOLF,  
DEFENDANT.

IN RE:

MICHAEL SHANE JONES,  
DEBTOR.

Case No. 91-11010B  
Chapter 7

CITY STATE BANK,  
PLAINTIFF,

V.

Adversary No. 91-0264

MICHAEL SHANE JONES,  
DEFENDANT.

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MEMORANDUM OPINION AND ORDER ON CITY STATE BANK'S  
OBJECTIONS TO DISCHARGE

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In these two Chapter 7 cases, identical adversary proceedings were filed by City State Bank of Martin, Tennessee ("Bank"), against the debtors David Jon Woolf and Michael Shane Jones. In a pre-trial order entered in Adversary Proceeding number 91-0261, that proceeding was transferred from Chief Judge David S. Kennedy to Judge William Houston Brown for the purpose of allowing the two adversary proceedings to be tried together. A trial was conducted in Jackson, Tennessee, on November 20, 1991, after which the Court took the issues under advisement until the Bank reported back to the Court on its efforts to recover and sell any collateral still in the possession or control of the two defendants. See Order entered

December 12, 1991. The attorney for the Bank has reported to the Court by letter dated January 30, 1992, with copies to counsel for the defendants, on the Bank's efforts.

#### FINDINGS OF FACT

The facts presented in these proceedings are not complicated. The Bank made a loan on June 9, 1989, to the two defendants for the principal sum of \$21,263.15, which note was to balloon on July 16, 1990. The note was secured by certain business equipment of the debtors, doing business as J. & W., and a security agreement and financing statement were executed and perfected. The security agreement, which was a part of the printed note, provided for security in "all business assets." The UCC financing statement described the security as "equipment." The original note was renewed on October 5, 1990. The Bank sued the defendants in the Weakley County, Tennessee, Chancery Court and obtained a default judgment on December 12, 1990, for \$23,199.03, plus costs. The Chapter 7 cases were filed by the defendants after the Bank obtained and attempted to execute upon its judgment.

The Bank, in filing the adversary proceedings, entitled them "Objection To Discharge;" however, the complaints refer to §523 of the Bankruptcy Code, which governs exceptions from discharge. Compare 11 U.S.C. §727(a) governing objections to discharge. The complaints also allege that the defendants "fraudulently disposed of the collateral without the authorization of the Bank, or fraudulently induced the Bank to make such loan without having such collateral." Further, the complaints allege that the collateral was disposed of without application of any proceeds to the Bank's loan. The prayer for relief asks the Court to grant the Bank's "objection to discharge of the debt owed to [the Bank]." The Court reads the complaints as not alleging a basis for a general denial of discharge under §727(a), but rather a basis for exception from discharge under §523(a). Unfortunately, the complaints do not refer to specific Code sections. However, the Sixth Circuit has recently observed that "[w]hether a complaint alleges a cause of action is a question of law...." Vulcan Coals, Inc., et al. v. Howard, 946 F.2d 1226, 1228 (6th Cir. 1991). The Court will discuss its conclusions of law later in this opinion.

At the trial of these proceedings the defendants apparently revealed for the first time to the Bank that

they still had some of the collateral in their possession. However, much of the collateral was left in the former business location of the defendants. The defendants had gone into the business of metal coating, and their equipment consisted largely of specialized plating tanks, dryers, rectifiers, and other items related to metal coating processes. See Trial Exh. 2. The defendants were not in business very long and they had operated in a portion of a building owned by Thomas M. Kesterson, who was engaged in the same type business. Mr. Kesterson assisted the defendants in going into business and leased some space to these defendants. When the defendants went out of business, they asked Mr. Kesterson for permission to leave some of the equipment in Mr. Kesterson's building, and he consented. However, after some period of time, Mr. Kesterson asked them to remove the equipment, and when they failed to do so, Mr. Kesterson set some of the tanks and equipment outside, where it deteriorated because of weather. The city eventually required Mr. Kesterson to have the equipment moved from outside the building. Some equipment, a power source and a beam system, are permanently attached to the building and are still there. Mr. Kesterson testified that he talked to David Hopkins with the Bank at some point and explained what had happened. Mr. Kesterson did not receive any proceeds from the junked items. See Trial Exh. 1.

Mr. Kesterson testified that the defendants hauled off the majority of their equipment, utilizing his fork lift for the moving. Mr. Kesterson also testified that the items listed in Trial Exhibit 2 were on the business premises when the defendants were operating.

Mr. David Hopkins, an officer of the Bank, testified that he came with the Bank in July, 1990, after this loan was made, and he was assigned this loan. In September, 1990, he met with the defendants to discuss working out the debt. He prepared renewal UCC documents but wanted to inspect the collateral before completing the documents, and the renewal UCC documents were never filed. Mr. Jones called Mr. Hopkins and told him that the equipment was in Mr. Kesterson's building. Mr. Hopkins testified that the defendants estimated the equipment to be worth \$15,000. A renewal note was dated October 5, 1990, in the amount of \$19,141.70, but that note was never actually renewed because Mr. Hopkins was unable to obtain an inventory of the collateral. Mr. Hopkins testified that Trial Exhibit 2, the list of equipment, was in the loan jacket when

he took over the loan. Mr. Hopkins testified that the Bank did not give its consent for the disposition of the collateral.

Michael Shane Jones testified that the two rectifiers were copper lined and would have a junk value of at least \$1,500 each. He further testified that he had in his possession one hoist and seven or eight tanks, along with some plating barrels and miscellaneous items. Mr. Jones testified that he attempted to get Mr. Hopkins to come to his house to see the items, and he stated that he had not received any money from disposition of any of the equipment by Mr. Kesterson. Mr. Jones admitted that he was served with the Chancery Court suit but did nothing to defend it.

David Woolf testified that he was present when the note renewal was discussed with Mr. Hopkins. At that point, he stated that Mr. Hopkins asked to see the equipment and that Mr. Hopkins was told that some of the collateral was at Mr. Woolf's house and some was at Mr. Jones' house. Mr. Woolf went on to state that he had several tanks, barrels, and a hoist at Mr. Jones' house. Mr. Woolf stated that he had personally talked with Mr. Hopkins a year ago about his seeing some of the equipment at Mr. Jones' house. Mr. Woolf denied selling any items and said that he had received no money from the disposition of any collateral. Mr. Woolf also admitted that he knew about the Chancery Court suit, but stated that he told his attorney, Mr. Herron, that he and Mr. Jones still had some of the equipment.

Both Mr. Woolf and Mr. Jones expressed a willingness to surrender the remaining collateral to the Bank. Mr. Hopkins was recalled on rebuttal to testify that the first time he heard that the defendants still had some of the collateral was in court at this trial. The Court observed that Mr. Speight, attorney for the Bank, appeared to be surprised to hear that the defendants still had some of the collateral.

Mr. Speight requested an opportunity to locate and evaluate the remaining collateral, and the Court granted that request. As stated, Mr. Speight has now reported to the Court, with a copy to the defendants' counsel, that an experienced auctioneer had examined the items in the possession of Mr. Jones and found five steel tanks, part of a roller with an attached electric motor, and an electric chain hoist. The auctioneer doubted that the tanks had anything other than salvage value because of their special purpose design. He also

estimated the hoist to have a value between \$75 and \$200. An attachment to the auctioneer's letter states, however, that ten rusty tanks, rather than five, were found at Mr. Jones' house.

#### CONCLUSIONS OF LAW

Based upon these facts, the Court can draw certain conclusions. First, as to the pleadings, the complaint does not allege a specific Bankruptcy Code section. However, it does allege fraudulent conduct and fraudulent disposition of the Bank's collateral. In Vulcan Coals v. Howard, 946 F.2d 1226, the Sixth Circuit construed a complaint which alleged that the debtor intentionally transferred mortgaged property without authorization or approval of the secured party to be a complaint which sufficiently alleged conversion under §523(a)(6). It may be concluded from that authority that pleading a specific Code section, while helpful, is not mandatory. See F.R.B.P. 7008. This complaint does sufficiently allege facts so as to put the defendants on notice of the basis for the complaint; however, the Court does not find the complaint to allege grounds for denial of the debtors' general discharge under §727(a).

Section 727(a)(2) does not apply since it requires action on the debtor's part within one year before the date of the bankruptcy filing. These bankruptcy petitions were filed in April 1991, and the letter from Mr. Kesterson stated that the equipment was moved out of his building over three years before the date of the letter, November 19, 1990. Trial Exh. 1. As to any continuing concealment, the Court is faced with a conflict between the testimony of the defendants and of Mr. Hopkins, and the Court found them all credible. The defendants both testified that they told Mr. Hopkins in the fall of 1990 that some equipment had been moved to their homes. The parties obviously do not have identical recall of that conversation. The Court does not find by a preponderance of the evidence that the defendants intentionally violated §727(a)(2).

There was no proof which would support a denial of the defendants' general discharge under any other provision of §727(a).

The Court has also examined §523(a) for exceptions from the general discharge that may be applicable under the proof. As to §523(a)(2)(A), the Court is not persuaded that there was any proof that the defendants obtained the loan from the Bank by any fraudulent means. In fact, the proof tends to show that the

Bank was rather informal in its loan requirements. The security agreement and the UCC financing statement do not have attachments of the specific equipment secured. Moreover, there is no proof that the debtors did not have the equipment when they obtained the loan. In fact, the proof is to the contrary. See, e.g., the testimony of Mr. Kesterson and Trial Exh. 2.

However, under §523(a)(6), the proof does establish a basis to except from discharge a portion of the debt to the Bank. The Court reaches that conclusion based upon the proof that Mr. Woolf and Mr. Jones moved much of the collateral from their business location without informing the Bank and that they further left some equipment for over three years in Mr. Kesterson's building, again without informing the Bank. The result of the defendants' reckless actions insofar as the Bank's collateral was that the collateral was allowed to deteriorate for several years. Now, the Bank is left without some of its collateral and the collateral remaining is virtually worthless. The defendants' actions harmed the Bank by depriving the Bank of its timely opportunity to recover its collateral and realize a higher value return. As the Sixth Circuit has stated in Perkins v. Scharffe, 817 F.2d 392, 394 (6th Cir. 1987), cert. denied, 484 U.S. 853 (1987), §523(a)(6) requires merely a "wrongful act done intentionally, which necessarily produces harm and is without just cause or excuse." Vulcan Coals, Inc. v. Howard, 946 F.2d at 1228. Thus, the defendants' intentional acts of failing to advise the Bank earlier of the collateral's location and of leaving the collateral outside so that it deteriorated necessarily produced harm to the secured property interest of the Bank in that collateral.

Having reached that conclusion, the more difficult problem is in determining how much of the debt is excepted from discharge. The Court concludes that the measure of damages is not the total debt to the Bank, but the amount equal to the injury caused the Bank by the defendants' wrongful acts. In re Modicue, 926 F.2d 452 (5th Cir. 1991); In re Leslie-Hughes, unpublished opinion, adversary number 89-0159, June 18, 1990 (Bankr. W.D. Tenn. 1990). The measure of damages which are excepted from discharge is the market value of the collateral at the time of the defendants' wrongful acts. In re Mills, 111 B.R. 186, 207 (Bankr. N.D. Ind. 1988). It is of course difficult to make such a determination of value so long after the wrongful acts occurred.

All the Court has in proof at this point is that the rectifiers, when left at Mr. Kesterson's building, had

a junk value of \$1,500; but this is not necessarily the market value at that time. Further, the Bank had the auctioneer's opinion, as yet untested in court, that the tanks have only junk value and that the hoist has no more than \$200 value. The Court also has Mr. Hopkins' testimony that the defendants estimated the collateral's value to be \$15,000 in the fall of 1990. While it may be tempting to bind the defendants to that estimate, the Court is not persuaded that such an estimate is a true expression of market value. From the proof before the Court at this point, the Court can not determine how much the equipment was worth when the defendants went out of business. It was at that point that the defendants should have notified the Bank to come pick up its collateral. The Court is confident that the market value of the collateral was considerably less than the amount of the debt to the Bank. This is true because of the peculiar nature of the collateral and the limited market for it. See, e.g., testimony of Mr. Kesterson.

The Court will set a further hearing on the amount of the debt which will be excepted from discharge, and the Court urges the parties to confer and attempt to reach an agreement on that amount.

IT IS THEREFORE ORDERED that a portion of the debt to the City State Bank is excepted from discharge under 11 U.S.C. §523(a)(6); however, the Court is not prepared, based upon the proof at this point, to determine how much is excepted from discharge. That amount will be based upon the market value of the collateral at the time the defendants went out of business. A further hearing will be set on March 25, 1992, at 11:00 a.m. in room 300, Federal Building, Jackson, Tennessee, for the purpose of receiving further proof on the amount of debt excepted from discharge in each defendant's case. If the parties are able to reach an agreement on that amount prior to March 25, a consensual order should be submitted by Mr. Speight. If March 25, 1992, is not a satisfactory date with any attorney or party, counsel are to confer on alternative dates and contact Carol Smith, the courtroom deputy, for another setting. The Court will not enter a final judgment until the March 25th hearing has been held.

SO ORDERED, this 20<sup>th</sup> day of February, 1992.

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WILLIAM HOUSTON BROWN  
UNITED STATES BANKRUPTCY JUDGE

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