

IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF ILLINOIS

MAGNA BANK, N.A.,)
)
 Plaintiff/Appellee,)
)
 vs.) NO: 98-CV-0692-PER
)
 DAVID OGDEN & DONNA OGDEN,) BK No. 97-30640
)
 Defendants/Appellants.) Adv. No. 97-3095

MEMORANDUM AND ORDER

RILEY, District Judge:

**I. Introduction, Facts and
Overview of Bankruptcy Court Proceedings**

David and Donna Ogden operated Automation Services, a business which designed, fabricated and installed conveyor systems. Automation Services was awarded projects for large industrial clients, including the Eureka Company and Bombardier, Inc. To finance these projects, the Ogdens obtained several loans from Magna Bank.

On March 5, 1997, the Ogdens filed a voluntary petition for relief under Chapter 7, Title 11 of the United States Bankruptcy Code. On May 15, 1997, Magna Bank, as a creditor of the Ogdens, filed in the U.S. Bankruptcy Court for the Southern District of Illinois a complaint under **11 U.S.C. 523(a)(6)**, seeking to determine the dischargeability of a debt owed by the Ogdens to Magna Bank. An overview of the facts regarding four loans made by Magna to the Ogdens aids resolution of the matter now before this Court.

On April 8, 1994, the Ogdens executed a promissory note payable to Magna in the principal

amount of \$25,000. The Court refers to this note as "Note 1". Note 1 was modified in April 1995 and April 1996. Note 1 (as modified) matured on October 10, 1996. When that date arrived, the Ogdens were not financially able to satisfy their outstanding debt on this loan. By May 1997, the Ogdens owed \$22,550 in principal on Note 1, plus interest and other charges.

On May 12, 1995, the Ogdens executed a promissory note payable to Magna in the principal amount of \$75,025 ("Note 2"). The terms of Note 2 were modified three times, and (as modified) the note matured on October 12, 1996. The Ogdens could not pay off this loan at that time. By May 1997, the Ogdens owed \$73,729.70 in principal on Note 2, plus interest and other charges.

On October 27, 1995, the Ogdens executed a promissory note payable to Magna in the principal amount of \$75,000 ("Note 3"). The terms of Note 3 were modified, and (as modified) the note matured on October 15, 1996. The Ogdens could not pay off this loan at that time. By May 1997, the Ogdens owed \$74,600 in principal on Note 3, plus interest and other charges.

On December 7, 1995, Donna Ogden (on her own behalf and as attorney-in-fact for David Ogden) executed a promissory note payable to Magna in the principal amount of \$45,000 ("Note 4"). Note 4 matured on October 15, 1996. The Ogdens could not pay off this loan at that time. By May 1997, the Ogdens owed \$45,000 in principal on Note 4, plus interest and other charges.

In its § 523 complaint filed in Bankruptcy Court, Magna asserted that the Ogdens' debts to Magna were secured by an interest in all accounts and rights to payment, specifically including the contract between the Ogdens and Eureka Company ("the Eureka Contract"). Magna pointed to a May 12, 1995 commercial security agreement executed by the Ogdens which supported Magna's claim regarding this security interest. Magna further noted that it perfected the security interest in the Ogdens' accounts and contract rights by

filing UCC- 1 financing statements with the Illinois Secretary of State on April 12, 1995 and with the Madison County Recorder of Deeds on April 7, 1995 and May 30, 1995. Copies of the UCC-1 forms were provided to the Court. Magna's § 523 complaint also alleged that on January 6, 1997, the Ogdens received at least \$57,000 from the Eureka Contract, that the Ogdens *knew* any funds they received from this contract were collateral for the debts they owed to Magna, and that despite this knowledge, the Ogdens paid none of the Eureka Contract monies to Magna. Instead, the Ogdens paid \$12,000 on nondischargeable federal and state taxes, made three house payments, purchased parts for their van, donated roughly \$500 to charity, paid attorneys' fees on a matter not involving the Eureka Contract, and took unnecessary ski trips with their children.

Magna asserted that the Ogdens' decision to use the Eureka Contract funds for personal benefit (rather than paying on the Magna debts) was malicious, without just cause or excuse, and made in conscious disregard of the Ogdens' duties. Magna argued that by these actions, the Ogdens destroyed the collateral which was securing the notes, so the Ogdens' debts to Magna should be adjudged nondischargeable to the extent of the monies the Ogdens received from the Eureka Contract (plus accrued interest from the date the Ogdens received those funds).

On June 1, 1998, U.S. Bankruptcy Judge Gerald D. Fines conducted a trial on Magna's § 523 complaint. The Court received extensive sworn testimony, reviewed documentary evidence, and heard counsel's arguments. At the conclusion of trial, Judge Fines orally found in favor of Magna and against the Ogdens. Judge Fines specifically announced that the debt in question was nondischargeable under **11 U.S.C. 523(a)(6)**. On June 29, 1998, Judge Fines issued a 12-page Opinion containing specific findings of fact and conclusions of law. Judgment was entered accordingly. The Judgment Order states that the

Ogdens owe Magna \$57,461 with interest running at 9% per annum.

The Ogdens filed a notice of appeal on July 21, 1998, together with a motion seeking leave to file the notice of appeal out of time. Judge Fines granted the Ogdens' motion for extension of time to file the notice of appeal. In October 1998, the Ogdens obtained an extension of time to file their brief in this Court. The brief was due on or before November 16, 1998. Four days before that deadline, the Ogdens sought another extension of time to file their brief. On November 18, 1998, this Court denied that motion. Ultimately, this Court permitted the Ogdens to file their brief out of time, *instanter*, on December 1, 1998. Union Planters Bank, N.A., successor to Magna Bank, timely filed its brief as appellee, and the Court now rules as follows.

II. Standard Governing This Court's Review

Pursuant to **28 U.S.C. 158(a)**, this Court has jurisdiction over the Ogdens' appeal from the final Judgment entered by Judge Fines on June 29, 1998. This Court may affirm, modify, or reverse the Judgment, **FEDERAL RULE OF BANKRUPTCY PROCEDURE 8013**, in accord with the followed standards.

Reviewing courts must accept a bankruptcy court's findings of fact unless they are clearly erroneous. The reviewing court must give due regard to the bankruptcy judge's opportunity to hear and weigh the credibility of the witnesses. Conclusions of law, however, are governed by *de novo* review. **FED. R. BANK. P. 8013; *In Re Image Worldwide, Ltd.*, 139 F.3d 574,576 (7th Cir. 1998); *Calder V. Camp Grove State Bank*, 892 F.2d 629, 631 (7th Cir. 1990).**

III. Analysis

The Ogdens present two issues on appeal:

- (1) Whether the Bankruptcy Court erred in finding that the Ogdens' actions with the Eureka funds constituted a willful, intentional injury to Magna under **11 U.S.C. 523(a)(6)**; and
- (2) Whether the Bankruptcy Court erred in refusing to find that Magna caused its own injury by failing to take steps to protect its collateral.

The Ogdens concede that the Bankruptcy Court accurately delineated the applicable law in stating that a debt is nondischargeable if the debtor willfully or maliciously injured another entity or the property of another entity. **11 U.S.C. 523(a)(6)**. But the Ogdens argue that the Bankruptcy Court should have applied a United States Supreme Court decision which requires a deliberate or intentional *injury* (not just a deliberate or intentional act that *leads to injury*) before a debt will be declared nondischargeable (Doc. 9, p. 5, citing *Kawaauhau v. Geiger*, **523 U.S. 57, 118 S. Ct. 974 (1998)**). The Ogdens suggest that under *Kawaauhau*, their actions did not constitute a deliberate, intentional injury, as they were simply using the funds from the Eureka Contract to keep Automation Services running, with the hope of using the funds from a pending lawsuit with another client (Bombardier, Inc.) to satisfy the Magna debts. As is described below, this Court rejects that argument.

When Automation Services was awarded the \$138,340 Eureka Contract, the Ogdens took out a 180-day loan from Magna (evidenced by a promissory note, Note 2) to finance their purchase of materials and supplies for that contract. Note 2 was secured by a security interest in the Ogdens' accounts and rights to payment, specifically including the Eureka Contract. This security interest is reflected in a commercial security agreement executed by the Ogdens on May 12, 1995.

Before the original maturity date of Note 2, the Ogdens (operating as Automation Services) were awarded a \$280,000 contract with Bombardier, Inc. in Benton, Illinois ("the Bombardier Contract"). To finance the purchase of supplies and materials on the Bombardier Contract, the Ogdens took out another

180-day loan from Magna (evidenced by Note 3). Note 3 was secured by an interest in the proceeds from the Bombardier Contract, as documented in a commercial security agreement executed by the Ogdens on October 27, 1995. The Ogdens also executed a "Notice of Assignment of Accounts, Contract Rights, and Income."

The payment deadline on Note 2 was extended several times. For instance, the deadline was extended when Eureka Company was not prepared for installation of the equipment fabricated by Automation Services, and the deadline was extended again when the project's completion date was postponed. In connection with these extensions, Donna Ogden indicated to Magna that she and her husband expected to receive payments on the Eureka Contract in December 1995 and February 1996. Based upon these representations, Magna permitted the Ogdens to extend loan payment dates to December 1995, January 1996, and February 1996. In December 1995, Magna lent the Ogdens an additional \$45,000 for supplies and materials on the Bombardier Contract. The Ogdens executed Note 4 in connection with this loan. Note 4 was secured by an interest in the Bombardier Contract, as documented in a commercial security agreement dated December 7, 1995.

Several weeks later, the Ogdens became enmeshed in a dispute with Bombardier. In January 1996, the Ogdens ceased work on the Bombardier Contract. In February 1996, Bombardier sued the Ogdens for breach of contract, tortious interference and defamation. In the meantime, Eureka Company advised the Ogdens not to return to their job site due to a disagreement regarding the Eureka Contract. Magna extended Note 2 in recognition of the fact that the Ogdens had not received their final payment on the Eureka Contract.

All four notes (as extended) matured in October 1996. When the maturity dates were reached,

the Ogdens did not have the funds needed to satisfy what was owed on the debts. In November 1996, Magna set off the money in the Ogdens' business checking account. The Ogdens persuaded Magna to restore the money to their business account, but Magna refused to extend the maturity dates on the notes any further. Bankruptcy Judge Fines found that following the set-off of their business account in November 1996, the Ogdens *knew* that Magna expected payment on the four notes then due, and Magna was interested in pursuing whatever means of payment was possible.

In December 1996, David Ogden agreed to settle his dispute with Eureka Company for \$57,461. David Ogden did not share this news with Magna. The Ogdens received \$57,461 on January 6, 1997. Instead of depositing the Eureka funds into their business account at Magna, the Ogdens deposited the funds into their personal account at Central Bank. Obviously, Magna could not reach the funds at Central Bank for a set-off.

Judge Fines found that several days prior to receiving the Eureka funds, the Ogdens consulted an attorney (David Lumerman) regarding filing a Chapter 7 bankruptcy petition. Judge Fines further found that within six days of depositing the Eureka funds into their personal account, the Ogdens wrote 78 checks, disposing of \$46,000 from those funds. Another 26 checks were written by the Ogdens by the end of January 1997, disposing of the remaining \$11,500. None of the Eureka funds was ever paid to Magna.

Judge Fines made other significant factual findings. He discounted the Ogdens' testimony that these checks on their personal account were written solely to keep Automation Services afloat, noting "the evidence indicates that a significant amount of money was spent other than on the business." Judge Fines further found (Opinion, p. 9, ¶ 23):

Credible evidence adduced at trial showed that the Ogdens knew that the Eureka Funds received on January 6, 1997, were collateral for Note #2 and that they [the Ogdens] were obligated to pay those funds to Magna Bank....

Additionally, Judge Fines concluded that the Ogdens did not inform Magna that they were negotiating a settlement with Eureka, did not inform Magna when they reached a settlement with Eureka, did not inform Magna that they had received \$57,461 from that settlement, and only told Magna about the Eureka funds after those funds completely were spent (Opinion, pp. 9-10).

The Ogdens challenge Judge Fines' conclusion that, in November 1996, they knew Magna expected payment on the four notes and that Magna was interested in pursuing any means of payment possible. The Ogdens also dispute Judge Fines' rejection of David Ogden's testimony that he thought Magna would work with the Ogdens until they could collect from the Bombardier litigation. But the record amply supports Judge Fines' factual findings on these points.

Furthermore, this Court must (and does) respect the Bankruptcy Judge's ability to see, hear, and judge the credibility of the witnesses who appeared at the trial of this matter. On the critical issue of the Ogdens' intent to injure Magna, Judge Fines clearly found the Ogdens' testimony not credible and their evidence not persuasive. For instance, at the conclusion of trial, Judge Fines plainly declared (Transcript pp. 392-393):

I think that the plaintiff [Magna] has proven each and every element of 523(a)(6).... I find the two bankers in this case to be credible witnesses.... I find that the defendants [the Ogdens] were not credible witnesses. I think they set out to take this money. I think they knew that they should pay the bank the fifty-seven thousand plus dollars when they got it. They knew exactly what they were doing. They had the intent that meets all the elements of 523(a)(6). I think Mr. Drazen [the Ogdens' counsel] did the best he could with what he had, but his clients didn't leave him with very much to work with. Their conduct in this case was impossible to defend.

Similarly, in his written findings of fact, Judge Fines explained that he found Magna's evidence credible - and the Ogdens' evidence not credible - on this issue. For instance, at page 9, paragraph 23) of his Opinion, Judge Fines found:

Credible evidence adduced at trial showed that the Ogdens knew that the Eureka Funds received on January 6, 1997, were collateral for Note #2 and that they were obligated to pay those funds to Magna Bank....

The Court defers to Judge Fines' credibility assessments, and the Ogdens have not demonstrated clear error as to any of Judge Fines' factual findings, including his findings regarding the deliberateness of the Ogdens' actions. The record before this Court also supports Judge Fines' legal conclusion that the Ogdens' conduct constituted a willful and malicious injury.

The Ogdens admit to receiving \$57,451 from Eureka, depositing it in their personal checking account at Central Bank, and spending it. All this was done without alerting Magna in advance. Indeed, the Ogdens never even informed Magna that they were working on (or had reached) a settlement with Eureka. When they received the Eureka funds, the Ogdens did not use a penny of it to pay the debts to Magna. The evidence demonstrated that the Ogdens took these actions knowing full well that the Eureka funds were collateral for Note 2 and that the Ogdens were obligated to pay those funds to Magna. Instead of making good on their debt, the Ogdens paid off bills they knew they could not discharge in bankruptcy (e.g., federal and state taxes), pre-paid a month of their mortgage, donated money to charities, and purchased personal items such as audiotape books, fish and bird feed, personal stationery, videotapes and a massage table.

11 U.S.C. 523(a)(6) provides an exception to the general rule that an individual debtor will be discharged of his debts via bankruptcy. No discharge will be allowed "for willful and malicious injury by

the debtor to another entity or to the property of another entity." As Judge Fines correctly noted, the phrase "willful and malicious injury" has been held to include a willful and malicious conversion. The debtor need not act with ill will or malevolent purpose toward the injured party. *In Re Lampi*, 152 B.R. 543, 545 (Bankr. C.D. Ill. 1993); *In Re Meyer*, 7 B.R. 932, 933 (Bankr. N.D. Ill. 1981).

The Ogdens' conduct was willful and malicious. As the Supreme Court noted in **Kawaauhau**, 118 S. Ct. at 977, n.3, the word "willful" in § 523(a)(6) means "deliberate or intentional." There was no cause or excuse for the Ogdens' conduct. The Ogdens deliberately and intentionally chose to pay off other debts and purchase personal items rather than satisfy their debts to Magna. They consulted a bankruptcy lawyer just days prior to obtaining the Eureka funds. They deposited the funds in an account other than their account at Magna Bank, hid from Magna the fact that they were to receive (and had received) the funds, and quickly wrote over 100 checks on those funds after the funds were deposited into their personal checking account at Central Bank. The fact they did all this *knowing* the money they were spending was collateral on Note 2 demonstrates the malicious quality of their actions. The Ogdens' argument that they converted the Eureka funds solely to keep their business running, like the argument that they did not realize they were supposed to turn those funds over to Magna, fails.

The Ogdens' conduct obviously worked to the detriment of Magna. The Ogdens destroyed the collateral which was securing Magna's loan. The Ogdens' secret, intentional disposition of Magna's collateral constitutes a deliberate or intentional injury, not merely an intentional act that led to injury. Thus, the Ogdens' actions satisfy the test for nondischargeability under **Kawaauhau**, 118 S. Ct. at 977.

Having conducted *de novo* review of the legal conclusion at issue, this Court finds that the Ogdens' disposition of the collateral on Note 2 to the detriment of Magna constituted a willful and malicious injury

to Magna or its property within the meaning of § 523(a)(6). Discovering no merit in the Ogdens' first point on appeal, the Court turns to the Ogdens' second appeal argument - that the Bankruptcy Court erred in refusing to find that Magna caused its own injury by failing to take steps to protect its collateral.

The Ogdens assert that because Magna failed to take "reasonable steps to protect its collateral," Magna is "prevented from applying the willful and malicious injury exception to discharge." The Ogdens devote roughly a page of argument to this theory. They do not specify exactly what Magna should or could have done to protect its collateral, other than to suggest that Magna failed to object in time to the Ogdens' own acts (Appellants' Brief, Doc. 9, p. 14):

Here, as in Wolfsman [**In Re Wolfson, 56 F.3d 52 (11th Cir. 1995)**], the debtors [the Ogdens] received funds which were allegedly pledged as collateral and disbursed those funds in July and August of 1995. The plaintiff [Magna] refused to object at that time and is [now] barred from raising the willful and malicious exception to discharge....

For multiple reasons, this argument (and the Ogdens' citation to **Wolfson**) falls flat. First, this is not a case of funds "allegedly" pledged as collateral. Note 2 was secured by an interest in the Ogdens' accounts and rights to payment, specifically including the Eureka Contract. Second, the evidence does *not* support the Ogdens' contention that Magna "was personally aware that Debtors had received funds from the 'Eureka Contract'" (Doc. 9, p. 14). Magna did not know that the Ogdens had received over \$57,000 from the Eureka Contract until *after* the Ogdens spent those funds. Magna could not object to the Ogdens' use of the collateral when Magna did not know the Ogdens were using it.

Third, unlike the debtors in **Wolfson**, the Ogdens obtained extensions on their loan due date by assuring their creditor (Magna) that they would pay the debt in question (Note 2) when they received final payment on the Eureka Contract. Then, upon receipt of that final payment, the Ogdens did just the

opposite - they used the Eureka funds to do everything *but* satisfy their obligation to Magna.

Finally, it appears that the Ogdens never raised this argument (that Magna caused its own injury by failing to protect its collateral) in its answer to the complaint filed in Bankruptcy Court. As such, this argument may well be waived. **See, e.g., *Herremans v. Carrera Designs, Inc.*, 157 F.3d 1118, 1123 (7th Cir. 1998).** For all these reasons, the Court finds meritless the Ogdens' second argument on appeal.

IV. Conclusion

This Court rejects both of the Ogdens' arguments on appeal and **AFFIRMS** the Judgment entered by U.S. Bankruptcy Judge Gerald D. Fines on June 29, 1998.

IT IS SO ORDERED.

DATED this 12th day of January, 1999.

/s/ PAUL E. RILEY
United States District Judge