IN THE UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF ARKANSAS
FAYETTEVILLE DIVISION

IN RE: JOHN BRACEY and LAURA BRACEY, Debtor **No. 5:11-bk-71663**
Ch. 7

DTDM, LLC **PLAINTIFF**

v. **5:11-ap-7099**

JOHN BRACEY and LAURA BRACEY **DEFENDANTS**

ORDER

Before the Court is the *Complaint to Determine Dischargeability of Certain Debts* filed by DTDM, LLC [DTDM] on July 5, 2011; the *Answer and Counter-Claim* filed by the debtors, John and Laura Bracey, on August 5, 2011; and DTDM's answer to the counter-claim filed on August 10, 2011. On October 31, 2011, the Court entered its order holding the adversary proceeding in abeyance pending conclusion of a related state court action between the parties. On August 15, 2012, the parties announced resolution of the state court action; the Court then set the adversary proceeding for trial on November 19, 2012. At the conclusion of the trial, counsel for the debtors announced that they were not pursuing their counter-claim against DTDM. The Court took the matter under advisement and is now ready to announce its decision. For the reasons stated more fully below, the Court finds the debt owed to DTDM by separate debtor John Bracey is non-dischargeable in the amount of $15,540 and the debt owed to DTDM by separate debtor Laura Bracey is dischargeable in its entirety.

As a preliminary matter, the Court will address the *Default Judgment* entered by the state court on June 18, 2012, and introduced as Plaintiff's Ex. 1. The Court cannot consider the damages awarded in the default judgment against the debtors in the amount of $41,139 for purposes of collateral estoppel. According to the judgment, the award was the result of damages for "Fraud (Deceit) and Trespass claims." However, the state court

finding does not contain information from which the Court can determine whether the damages would be non-dischargeable in bankruptcy. First, the state court did not indicate the amount of damages resulting from trespass. Generally speaking, damages as a result of civil trespass are dischargeable in bankruptcy. Without a breakdown of the claims and the related damage award, the Court cannot determine how much of the award was for fraud and how much was for trespass. Second, the state court did not list the elements under which the damages for "Fraud (Deceit)" were awarded. The elements for a finding of fraud in bankruptcy are slightly different than the elements under Arkansas law, and, to the extent the damages are a result of constructive fraud, the Eighth Circuit does not recognize constructive fraud under § 523(a)(2)(A). *Thul v. Ophaug* (*In re Ophaug*), 827 F.2d 340, 342 n.1 (8th Cir. 1987) ("only actual fraud, and not fraud implied in law, satisfies section 523(a)(2)(A) . . . ."). For these reasons, the Court did not consider the *Default Judgment*, which was entered into evidence as Plaintiff's Ex. 1, for its determination of damages.

The underlying facts of this case are not in dispute. The debtors rented a house from Todd Wood for approximately three years prior to DTDM purchasing the property from Mr. Wood in August 2010. Upon the transfer of the property to DTDM, the debtors and DTDM entered into a lease agreement and the debtors gave DTDM a check for $5000 as the debtors' deposit and a check for $2800 for their first month's rent. The checks were written on the debtors' EastFay, LLC bank account. However, at the time the checks were given to DTDM, the EastFay, LLC account was a closed account. According to Mr. Bracey, he did not know the account was closed at the time the checks were given to DTDM. The debtors remained in the property until February 2012. Although Mr. Bracey testified that he paid rent while they lived in the house, the testimony of Mr. Bracey and Ms. Dible (the representative for DTDM) only supports a payment of $4000 in December 2010. This was the only payment ever made toward rent for the property.

Section 523(a)(2)(A) of the Bankruptcy Code states that discharge is not available to a debtor for any debt for money, property, or services obtained by "false pretenses, false

representation, or actual fraud, other than a statement respecting the debtor's or insider's financial condition." 11 U.S.C. § 523(a)(2)(A). Under this section, in order to prevail, DTDM must prove by a preponderance of the evidence the following:

1. that the debtor made a representation;

2. that at the time the debtor knew that the representation was false;

3. that the debtor made the representation deliberately and intentionally with the intention and purpose of deceiving the creditor;

4. that the creditor justifiably relied on such representation; and

5. that the creditor sustained the alleged loss and damage as a proximate result of the representation having been made.

Merchants Nat'l Bank of Winona v. Moen, (*In re Moen*), 238 B.R. 785, 790 (B.A.P. 8th Cir. 1999) (quoting *In re Ophaug*, 827 F.2d 340 (8th Cir. 1987)). Unless there is sufficient proof as to each element, judgment cannot be entered for DTDM.

At the outset, the Court finds that DTDM failed to present any evidence concerning Ms. Bracey's alleged representations sufficient to find in DTDM's favor. Accordingly, the Court denies DTDM's complaint against separate debtor Laura Bracey. With regard to Mr. Bracey, the Court will review each element in turn.

1. That the debtor made a representation

The Court finds that when Mr. Bracey presented the two checks to DTDM dated November 8, 2010--one in the amount of $5000 for the deposit and one in the amount of $2800 for the first month's rent--he was implicitly representing to DTDM that he had money in the bank and that the bank would honor the checks.

2. That at the time the debtor knew that the representation was false

Previously, in March and April 2010, Mr. Bracey presented two checks on the EastFay, LLC account to Aaron Nickell, one for $13,000 and one for $13,500. Neither of those checks were honored by the bank because the account had been closed by that time. Mr.

Bracey acknowledged at trial the EastFay, LLC account was closed in the spring of 2010, but he denied *knowing* it was closed when he gave the checks to DTDM in September 2010. Because the account was closed, Mr. Bracey would not have been getting any bank statements. Further, almost certainly, Nickell or someone on his behalf would have advised Mr. Bracey of the dishonored checks given to Nickell in March and April 2010. Because of those facts and Mr. Bracey being unable to make a deposit into the closed account, the Court finds that Mr. Bracey either knew or should have known the EastFay, LLC account was closed when he presented checks on that account to DTDM nearly six months later in September 2010. Additionally, at trial, Mr. Bracey admitted he knew he did not have money in the account to cover the checks to DTDM, which in itself is also a false representation (even if Mr. Bracey was to be given the benefit of the doubt that he did not know the account was closed).[1] The Court finds that Mr. Bracey either knew the representation to DTDM was false when he made the representation or made the representation with a reckless disregard for the truth, which also satisfies the knowledge requirement. *In re Moen*, 238 B.R. at 791 (quoting *In re Duggan*, 169 B.R. 318, 324 (Bankr. E.D.N.Y. 1994).

3. That the debtor made the representation deliberately and intentionally with the intention and purpose of deceiving the creditor

A bad check by itself is not sufficient to support a claim for fraud or false representation. It also requires an intent by the debtor to deceive the creditor. *Tina Livestock Sales, Inc. v. Schachtele* (*In re Schachtele*), 343 B.R. 661, 668-69 (B.A.P. 8th Cir. 2006). However, the intent to deceive can be proven with circumstantial evidence. *In re Van Horne*, 823 F.2d 1285, 1287 (8th Cir. 1987) ("Direct evidence of intent seldom exists and thus courts may look to surrounding circumstances to ascertain intent."). In this instance, the Court finds that Mr. Bracey had the requisite intent to deceive DTDM. The Court can think of

[1] Mr. Bracey claimed a relative was supposed to wire money to the account to cover the checks but that the relative never sent the money. The Court does not find this testimony credible; there was no testimony from the relative or any other evidence to support the Mr. Bracey's assertion.

no other reason to give a creditor a check on an account that the debtor knew was closed other than to deceive that creditor. This is not a situation where a debtor wrote a check on an account that was dishonored for insufficient funds in the account. In this instance, the account did not exist, and the debtor was or should have been aware of that as early as March 2010, nearly six months earlier.

4. That the creditor justifiably relied on such representation

Ms. Dible testified that DTDM did not perform a credit check on the debtors. According to Ms. Dible, Todd Wood, the debtors' previous landlord, had advised DTDM that the debtors had been paying rent during the time they were in the property. Ms. Dible also said that DTDM relied on the background check from Todd Wood. The Court finds that DTDM was justified in believing that the checks presented by Mr. Bracey would be honored by the bank and that they were written on an open account. Justifiable reliance is not as high a burden as the reasonable reliance that is required under § 523(a)(2)(B). Justifiable reliance is a subjective question of whether a person is justified in relying on a representation of fact, even though the person may have discovered that the representation was false had the person made an investigation. *In re Ungar*, 633 F.3d 675, 679 (8th Cir. 2011) (citing *Field v. Mans*, 516 U.S. 59, 70 (1995)). In this instance, DTDM satisfied its reliance requirement when it relied on the information provided by the Braceys' landlord for the previous three years and Mr. Bracey's representation the checks were written on a valid account. *See, e.g.*, *In re Ophaug*, 827 F.2d at 343 (holding under § 523(a)(2)(A), a creditor need only show it relied on the representation).

5. That the creditor sustained the alleged loss and damage as a proximate result of the representation having been made

Mr. Bracey's misrepresentations caused DTDM to suffer a loss not only for the first month's rent, but also for the subsequent months the debtors remained in the property. *See Cohen v. de la Cruz*, 523 U.S. 213, 218-19 (1998) ("Once it is established that specific money or property has been obtained by fraud, however, 'any debt' arising therefrom is excepted from discharge.").

Under the terms of the parties' lease agreement, the debtors are liable for rent in the amount of $2800 per month, a late charge of $15 per day for each day payment was delayed, and a "bad check service charge" in the amount of $25 for the initial dishonored check for rent. The debtors are also entitled to a credit for the $4000 they paid in December 2010. Based on the testimony that the debtors were evicted in late February or mid-March, the Court finds that the debtors were in possession of the property from September 2010 through February 2011, a total of six months or 181 days. The debtors' possession resulted in a total damage award related to the false representation in the amount of $15,540.[2]

At trial, the debtors argued that any resulting damages should be setoff by the amount DTDM received from the sale of the debtors' personal property that remained in the rental property. Despite the plaintiffs' argument concerning the appropriateness of setoff, the state court previously found in its *Default Judgment* that

> It is further and summarily adjudged, decreed, and declared that, upon termination of the subject lease agreement between the parties, which occurred on or before February 15, 2011, if not months prior thereto, all personal property that remained thereon was "abandoned" by Defendants and, thereupon, the property of the Plaintiff, in accordance with Arkansas law.

Under Arkansas law, abandoned property "may be disposed of by the lessor as the lessor shall see fit without recourse by the lessee." Ark. Code Ann. § 18-16-108. The Court is bound by the state court finding under the Rooker-Feldman doctrine. *See Fielder v. Credit Acceptance Corp.*, 188 F.3d 1031, 1034 (8th Cir. 1999) ("The doctrine also deprives lower federal courts of jurisdiction over claims that are 'inextricably intertwined' with claims adjudicated in state court.") Because the debtors were no longer the owners of the personal property according to the state court judgment and Arkansas

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[2] The damages represent six months of occupancy times $2800/month for $16,800; plus 181 days times $15/day for delay of payment for $2715; plus a $25 "bad check service charge"; less $4000 the debtors paid in December.

law, setoff is not applicable in this situation.[3]

For the reasons stated above, the Court finds that the debt owed to DTDM by separate debtor John Bracey is non-dischargeable in the amount of $15,540 and the debt owed to DTDM by separate debtor Laura Bracey is dischargeable in its entirety.

IT IS SO ORDERED.

Ben Barry
United States Bankruptcy Judge
Dated: 12/12/2012

cc: Robert Jeffery Conner
Stephen Lance Cox
Jill R. Jacoway

[3] The Court also recognizes that setoff is an affirmative defense. *In re Kroh Bros. Dev. Co.*, 101 B.R. 114, 118-19 (Bankr. W.D. Mo. 1989); *see also In re Nat'l Hydro-Vac Indus. Servs., LLC*, 314 B.R. 753, 764 (Bankr. E.D. Ark. 2004) (recognizing setoff as type of counterclaim or affirmative defense). DTDM objected to the debtor's setoff argument. According to DTDM's counsel, the debtors did not raise setoff in their answer and DTDM was not prepared to argue setoff at trial.