

**UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF VIRGINIA
Lynchburg Division**

In re: JOHN THOMAS DOWLING,)	Case No. 12-60031-LYN
)	
Debtor.)	
_____)	
ROBERT M. JOHNSON,)	Adv. No. 12-06017
)	
Plaintiff,)	
)	
v.)	
)	
JOHN THOMAS DOWLING,)	
)	
Defendant,)	
)	
_____)	

JUDGMENT

For the reasons stated in the accompanying memorandum,

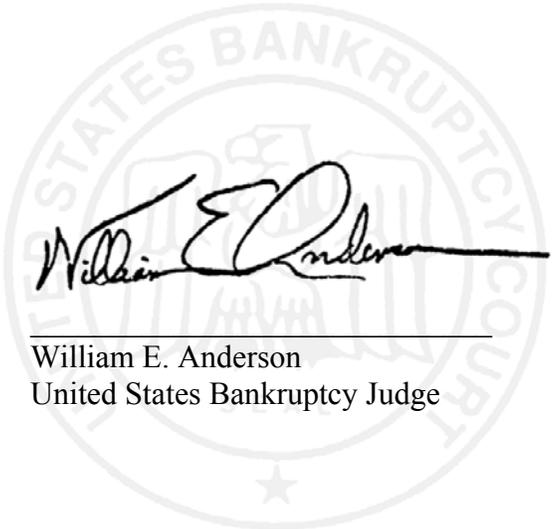
It is ORDERED, ADJUDGED, and DECREED that judgment in the above-captioned adversary proceeding shall be, and hereby is, entered in favor of the defendant John Thomas Dowling. The Plaintiff shall take nothing by his complaint. The debt owed by the Defendant to the Plaintiff is dischargeable in the above-styled bankruptcy case.

Upon entry of this Judgment the Clerk shall forward a copy to Margaret Valois, Esq., J. Frederick Watson, Esq., and the chapter 7 trustee.

Entered on this 27th day of September, 2012.



William E. Anderson
United States Bankruptcy Judge



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v.)	
)	
JOHN THOMAS DOWLING,)	
)	
Defendant,)	
)	

MEMORANDUM

This matter comes before the court on a complaint by Robert M. Johnson (“the Plaintiff”) seeking a declaration that a debt owed to him by John Thomas Dowling (“the Debtor” or the “Defendant”) is nondischargeable under 11 U.S.C. § 523(a)(2),(4)&(6). Judgment shall be

entered in favor of the Defendant.

Jurisdiction

This Court has jurisdiction over this matter. 28 U.S.C. § 1334(a) & 157(a). This proceeding is a core proceeding. 28 U.S.C. § 157(b)(2)(A)&(I). This Court may enter a final order. This memorandum shall constitute the Court’s findings of fact and conclusions of law as required by Fed. R. Civ. P. 52, which is made applicable in this proceeding by Fed. R. Bankr. P. 7052.

Facts

The Plaintiff is a semi-retired home-builder who spent thirty years in that business.¹ The Plaintiff and the Debtor met in or about 2004 at a car show that had been organized by the Debtor.² They became friends thereafter.³

In December of 2007, the Debtor and his wife held a 66.239% equity interest in Dowling Enterprises, LLC (“Dowling Enterprises”). Dowling Enterprises owned land (“the Original Carwash Land”) on which a car wash was operated by The Chesterfield Carwash Company, LLC (“Chesterfield Carwash”). The Debtor also held an equity interest in Chesterfield Carwash.

In January of 2008, Temecula Valley Bank (“TVB”) held a security interest in the Original Carwash Land that secured a debt owed by Dowling Enterprises in the approximate amount of \$2,000,000.00.

In or about January of 2008, the Debtor sought to borrow \$150,000.00 (“the Loan

¹ Testimony of the Plaintiff, Transcript of Hrg., p. 10.

² Testimony of the Plaintiff, Transcript of Hrg., p. 9.

³ Testimony of the Plaintiff, Transcript of Hrg., p. 10.

Funds”) from the Plaintiff. The Debtor represented to the Plaintiff that the Loan Funds would be used to make a down payment toward the purchase price of a separate parcel of land (“the New Carwash Land”) on which the Debtor intended to establish another car wash.⁴ The Debtor characterized the loan as a short term loan and also represented to the Plaintiff that he would be able to pay it back in less than sixty days because a lender, Alpha Omega Financial Corp. (“Alpha Omega”), had agreed to refinance the note held by TVB by means of a transaction that would result in a cash payment to Dowling Enterprises.⁵ The Debtor testified that he expected to receive \$300,000.00 to \$400,000.00 in cash from the transaction. The Debtor told the Plaintiff that he had received a commitment letter from TVB.⁶ The Plaintiff made no investigations into the representations of the Debtor.⁷

On February 1, 2008, the Plaintiff lent Dowling Enterprises \$150,000.00. The resulting debt was evidenced by a “Deed of Trust Note”⁸ and was secured by a lien on the Original Carwash Land. The Debtor executed the Deed of Trust Note on behalf of Dowling Enterprises and also as a guarantor.

The Alpha Omega loan never closed. Dowling Enterprises never received any money from Alpha Omega. Dowling Enterprises never purchased the New Carwash Land. Consequently, none of the Loan Funds were used toward the purchase of the New Carwash

⁴ Testimony of the Debtor, Transcript of Hrg., p. 33.

⁵ Testimony of the Debtor, Transcript of Hrg., p. 34.

⁶ Testimony of the Debtor, Transcript of Hrg., p. 34-5.

⁷ Testimony of the Plaintiff, Transcript of Hrg., p. 17.

⁸ Plaintiff’s Exhibit no. 1.

Land.

On February 1, 2008, the same day that the Plaintiff lent the Debtor the \$150,000.00, Dowling Enterprises paid H&B Associates, Inc. (“H&B”) \$21,500.00, thus reducing or paying off a debt owed to H&B and secured by a second-priority lien on the Original Carwash Land.

Thereafter, the Debtor purchased a \$50,000.00 equity interest in Dowling Enterprises held by Bruce Griggs. Mr. Griggs’ equity interest was transferred to the Debtor.⁹ After the Plaintiff lent the money to Dowling Enterprises, the Debtor, or Dowling Enterprises, paid off a debt of approximately \$15,000.00 owed to American Express.¹⁰

The Debtor was unable to timely pay the debt arising under the Deed of Trust Note. The parties agreed that the Debtor, or Dowling Enterprises, would pay the Plaintiff \$15,000.00 on April 2, 2008, and \$2,250.00 per month thereafter.¹¹ On May 1, 2008, the Debtor made the \$15,000.00 payment. He also made two payments of \$2,250.00 on May 1, 2008, and single payments of \$2,250.00 on June 27, 2008, and on August 8, 2008. He also made payments of \$2,475.00 on December 24, 2008, and on January 2, 2009. The total amount of these payments was \$28,950.00.¹² No payments were made to the Plaintiff thereafter toward the debt due under the Deed of Trust Note.

The Debtor ceased operating Dowling Enterprises in August of 2010. On February 11, 2011, he sold, or otherwise transferred, his interest in Dowling Enterprises to his wife at that

⁹ Testimony of the Debtor, Transcript of Hrg., p. 49-50.

¹⁰ Testimony of the Debtor, Transcript of Hrg., p. 50-51.

¹¹ Plaintiff’s Exhibit # 2.

¹² *Id.*

time.¹³

Although Dowling Enterprises defaulted on the Deed of Trust Note, the Plaintiff did not foreclose on the Original Carwash Land because he could not afford to pay the TVB debt.¹⁴ Dowling Enterprises subsequently entered into a Chapter 11 bankruptcy case¹⁵ and the Original Carwash Land was sold for an amount that was insufficient to pay off the TVB first deed of trust.¹⁶ Consequently the Plaintiff did not receive any money from the sale of the Original Carwash Land.

On November 13, 2009, a judgment (“the State Court Judgment”) was entered in favor of the Plaintiff and jointly and severally against the Debtor and Dowling Enterprises in the Circuit Court for the City of Virginia Beach in the amount of \$175,987.50 plus costs and interest at the rate of 18% per annum.

On January 6, 2012, the Debtor filed a bankruptcy petition initiating the above-styled Chapter 7 case. On February 24, 2012, the Plaintiff filed an adversary complaint initiating the above-styled adversary proceeding seeking to have the debt arising under the Deed of Trust Note declared non-dischargeable.

Discussion.

The complaint is brought under 11 U.S.C. § 523(a)(2)(A),(4)& (6). The Plaintiff must

¹³ Testimony of the Debtor, Transcript of Hrg., p. 36. Testimony of Ms. Dowling, Transcript of Hrg., p. 53-5.

¹⁴ Testimony of the Plaintiff, Transcript of Hrg., p. 29.

¹⁵ It is unclear whether Dowling Enterprises filed a chapter 11 petition or an involuntary petition was filed on its behalf.

¹⁶ Testimony of Ms. Dowling, Transcript of Hrg. P. 58.

meet the burden of going forward and must carry the burden of proof on each element of at least one of the claims by a preponderance of the evidence. *See Grogan v. Garner*, 498 U.S. 279, 111 S.Ct. 654, 112 L.Ed. 2d 755 (1991).

I.

The Complaint must fail under Section 523(a)(4). Section 523(a)(4) provides that:

(a) A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt—

...

(4) for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny;

The Fourth Circuit Court of Appeals, in considering the preclusive effect of a state court judgment, has provided guidance for trial courts when considering a cause of action alleging defalcation under Section 523(a)(4).

... A defalcation under 523(a)(4) is “misappropriation of trust funds or money held in any fiduciary capacity; [or the] failure to properly account for such funds.” *In re Niles*, 106 F.3d 1456, 1460 (9th Cir.1997) (quoting Black's Law Dictionary 417 (6th ed.1990)). “[A] ‘defalcation’ for purposes of this statute does not have to rise to the level of ‘fraud,’ ‘embezzlement,’ or even ‘misappropriation.’ ” *Quaif v. Johnson*, 4 F.3d 950, 955 (11th Cir.1993) (citing *Central Hanover Bank & Trust Co. v. Herbst*, 93 F.2d 510, 512 (2d Cir.1937) (Learned Hand, J.)).

In re Ansari, 113 F.3d 17, 20 (4th Cir. 1997). In a subsequent opinion, the Court noted that even “an innocent mistake” could result in a finding of defalcation.

To be defalcation for purposes of 11 U.S.C. § 523(a)(4), an act need not “rise to the level of ... ‘embezzlement’ or even ‘misappropriation.’ ” *Pahlavi v. Ansari (In re Ansari)*, 113 F.3d 17, 20 (4th Cir.1997) (citations omitted). Thus, negligence or even an innocent mistake which results in misappropriation or failure to account is sufficient.

In re Uwimana, 274 F.3d 806 (4th Cir. 2001).

To summarize, defalcation occurs when a fiduciary fails to properly account for funds or money held in a fiduciary capacity. It is sufficient for a finding of defalcation if the funds are

missing due to negligence or an innocent mistake on the part of the fiduciary. “[T]he concept of fiduciary under § 523(a)(4) is narrower than it is under the general common law. Under § 523(a)(4), ‘fiduciary’ is limited to instances involving express or technical trusts.” Texas Lottery Comm'n v. Tran, 151 F.3d 339, 342 (5th Cir.1998). In the instant case, the Plaintiff has presented no evidence that the Debtor owed him a fiduciary duty. The Plaintiff cannot prevail under Section 523(a)(4).

II.

The complaint must also fail under Section 523(a)(6), which provides:

(a) A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) 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;

In order to be a debt for willful and malicious injury, the act in question must be done with an actual intent to cause injury. Kawaauhau v. Geiger, 188 S.Ct. 974, 977 (1998). In this case, the Plaintiff presented no evidence that would support a conclusion that the Debtor intended to injure the Plaintiff. The Debtor’s actions do not give rise to a debt for willful and malicious injury that is non-dischargeable claim under 11 U.S.C. § 523(a)(6).

III.

Section 523(a)(2)(A) provides:

(a) A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt-

...

(2) for money, property, services or an extension, renewal, or refinancing of credit, to the extent obtained by-

(A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor’s or an insider’s financial condition.

Section 523(a)(2)(A), then, concerns fraud, except fraud respecting a debtor's financial condition. The analysis is fostered by considering the exception first and then the issue of fraud.

A.

The first issue is whether the representations made by the Debtor fall under the financial-condition exception. The Plaintiff asserts that the Debtor made two representations on which he relied. First he asserts that the Debtor represented that he could repay the Loan Fund because Alpha Omega had approved his loan application for funds to be used to purchase the New Carwash Land. Second, the Plaintiff asserts that the Debtor represented that he would use the Loan Funds to purchase the New Carwash Land.

Section 523(a)(2)(A) does not include all cases of fraud. It carves out an exception by excluding any representation respecting the debtor's financial condition.¹⁷ The phrase "respecting the debtor's financial condition," as used in Section 523(a)(2)(A), should be interpreted strictly to refer only to information on a debtor's "overall net worth, overall financial health, or equation of assets and liabilities." *In re Joelson*, 427 F.3d 700, 705 (10th Cir. 2005).

The *Joelson* Court reasoned:

The Code defines "insolvent" as, inter alia, the "financial condition such that the sum of [an] entity's debts is greater than all of such entity's property ... exclusive of [certain types] of property." 11 U.S.C. § 101(32)(A) (emphasis added); see also id. § 101(32)(C) (defining a municipality's insolvency as the "financial condition such that the municipality is (I) generally not paying its debts as they become due unless such debts are the subject of a bona fide dispute; or (ii) unable to pay its debts as they become due") (emphasis added). The Code's use of the term "financial condition" in these definitions to refer to the difference between an entity's overall property and debts-the entity's net worth-in defining the word "insolvent" suggests that the term "financial condition" in § 523(a)(2)(A) and (B) also relates to a debtor's net worth or overall financial condition. This conclusion is buttressed by the fact that the Code uses the term "financial condition"

¹⁷ Section 523(a)(2)(B) includes a fraudulent representation concerning the debtor's financial condition if it is made in writing. In the case at bar, none of the alleged representations were made in writing.

to refer to an overall flow of funds—a cash flow—in defining when a municipality is insolvent.

Joelson, 427 F.3d at 706-7. Also see *In re Belice*, 461 B.R. 564 (9th Cir. B.A.P. 2011) (The phrase “respecting the debtor's financial condition,” as used in statutory exception to discharge for debt obtained by debtor's false pretenses, false representation, or actual fraud, other than a statement respecting debtor's or an insider's financial condition, should be interpreted strictly to refer only to information on a debtor's overall financial net worth or condition.).

Under this definition, neither representation concerned the financial condition of the Debtor. A statement regarding a debtor’s ability to repay a debt based on an expected loan is not a statement respecting that debtor’s overall financial health. See *In re Joelson*, 427 F.3d at 715. In *Joelson*, the debtor represented that the creditor could look to the debtor’s brother for repayment. The Appeals Court held that such a statement was not a statement concerning the debtor’s financial condition. The Court reasoned that a statement to the effect that a statement concerning “one part of [the debtor’s] income flow - the flow of funds from her brother - does not reflect [the creditor’s] overall financial health” and that it, therefore, was not a statement respecting the debtor’s financial condition. *Joelson*, 426 F.3d at 715.¹⁸ It is concluded that the Debtor’s representation that he had obtained a financing commitment from Alpha Omega was not a statement respecting Dowling Enterprises’ or the Debtor’s financial condition.

Nor does the Debtor’s second representation, that he would use the Loan Funds to purchase the New Carwash Land, concern his overall financial condition.

¹⁸ *But cf. In re Hilley*, 124 Fed.Appx. 81, *1 (3rd Cir. 2005). In *Hilley*, the debtor borrowed money from the creditor and, within six months, his wife resigned from her job and they filed a chapter 7 petition. The creditor argued that the debtor impliedly misrepresented his ability to repay the debt. The Bankruptcy Court held for the debtor and the United States District Court and the Third Circuit Court of Appeals summarily affirmed holding that the debtor’s ability to repay the debt concerned his financial condition.

B.

We turn now to the issue of fraud. Section 523(a)(2) does not give rise to an independent cause of action. *See Maneval v. Davis (In re Davis)*, 155 B.R. 123, 132 (Bankr. E.D. Va. 1993) (rejecting the argument that the filing of a bankruptcy petition grants a plaintiff an independent cause of action arising out of section 523(a)(2)). *Also cf. Legal Econometrics, Inc., v. Chama Land Cattle Co., Inc., et al. (In re Legal Econometrics, Inc.)* 169 B.R. 876, (Bankr. N.D. Tex. 1994) (Concluding that section 523(a)(6) does not give rise to an independent cause of action and that a plaintiff must prove that it is entitled to relief under some cause of action recognized by state or federal law.) Section 523(a)(2)(A), then, only provides that a claim for fraud founded on other applicable law may not be discharged in bankruptcy.

Section 523(a)(2)(A) was intended to codify case law as expressed in *Neal v. Clark*, 95 U.S. 704, 12 L.Ed. 586 (1878), *which interpreted fraud to mean actual or positive fraud or fraud in fact implying moral turpitude or intentional wrong*, and not implied fraud or fraud in law, which may exist without the imputation of bad faith or immorality. 4 Collier on Bankruptcy, “Exceptions to Discharge”, ¶ 523.08 (16th ed. rev.) (Emphasis added.).

Under Subsection 523(a)(2)(A), the plaintiff must prove the common law elements of fraud. “The operative terms in § 523(a)(2)(A)...‘false pretenses, a false representation, or actual fraud,’ carry the acquired meaning of terms of art. They are common law terms, and . . . they imply elements that the common law has defined them to include.” *Field v. Mans*, 516 U.S. 59, 69, 116 S.Ct. 437, 443, 133 L.Ed.2d 351 (1995). “Then, as now, the most widely accepted distillation of the common law of torts was the Restatement (Second) of Torts (1976), published shortly before Congress passed the Act.” *Id.*, 516 U.S. at 70, 116 S.Ct. at 443-444. “We

construe the terms in § 523(a)(2)(A) to incorporate the general common law of torts, the dominant consensus of common-law jurisdictions, rather than the law of any particular state.”

Id. at n. 9.

To prevail on a claim for actual fraud under section 523(a)(2)(A), a creditor must prove each of five elements: (1) that the debtor made a representation; (2) that at the time the representation was made, the debtor knew it was false; (3) that the debtor made the false representation with the intention of defrauding the creditor; (4) that the creditor justifiably relied upon the representation; and (5) that the creditor was damaged as the proximate result of the false representation. *See Foley & Lardner v. Biondo (In re Biondo)*, 180 F.3d 126, 134 (4th Cir.1999); *MBNA Am. v. Simos (In re Simos)*, 120 B.R. 188, 191 (Bankr.M.D.N.C.1997). *Also see* 4 Collier on Bankruptcy, §523.08[1][e], pg 523-45 to 523-46 (15th ed. Rev.) (Citations omitted). The elements of fraud are presented in conjunctive. In order to prevail under section 523(a)(2), a creditor must meet the burden of going forward and must prove each element by a preponderance of the evidence. *Grogan v. Garner*, 498 U.S. 279, 290, 111 S.Ct. 654, 661, 112 L.Ed.2d 755 (1991). A plaintiff cannot prevail under Section 523(a)(A) if it fails to meet its burden concerning even one of these five elements.

In this instance, the dispute may be resolved by considering the third element, whether the Debtor intended to deceive the Plaintiff when he represented that he had obtained refinancing, including a commitment letter, for the TVB debt which would permit him to repay the Loan Funds to the Plaintiff within sixty days and when he represented that he would use the funds to make a down payment on the New Carwash Land. The Debtor does not deny that he made these representations to the Plaintiff.

The third element of fraud concerns whether the debtor made the representation with the intent and purpose of deceiving the plaintiff. *See In re Church*, 69 B.R. 425 (Bankr. N.D.Tex. 1987). *Also se In re Reath* 368 B.R. 415 (Bankr. N.J. 2006) (For purposes of discharge exception, “actual fraud” consists of any deceit, artifice, trick, or design involving direct and active operation of mind, used to circumvent and cheat another-something said, done, or omitted with design of perpetuating what is known to be cheat or deception.). If a debtor enters into a contract intending not to comply with its terms and later defaults under that contract, such contract may provide a basis for exceptions to discharge on the grounds of fraud if the other remaining elements are satisfied. *In re Taylor*, 49 B.R. 849, 851 (Bankr. E.D.Pa.1985).

In determining whether a debtor possessed fraudulent intent, the question is whether the debtor subjectively intended to defraud the creditor. *See Rembert v. AT & T Universal Card Servs., Inc. (In re Rembert)*, 141 F.3d 277, 281 (6th Cir.1998), cert. denied, 525 U.S. 978, 119 S.Ct. 438, 142 L.Ed.2d 357 (1998); *Citibank (S.D.), N.A. v. Eashai (In re Eashai)*, 87 F.3d 1082, 1090 (9th Cir.1996). *Also see Field v. Mans*, 516 U.S. 59, 69, 116 S.Ct. 437, 133 L.Ed.2d 351 (1995) (concluding that elements of § 523(a)(2) incorporate the general common law of torts). A debtor subjectively intends to defraud a creditor when he in bad faith incurs a debt with the knowledge that the debt is unlikely to be repaid. *See Rembert*, 141 F.3d at 281.¹⁹

The important point here is that a plaintiff must prove that the debtor intended to breach the contract at the time the contract is made. In this instance, in order to prevail, the Plaintiff must prove that the Debtor intended, at the time the parties executed the Deed of Trust Note, to

¹⁹ The opinions in this paragraph and the sentiment expressed were followed in a Fourth Circuit unpublished opinion, *Lind-Waldock & Co. v. Morehead*, 1 Fed.Appx 104, 2001 WL 7516 (4th Cir. 2001).

default on his payment obligation under that note.

Existence of fraud under Section 523(a)(2)(A) may be inferred if the totality of the circumstances presents a picture of deceptive conduct by a debtor which indicates he intended to deceive or cheat a creditor. *In re Schmidt*, 70 B.R. 634, 640 (Bankr. N.D. Ind. 1986).

The Court may logically infer this intent not to pay from the relevant facts surrounding each particular case. *See, In re Kimzey*, 761 F.2d 421, 424 [(7th Cir. 1985)]. And a person's intent, his state of mind, has been long recognized as capable of ascertainment and a statement of present intention is deemed a statement of a material existing fact sufficient to support a fraud action. *In re Pannell*, 27 B.R. 298, 302 (Bankr. E.D.N.Y. 1983). Questions of scienter are questions of fact. *Gabellini v. Swidler*, 724 F.2d 579, 11 B.C.D. 1017, 1018 (7th Cir.1984).

Schmidt, 70 B.R. at 640. *Also see In re Valdes*, 188 B.R. 533 (Bankr. D.Md. 1995); *In re Ettell*, 188 F.3d 1141 (9th Cir. 1999); *In re Hashemi*, 104 F.3d 1122 (9th Cir. 1997); *In re Anastas*, 94 F.3d 1280 (9th Cir. 1996). When applying this test, bankruptcy courts “may infer the existence of the debtor’s intent not to repay if the facts and circumstances of a particular case present a deceptive pattern. This theory requires that *actual fraud* be proven upon the part of the debtor.” *In re Eashai*, 87 F.3d 1082 (9th Cir. 1996) (Emphasis added.).

First, we consider the evidence put forth by the Plaintiff in support of the complaint. The Plaintiff asserts that the Debtor intended to deceive him when he represented that Dowling Enterprises had received a commitment letter²⁰ from Alpha Omega indicating that it would refinance the TVB note, a transaction that would provide funding from which the Debtor would be paid in sixty days. The Plaintiff asserts that the Debtor did not have such a commitment. The Debtor asserts that he had received a commitment, and a commitment letter, from Alpha Omega, but that he was unable to provide it because his former wife had possession of the Dowling

²⁰ A commitment letter is “A lender's written offer to grant a mortgage loan. • The letter generally outlines the loan amount, the interest rate, and other terms.” Black’s Law Dictionary (9th ed. 2009).

Enterprises records. His former wife testified that during their divorce she obtained his interest in Dowling Enterprises and that she had recently searched its records but was unable to locate any document indicating that Alpha Omega had approved the loan to Dowling Enterprises.²¹ It would not, however, be surprising if a commitment letter existed but was jettisoned after the deal fell through. The fact that the Debtor was unable to produce the commitment letter some four years after the fact and two years after he last held an interest in Dowling Enterprises is not evidence sufficient to meet the burden of going forward.

The Plaintiff also asserts that the Loan Closing Statement for the Alpha Omega loan, dated five days before the Plaintiff lent the money to the Debtor, indicates that the parties had not yet agreed to all of the relevant terms of the refinance.²² The amount to be paid to H&B (the entity that held a second deed of trust on the Original Carwash Land) was interlined as \$21,500.00, and was noted as being “still under negotiation”. This fact simply indicates that the Alpha Omega Loan had not be finalized, not that the Dowling Enterprises did not have a commitment from Alpha Omega.

The Debtor also represented that he intended to use the Loan Funds as a down payment on the New Carwash Land. The Plaintiff asserts that the fact that he never made such a down payment supports the complaint. The Debtor, however, provided two plausible explanations why he never used the Loan Funds for that purpose. First, the price of the New Carwash Land was driven up by other potential buyers. Second, further consideration of the terrain and location of the New Carwash Land revealed that there were problems with access to and from

²¹ Testimony of Ms. Dowling, Transcript of Hrg., July 26, 2012, p. 56-57.

²² See Plaintiff’s Exhibit no. 6, Loan Closing Statement, dated January 26, 2008.

the adjacent road.

The Plaintiff asserts that the Debtor then used the Loan Funds to finance the operations of Chesterfield Carwash and to purchase Dowling Enterprises stock.²³ There is no doubt that Chesterfield Carwash was a struggling business at that point in time. Money, however, is fungible and therefore it cannot necessarily be concluded that the funds used to pay H&B and expenses of the business were taken from the Loan Funds.

The Plaintiff also argues that it is relevant that the Debtor would not have had sufficient funds to repay the loan in sixty days if he made the down payment even if an Alpha Omega refinance agreement came to fruition. It would appear from the Loan Closing Statement that the Debtor would not have received enough money to pay back the \$150,000.00 plus interest of \$15,000.00 if he used the Loan Funds as a down payment on the New Carwash Land. The Pro Forma Loan Closing Statement indicates that the Dowling Enterprises would receive \$107,464.52, an amount that would be insufficient to repay the Plaintiff \$165,000.00. This would be true even if the \$107,464.52 were added to the total of all cash held by Dowling Enterprises, \$23,360.71, as indicated by the balance sheet constructed by Dowling Enterprises just three weeks after the loan.²⁴ The Debtor, however, testified that he expected to receive more than three hundred thousand dollars from the refinance of the Original Carwash Land. While the Pro Forma Loan Closing Statement would seem to indicate that the Debtor should have known

²³ The Debtor purchased, for his personal benefit, an equity interest in Dowling Enterprises for \$50,000.00 from Mr. Griggs. He used approximately \$15,000.00 of the Loan Funds to pay off a debt owed to American Express and he spent the balance of approximately \$64,000.00 on operation expenses of Chesterfield Carwash. The Debtor also used \$21,500.00 to repay a debt, or a part thereof, that Dowling Enterprises owed to H&B, on the same date that the Debtor received the Loan Funds.

²⁴ See Plaintiff's Exhibit no. 7, Dowling Enterprises, LLC, Balance Sheet as of February 22, 2008.

that he would be unable to repay the Loan Funds in sixty days, the court concludes that the Debtor believed that he would receive sufficient funds to repay the debt.

Courts are divided on whether a debtor's ability to repay should even be considered in determining whether there is actual fraud. It would appear that the majority of courts have concluded that it is proper to focus on whether the debtor intended to repay the debt, not on whether he or she had the ability to repay the debt. *See, e.g., AT & T Universal Card Services, Inc. v. Rembert (In re Rembert)*, 141 F.3d 277, 281 (6th Cir. 1998); *In re Stahl*, 222 B.R. 497, 503 (Bankr. W.D.N.C. 1998); *In re Koop*, 212 B.R. 106, 108 (Bankr. E.D.N.C. 1997); *In re Kitzmiller*, 206 B.R. at 427; and *In re Simos*, 209 B.R. 188, 192 (Bankr. E.D.N.C. 1997) (“[T]he representation made by the credit card holder in a credit card transaction is not that he or she has the ability to repay the debt, but that he or she has the intention of repaying the debt.”)

One court has held that, while the debtor's inability to repay a debt when it is incurred may be a factor in proving subjective intent, it should never be substituted for a finding of actual fraud. *See Anastas v. Am. Sav. Bank (In re Anastas)*, 94 F.3d 1280, 1286 (9th Cir.1996) (“[T]he hopeless state of a debtor's financial condition should never become a substitute for an actual finding of bad faith.”). It is concluded that the Debtor's perceived inability to repay the Loan Funds should be given very little weight, if any at all, in this case.

On the other hand, there is strong countervailing evidence that the Debtor intended to repay the debt. When the Alpha Omega loan failed to materialize and the Debtor failed to repay the Loan Funds timely, the parties agreed to a repayment schedule under which the Debtor, or Dowling Enterprises, would pay the Plaintiff \$15,000.00 on April 2, 2008, and \$2,250.00 per

month thereafter.²⁵ The Debtor was unable to make all of these payments, but he did make payments totaling \$28,950.00 during the next two years. The court finds it telling that the Debtor offered to pay the debt over time, that the Plaintiff freely accepted the offer, and that the Debtor made substantial payments pursuant to the resulting agreement. These are not the acts of a debtor who was intent on fraud nor are they the acts of a creditor who believed that he had been defrauded.

As noted, a debtor's actual intent to deceive his creditor must be ascertained from the facts surrounding the transaction. The Plaintiff must meet the burden of going forward and must present more evidence than the Debtor concerning the intent to deceive. This is a close case, but it is the court's opinion that the Debtor did not intend to deceive the Plaintiff when he stated that he had a loan commitment from which he could repay the Loan Funds in sixty days or when he stated that he intended to use the funds as a down payment on the New Carwash Land.

The other elements of fraud need not be considered.

Conclusion

When the Debtor approached the Plaintiff for a loan, Dowling Enterprises was a struggling business. The fact that the Debtor contemplated expansion at a time when consolidation would have been the prudent path is evidence that his business skills left much to be desired. The issue, however, is not whether he made bad business decisions, but rather whether he intended to deceive the Plaintiff. The Court cannot conclude that he did. The Plaintiff shall take nothing by his complaint.

An appropriate judgment shall issue.

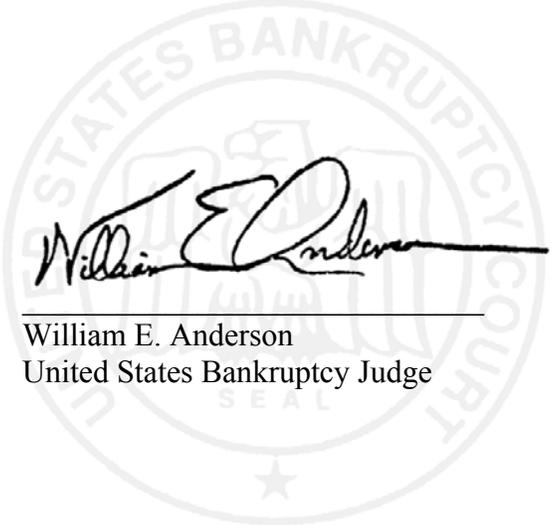
²⁵ Plaintiff's Exhibit # 2.

Upon entry of this Memorandum the Clerk shall forward a copy to Margaret Valois, Esq., J. Frederick Watson, Esq., and the chapter 7 trustee.

Entered on this 27th day of September, 2012.



William E. Anderson
United States Bankruptcy Judge

The seal of the United States Bankruptcy Court is visible in the background. It is a circular seal with the words "UNITED STATES BANKRUPTCY COURT" around the perimeter and a star at the bottom. The word "SEAL" is also visible in the center.