UNPUBLISHED OPINION 369

IN THE UNITED STATES BANKRUPTCY COURT

FOR THE DISTRICT OF UTAH

CENTRAL DIVISION

In re:	
GARY RUSSELL PORTER and LUGENE E. PORTER	Bankruptcy Number 92-25520 JAB
Debtors.	[Chapter 7]
STOCKMEN'S HOTEL, INC., a Nevada Corporation	Adversary Proceeding Number 92PB-2535
Plaintiff,	
v.	
GARY RUSSELL PORTER	
Defendant.	

MEMORANDUM DECISION AND ORDER OF DISMISSAL

Stockmen's Hotel Inc., (Hotel) is before the court on an application for default judgment. The Hotel filed this adversary proceeding to determine the dischargeability of a debt of $886.00 allegedly owed to it by defendant, Gary Russell Porter (Debtor), pursuant to 11 U.S.C. §§ 523(a)(2)(A) and/or (B).[1] The Hotel asserts the debt is evidenced by a check issued

[1] Subsequent statutory references are to Title 11 of the United States Code unless otherwise indicated.

by the Debtor to a third party, cashed by that third party at the Hotel, and returned from the bank for insufficient funds.

The first issue presented to the court is the nature of proof necessary for the Hotel to prevail in its application for default judgment. The second issue is whether a state court default judgment obtained by the Hotel pursuant to Nevada Revised Statutes § 41.620 should be given collateral estoppel effect. If collateral estoppel is inapplicable, the remaining issue is whether the Hotel has proved that the Debtor made a false pretense, false representation or committed actual fraud under § 523(a)(2)(A), or intended to deceive under § 523(a)(2)(B). The Hotel wishes to set a precedent in this jurisdiction with this case. It is because the Hotel intends to make this a test case that the court took this matter under advisement and allowed the Hotel to prepare a memorandum in support of its application for default judgment.

The court has now reviewed the evidence, considered the Hotel's memorandum, and independently evaluated the applicable statutes and case law. The court concludes that the Hotel has failed to prove that the obligation owed to it is nondischargeable pursuant to §§ 523(a)(2)(A) and/or (B), and the complaint will be dismissed. The rationale for the decision follows.

FACTS

The facts are relatively simple. On October 29, 1990, the Debtor issued and signed a check for $125 drawn on Nevada Bank and Trust to Ken Warner (Warner)[2]. On or about October 29, 1990, Warner presented the check to the Hotel and received cash in exchange. On November 26, 1990, the bank returned the check for insufficient funds.

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[2] Counsel for the Hotel represented that Warner was the Debtor's employee, although there is no evidence in the record that supports that assertion.

Over a year later, on December 24, 1991, the Hotel's attorney forwarded a letter making demand for repayment of the check and allowing thirty days in which to pay the check by certified mail upon the Debtor at an address in Elko, Nevada. The certified mail receipt was signed by Lugene Porter. Another signature on the receipt is crossed out. The Hotel received no response to its correspondence nor any funds from the Debtor.

On February 5, 1992, the Hotel allegedly filed a complaint in the Justice Court for the Township of Elko, County of Elko, State of Nevada. The Debtor did not file a response to the complaint and a default judgment was filed on May 12, 1992, pursuant to Nev. Rev. Stat. § 41.620.[3] Although referenced in the complaint filed in this court and in an affidavit in support of default judgment, a copy of the judgment was never received in evidence. The default judgment was allegedly entered on June 17, 1992, for the principal amount of $500.00; interest thereon at 8.5 percent per annum from April 1, 1992, attorney's fees of $350.00, and costs of $36.00.

On August 27, 1992, the Debtor filed a Chapter 7 petition. Neither the Hotel nor its counsel are listed as creditors on the Debtor's schedules or matrix. On August 31, 1992, shortly after the Chapter 7 was filed, the Hotel filed a Notice of Judgment in Utah. The Hotel received no response within the thirty days of mailing the notice regarding the foreign judgment. On December 7, 1992, the Hotel timely filed a complaint under §§ 523(a)(2)(A) and/or (B) to

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[3] Nev. Rev. Stat. section 41.620 states:

Any person who:

(a) Makes, utters, draws or delivers a check or draft for the payment of money drawn upon any financial institution or other person, when he has no account with the drawee of the instrument or has insufficient money, property or credit with the drawee to pay; or

(b) . . . and who fails to pay the amount in cash to the payee, issuer or other creditor within 30 days after a demand therefor in writing is mailed to him by certified mail, is liable to the payee, issuer or other creditor for the amount of the check, draft or extension of credit, and damages equal to three times the amount of the check, draft or extension of credit, but not less than $100 nor more than $500.

determine the dischargeability of the debt allegedly owed to it by the Debtor for $886.00, plus costs and attorneys' fees.

A certificate of mailing indicates the complaint was served on December 10, 1992, by mail on the Debtor's attorney, but not the Debtor. The Debtor failed to respond and the Hotel requested that default be entered. The bankruptcy clerk declined to enter default because of lack of service on the Debtor. The court issued an additional summons on February 8, 1993, that was returned indicating that on February 11, 1993, the Debtor's attorney was again served and the Debtor was served at a post office box in Morgan, Utah. The bankruptcy court clerk's office entered default dated March 23, 1993, against the Debtor.[4] The court heard the application for default judgment on September 8, 1993, upon notice to Debtor's attorney, but not the Debtor. At no time during any of the above proceedings has the Debtor or his attorney objected to, answered, denied or appeared before any court.

The only evidence presented in support of the application for default judgment was an affidavit of Michael Gilligan, an office manager with the Hotel, indicating that Warner had cashed the $125.00 check issued by the Debtor, and that the check was returned to the Hotel on or about November 26, 1990. He further indicated that the state court judgment was entered on May 12, 1992, and referenced as attached exhibits the check and the default judgment. Neither document was attached to the affidavit.

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[4] No affidavit required by Local Rule 535(d) regarding whether the Debtor was an infant, incompetent, or in the armed forces is contained in the court's adversary proceeding file.

LEGAL ANALYSIS

JURISDICTION

This matter is a core proceeding under 28 U.S.C.§ 157(b)(2)(I) involving the dischargeability of a particular debt. It is before the court pursuant to 28 U.S.C. § 1334(b) and Local Rule 404 of the United States District Court for the District of Utah referring bankruptcy cases and proceedings to this court for hearing and determination. The court has subject matter jurisdiction and venue is proper in the Central Division for the District of Utah.

For this court to have *in personam* jurisdiction over this Debtor, the adversary proceeding must have been properly filed and service obtained over the Debtor, or any default judgment is void. *Campbell v. Castelo (In re Campbell)*, 105 B.R. 19, 21 (9th Cir. BAP 1989). Service may be accomplished by mailing a copy of the complaint and summons by first class mail, postage prepaid, to the individual's dwelling house or usual place of abode, or to the place where the individual regularly conducts a business or profession. Bankruptcy Rule 7004(b)(1). Service upon a post office box is not service upon the individual's dwelling house or usual place of abode and does not comply with the rule. There is no evidence in the record that the post office box listed on the summons' certificate of service is the address where the Debtor regularly conducts his business.

Alternatively, service by mail may be obtained upon a debtor by mailing the complaint and summons to the debtor at the address shown in the petition or statement of affairs, or to such other address as the debtor may designate in a filed writing. Bankruptcy Rule 7004(b)(9). The only address for the Debtor listed in the petition and schedules, and in the court file, is 2945 So. Hwy. 66, Morgan, Ut. 84050, not the post office box stated on the return of

service. The deficiency of service should be sufficient to warrant dismissal of this proceeding. However, in the event the post office box represents the address at which the Debtor conducts his business, the following determination is made of the issues raised.

BURDEN OF PROOF AND STANDARD OF PERSUASION

Because the Bankruptcy Code seeks to provide an honest debtor with a fresh start, interpretation of the statutory exceptions to discharge are narrowly construed. *John Deere Co. v. Gerlach (In re Gerlach)*, 897 F.2d 1048, 1052 (10th Cir. 1990); *Driggs v. Black (In re Black)*, 787 F.2d 503, 505 (10th Cir. 1986). The party opposing the debtor's discharge must prove that the debt falls within the statute's purview by a preponderance of the evidence. *Grogan v. Garner*, 498 U.S. 279, 286, 111 S. Ct. 654, 112 L.Ed.2d 755 (1991).

STANDARD OF PROOF ON DEFAULT JUDGMENT

Bankruptcy Rule 7055(b)(1) and Local Rule 535(d) provide that in all cases other than when the clerk of the court enters default for a sum certain that can by computation be made certain, the party shall apply to the court for default judgment. If it is necessary to establish the truth of any averment by evidence, the court may conduct such hearings as it deems necessary. The Hotel is not entitled to a default judgment as a matter of right. A decision to grant summary judgment requires the court to exercise its discretion, weighing several factors. *Howell Enterprises, Inc. v. First Nat'l Bank (In re Howell Enterprises, Inc.)*, 99 B.R. 413, 415 (Bankr. E.D. Ark. 1989). The minimum elements required to be proved by the Hotel for this court to consider granting default judgment are jurisdiction over the subject matter and over the person, and prima facie evidence that the elements of §§ 523(a)(2)(A) and/or (B) have been met.

COLLATERAL ESTOPPEL IN NONDISCHARGEABILITY PROCEEDINGS

The Hotel first relies upon the collateral estoppel effect of its state court default judgment obtained against the Debtor pursuant to the treble damage civil provisions of the Nevada Revised Statutes. It argues that the default judgment has collateral estoppel effect regarding whether the Debtor had the intent to defraud the Hotel at the time the Debtor issued the check to the Warner.

For collateral estoppel to apply the issue precluded must have been: (i) identical with the issue decided in the earlier action; (ii) actually litigated in the prior action; (iii) necessary and essential to the prior judgment; and (iv) determined by a valid and final judgment. *Grogan v. Garner*, 498 U.S. at 284-85, 111 S. Ct. 654, 112 L.Ed.2d 755; *Goss v. Goss*, 722 F.2d 599, 604 (10th Cir. 1983). Collateral estoppel applies in bankruptcy dischargeability proceedings only where the issue was actually litigated and where all the elements required to establish actual fraud under § 523(a)(2)(A) have been proved in the original trial. *Grogan v. Garner,* 498 U.S. at 284 (quoting Restatement (Second) of Judgments § 27 (1982)).

Application of the elements of collateral estoppel to this default judgment (assuming, *arguendo*, that it was properly obtained) indicate it is inapplicable. The elements articulated under Nev. Rev. Stat. § 41.620 are not identical with the elements required to prevent discharge under §§ 523(a)(2)(A) and/or (B) of the Bankruptcy Code. Nevada Revised Statutes § 41.620 merely makes the issuer of a bad check liable to the payee or other creditor for the amount of the check plus damages of up to three times the check's value. Since the Nevada judgment against the Debtor was a default judgment, the issues of the Debtor's liability or intent were never actually litigated. Therefore, the state court default judgment finding

Debtor liable for issuing a check without sufficient funds will not be given collateral estoppel effect against the Debtor in this nondischargeability action.

NONDISCHARGEABILITY UNDER SECTIONS 523(a)(2)(A) AND/OR (B)

Given the state court default judgment lacks collateral estoppel effect, the issue is whether the Hotel has proved by a preponderance of the evidence the elements necessary to have a debt excepted from discharge under §§ 523(a)(2)(A) and/or (B).[5] The validity of a creditor's claim is determined by state law. *Grogan v. Garner*, 498 U.S. at 283. Since 1970, the issue of nondischargeability has been a matter of federal law governed by the terms of the Bankruptcy Code. *Grogan v. Garner*, 498 U.S. at 284. Similar to other exceptions to discharge, §§ 523(a)(2)(A) and/or (B) are to be construed narrowly to assure that the basic bankruptcy policy of giving an honest debtor a fresh start is not frustrated.

The Debtor Did Not Obtain Anything of Value.

Under both §§ 523(a)(2)(A) and/or (B), the Hotel must show that the Debtor obtained money, property, services, or credit by false pretenses, representation or fraud. The Hotel alleges that it was defrauded by the Debtor at the time the third party, Warner, cashed the check. Since Warner, a third party, passed the check to the Hotel, the Hotel has failed to explain how the Debtor received anything of value. There is no evidence that the Debtor, as opposed to Warner, received anything of value when the check was passed to the Hotel.

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[5] To state a claim under section 523(a)(2)(A), a plaintiff must prove that: (1) the defendant made a false or willful misrepresentation; (2) the defendant intended to deceive the plaintiff with the misrepresentation; (3) the plaintiff reasonably relied upon the representation; and (4) the plaintiff's loss occurred as a result of the defendant's misrepresentation. *First Bank of Colorado Springs v. Mullet (In re Mullet)*, 817 F.2d 677, 680 (10th Cir. 1987).

Section 523(a)(2)(B) requires the plaintiff to prove that the debtor obtained money or property by the use of a statement in writing that is (1) materially false; (2) respecting the debtor's financial condition; (3) upon which the creditor reasonably relied: and (4) that the debtor caused to be made or published with intent to deceive.

False Misrepresentation

The Hotel's complaint pleads nondischargeability under both §§ 523(a)(2)(A) and/or (B). Section 523(a)(2)(A) requires a statement or representation made by the Debtor that is false upon which the creditor relied. The Hotel asserts that the issuance of a check upon an account containing insufficient funds in and of itself is an implied representation sufficient to qualify as a statement or representation that there are sufficient funds on account to cover the check. There is a split of authority whether this assertion is correct. The cases holding that mere issuance of an insufficient funds check constitutes such an implied representation are set forth in *Microtech v. Horwitz (In re Horwitz)*, 100 B.R. 395, 398 (Bankr. N.D. Ill. 1989).[6]

The courts taking the "no-representation" position have the support of *Williams v. United States*, 458 U.S. 279, 102 S. Ct. 3088, 73 L.Ed.2d 767 (1982). *Williams* involved a check-kiting scheme in violation of 18 U.S.C. § 1014, (which prohibits the use of knowingly false statements to influence the actions of financial institutions) deciding whether the deposit of an insufficient funds check in a federally insured bank was prohibited by the statute. The Court ruled that although the defendant had deposited several checks without sufficient funds, the defendant's conduct did not involve the making of a false statement, stating:

> [A] check is not a factual assertion at all, and therefore cannot be characterized as "true" or "false." Petitioner's bank checks served only to direct the drawee banks to pay the face amounts to the bearer, while committing petitioner to make

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[6] *See also, 119th & Halsted Currency Exchange v. Blake-Ware (In re Blake-Ware)*, 155 B.R. 476 (Bankr. N.D. Ill. 1993) (debtor also made oral representations); *Roebuck Auto Sales, Inc., v. Mahinske (In re Mahinske)*, 155 B.R. 547 (Bankr. N.D. Ala. 1992) (no contemporaneous verbal representation); *Western Petroleum Company v. Burgstaler (In re Burgstaler)*, 58 B.R. 508 (Bankr. D. Minn. 1986) (turned on the failure to prove intent); *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Younesi (In re Younesi)*, 34 B.R. 828 (Bankr. C.D. Cal. 1983) (reluctantly following *Bear Stearns & Co. v. Kurdoghlian (In re Kurdoghlian)*, 30 B.R. 500 (9th Cir. BAP 1983)).

> good the obligations if the banks dishonored the drafts. Each check did not, in terms, make any representation as to the state of petitioner's bank balance. As defined in the Uniform Commercial Code, . . . a check is simply 'a draft drawn on a bank and payable on demand,' . . . which 'contain[s] an unconditional promise or order to pay a sum certain in money' . . . .

Williams, 458 U.S. at 284-85.

This court recognizes that the above statement was made outside a bankruptcy context. However, the circumstances of *Williams* have not prevented its holding from being adopted in the bankruptcy context. Even the district in which the "representation" line of cases began has retreated because of *Williams*. *See, Timberline Systems, Inc., v. Hammett (In re Hammett)*, 49 B.R. 533, 535 (Bankr. M.D. Fla. 1985) (The Supreme Court's "characterization of a check as a non-statement is so broad and unequivocal that this Court does not feel able to find that it is intended to be limited to a context of criminal prosecution."). *See also, Roebuck Auto Sales, Inc., v. Mahinske (In re Mahinske)*, 155 B.R. 547, 551 (Bankr. N.D. Ala. 1992); *Doug Howle's Paces Ferry Dodge, Inc. v. Ethridge (In re Ethridge)*, 80 B.R. 581, 588-89 (Bankr. M.D. Ga. 1987) (plaintiff did not prove requisite intent).

Most of the more recent decisions dealing with this question have tended to follow *Williams*. *See, e.g., Mahinske*, 155 B.R. at 551; *Horwitz*, 100 B.R. at 398 (listing cases up to 1989 following *Williams*). The cases supporting the assertion that passing a bad check is a false representation fail to deal with or even cite *Williams*. The better reasoning is set forth in *Mahinske* where Judge Mitchell held:

> This Court concludes that *Williams*' reasoning about the nature of checks is sound, and that its application to the facts of this case would further the Code's promise of a fresh start to the honest but unfortunate debtor. It is also harmonious with the nature of a fraud action under Section 523, which requires that the Plaintiff show actual, as opposed to implied, fraud (citation omitted). Finally, allowing the use of an insufficient funds check to automatically transform

> an otherwise innocent transaction into a fraudulent one would ignore commercial and consumer realities; honest people often write checks knowing that their funds are lacking, but do so with the honest belief that they will be able to make up the deficit before the check is presented.

Mahinske, 155 B.R. at 551.

The courts following *Williams* have held that no fraud will exist absent an oral representation or affirmative statement regarding the sufficiency of the debtor's bank account. Because the Hotel has not presented any evidence that the Debtor made any oral representation regarding the check, the element of reliance must also fail.

The Hotel also asserted that the alleged debt owed to it was nondischargeable under § 523(a)(2)(B). "11 U.S.C. § 523(a)(2)(A) . . . while barring discharge for money obtained by false pretenses . . . provides an exception where representations made were 'statement[s] respecting the debtor's or an insider's financial condition.' . . . Such statements fall within the purview of 11 U.S.C. § 523(a)(2)(B) which expressly provides that the statements be written." *Blackwell v. Dabney (In re Blackwell)*, 702 F.2d 490, 491 (4th Cir. 1983). As set forth in *Ethridge*, 80 B.R. at 588, a check is a negotiable instrument, and a negotiable instrument is an unconditional promise to pay a sum certain. As such, a check is not a statement of a person's financial condition, but is instead evidence of a debt. *A.G. Edwards & Sons, Inc., v. Paulk (In re Paulk)*, 25 B.R. 913, 917 (Bankr. M.D.Ga. 1982). Since *Williams* held that a check was not a statement of financial condition, it also can not be the basis, without more, for a finding of nondischargeability under § 523(a)(2)(B). *Jack Masters, Inc. v. Collins (In re Collins)*, 28 B.R. 244, 247 (Bankr. W.D. Okla. 1983).

Intent to Defraud

Even assuming a check was an implied representation as the Hotel alleges, no evidence has been presented to show the Debtor's intent to defraud. The Hotel relies solely on *Bear Stearns & Co. v. Kurdoghlian (In re Kurdoghlian)*, 30 B.R. 500, 502 (9th Cir. BAP 1983). In *Kurdoghlian*, the Ninth Circuit's Bankruptcy Appellate Panel held that the evidence as a whole indicated that the debtor, a regular trader in options, who issued insufficient funds checks to his security broker demonstrated the debtor's conscious, or at least reckless, disregard for the state of his bank account that amounted to actual knowledge that the account contained insufficient funds. *Id.* at 502. The case turns on the totality of the circumstances evidencing reckless disregard that the BAP considered equivalent to intentional fraud.

The Tenth Circuit also acknowledges that "the requisite intent may be inferred from a sufficiently reckless disregard of the accuracy of the facts." *Black,* 787 F.2d at 506. *See also Central Nat'l Bank & Trust Co. v. Liming (In re Liming),* 797 F.2d 895, 897 (10th Cir. 1986) ("a statement need only be made with reckless disregard for the truth . . . under § 523(a)(2)(B)"). The premise that scienter can be proved by elements other than direct proof is the prevailing case law.

> [I]t is sufficient to show that a false representation on a financial statement . . . was made with reckless indifference and disregard of the actual facts and without examining the available sources which were readily available and the statement was made without reasonable grounds to believe that the statement was, in fact, correct.

Sun Bank & Trust Co., v. Rickey (In re Rickey), 8 B.R. 860, 863 (Bankr. M.D. Fla. 1981).

For the court to infer deceptive intent from surrounding circumstances, significantly more evidence would be necessary than that presently before the court. Here, the

Debtor issued a single check for $150 to Warner. There is no other evidence of the Debtor's financial history or the history of the account upon which the check was drawn. There could be a myriad of reasons why the check issued by the Debtor was returned and never paid, and without more, a finding of intent to defraud would be mere speculation. In the "representation line" of cases, there are usually multiple checks issued with insufficient funds that total a substantial amount above the debtor's balance, lending cumulative evidence of intent or recklessness.

The Hotel asserts that the element of intent should be implied because of the Debtor's continued failure to respond to the year-old demand for payment, failure to respond to the Notice of Judgment filed in violation of the automatic stay, to respond to the complaint filed herein but not properly served, and to the notice of hearing on the application for default mailed to the Debtor's attorney who has not appeared in this adversary proceeding. Even assuming that the Debtor received the year-old demand for payment, that the Notice of Judgment was not void, that service had been effectuated upon the Debtor such that an answer was required, and that the Debtor's attorney forwarded the notice of hearing to the Debtor, no evidentiary weight can be attributed to the Debtor's failure to act. Such circumstantial evidence is insufficient for the court to give any weight in making a finding of actual intent.

The Hotel's final argument is that intent should be implied as a matter of law. Under Nevada law, criminal intent is presumed to exist if, after demand is made, no payment is received within ten (10) days. Nev. Rev. Stat. § 205.132(1)(b) states:

> In a criminal action for issuing a check or draft against insufficient or no funds with intent to defraud, that intent and the knowledge that the drawer has insufficient money, property or credit with the drawee is presumed to exist if:

> . . . (b) Payment of the instrument is refused by the drawee when it is presented in the usual course of business, unless within ten (10) days after receiving notice of this fact from the drawee or the holder, the drawer pays the holder of the instrument the full amount due plus any handling charges.[7]

Assuming for the purpose of this argument that the demand made upon the Debtor a year after issuing the check, and received by Lugene Porter, was sufficient notice to comply with Nev. Rev. Stat. § 205.132(1)(b), the presumption of intent to defraud provided in the statute is insufficient to satisfy the intent requirement in §§ 523(a)(2)(A) and/or (B).

The Tenth Circuit has indicated that § 523(a)(2)(A) "includes only those frauds involving moral turpitude or intentional wrong, and does not extend to fraud implied in law which may arise in the absence of bad faith or immorality." *Black*, 787 F.2d at 505. That interpretation is consistent throughout the case law. *Thul v. Ophaug (In re Ophaug)*, 827 F.2d 340, 342 n.1 (8th Cir. 1987) (only actual fraud and not fraud implied at law satisfied § 523(a)(2)(A)); *Schweig v. Hunter (In re Hunter)*, 780 F.2d 1577, 1579 (11th Cir. 1986) (debtor must be guilty of positive fraud involving moral turpitude, and not implied fraud or fraud in law); *Western Petroleum Company v. Burgstaler (In re Burgstaler)*, 58 B.R. 508, 514 (Bankr. D. Minn. 1986) (Minnesota criminal statute that presumed intent is insufficient to show actual fraud involving moral turpitude). Therefore, there is no evidentiary value taken from the Nevada Criminal statute that is sufficient to meet the Hotel's burden of proof.

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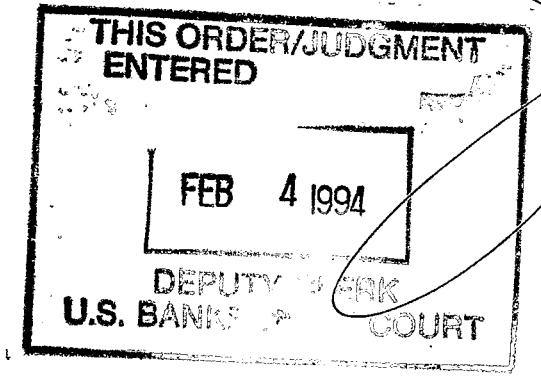
[7] It appears that the current version of Nev. Rev. Stat. § 205.132(1)(b) has been amended to provide that once demand is made on the drawer, the drawer is allowed only five (5) days to pay the holder of the instrument the full amount due plus any handling charges.

CONCLUSION

Based on the foregoing analysis and the evidence presented, the Hotel has not proven: 1) that the Debtor received money, property or services from the Hotel; 2) that the Debtor made a false pretense, false representation or statement to the Hotel; and 3) that the Debtor intended to defraud the Hotel. The state court default judgment obtained in Nevada in favor of the Hotel against the Debtor is a dischargeable debt. Therefore, it is hereby

ORDERED, that the Hotel's claims that the state court default judgment is nondischargeable pursuant to §§ 523(a)(2)(A) and/or (B) are denied and the adversary proceeding dismissed.

DATED this 4th day of February, 1994.



JUDITH A. BOULDEN
United States Bankruptcy Judge