

FEB 12 2009

HAROLD S. MARENUS, CLERK
U.S. BKCY. APP. PANEL
OF THE NINTH CIRCUIT

NOT FOR PUBLICATION

UNITED STATES BANKRUPTCY APPELLATE PANEL
OF THE NINTH CIRCUIT

In re:)	BAP No.	MT-08-1165-DMoPa
)		
MICHAEL ANDREW LONG,)	Bk. No.	07-60011
)		
Debtor.)	Adv. No.	07-00026
)		
_____)		
MOUNTAIN WEST BANK OF)		
KALISPELL, N.A.,)		
)		
Appellant,)		
)		
v.)	MEMORANDUM¹	
)		
MICHAEL ANDREW LONG,)		
)		
Appellee.)		
_____)		

Argued and Submitted on January 22, 2009
at Pasadena, California

Filed - February 12, 2009

Appeal from the United States Bankruptcy Court
for the District of Montana

Honorable Ralph B. Kirscher, Chief Bankruptcy Judge, Presiding

Before: DUNN, MONTALI and PAPPAS, Bankruptcy Judges.

¹This disposition is not appropriate for publication. Although it may be cited for whatever persuasive value it may have (see Fed. R. App. P. 32.1), it has no precedential value. See 9th Cir. BAP Rule 8013-1.

1 Mountain West Bank of Kalispell, N.A. ("MW Bank") filed an
2 adversary proceeding seeking to deny the debtor, Michael Andrew
3 Long ("Mr. Long"), a discharge in bankruptcy under § 727(a)(3)
4 and (a)(4)(A) of the Bankruptcy Code,² and/or to except its debt
5 from Mr. Long's discharge under § 523(a)(4) and (a)(6).
6 Following a trial, the bankruptcy court entered a judgment in Mr.
7 Long's favor on all of MW Bank's claims.

8 We agree with the bankruptcy court's conclusions that MW
9 Bank did not meet its burden of proof to prevail on its
10 § 523(a)(4) and § 727(a)(3) and (a)(4)(A) claims for relief.
11 However, Mr. Long's fruitless efforts to start a new business
12 were not the same as a good faith effort to keep his business
13 going within the meaning of Transamerica Comm'l Fin. Corp. v.
14 Littleton (In re Littleton), 942 F.2d 551 (9th Cir. 1991), when
15 he sold the principal assets of his corporation, failed to
16 disclose the sale and remit the sale proceeds to the creditor
17 with a security interest in those assets, and appropriated a
18 substantial portion of those sale proceeds for his personal use.
19 Accordingly, we REVERSE the bankruptcy court's judgment in favor
20 of Mr. Long on MW Bank's § 523(a)(6) cause of action and REMAND
21 to the bankruptcy court for a determination of MW Bank's damages
22 excepted from Mr. Long's discharge.

23 / / /

24 / / /

25 / / /

27 ²Unless otherwise indicated, all chapter, section and rule
28 references are to the Bankruptcy Code, 11 U.S.C. §§ 101-1532, and
to the Federal Rules of Bankruptcy Procedure, Rules 1001-9037.

1 **I. FACTS**

2 A. Background

3 AboutMontana.net, Inc. ("AboutMontana"), a for-profit
4 Montana corporation incorporated in early 2000, operated
5 principally as a dial-up internet service provider ("ISP") in the
6 Kalispell, Montana area. Beginning sometime in 2003, Mr. Long
7 became AboutMontana's controlling shareholder.³ At all times
8 relevant to this appeal, Mr. Long had sole responsibility for the
9 financial affairs of AboutMontana and exclusive authority over
10 its bank account.

11 In 2004, AboutMontana developed a business plan ("Business
12 Plan") to expand its ISP services by offering free high speed
13 broadband internet services to the Whitefish, Montana area. The
14 Business Plan contemplated the eventual franchising of
15 AboutMontana's sales and marketing model. To implement the
16 Business Plan, on November 29, 2004, AboutMontana borrowed
17 \$100,000 from MW Bank. In support of its application for the
18 loan, AboutMontana provided MW Bank with four years of profit and
19 loss statements, which reflected that historically 83% of
20 AboutMontana's income was generated from ISP accounts, and that
21 over the subject four-year period, the ISP accounts had become an
22 increasing proportion of AboutMontana's income. By its fiscal
23 year ending in June 2004, the ISP accounts represented 94% of
24 AboutMontana's income. By contrast, web design services
25 accounted for 4.1% of AboutMontana's income during the four-year
26

27 ³Mr. Long held 64% of the stock of AboutMontana; the other
28 stock was held by either eight or ten investors, none of whom
participated in the operation of AboutMontana's business.

1 period covered by the profit and loss statements, and less than
2 1% by the end of AboutMontana's fiscal year ending in June 2004.

3 As collateral for the loan, MW Bank was granted a security
4 interest in all of AboutMontana's assets, including inventory,
5 accounts, equipment and general intangibles. MW Bank also
6 obtained a personal guaranty of the loan from Mr. Long. The
7 commercial security agreement through which AboutMontana pledged
8 the collateral for the MW Bank loan provided in relevant part:
9 "Unless waived by Lender, all proceeds from any disposition of
10 the Collateral (for whatever reason) shall be held in trust for
11 Lender and shall not be commingled with any other funds . . .
12 Upon receipt, Grantor shall immediately deliver any such proceeds
13 to Lender."

14 AboutMontana's Business Plan failed when it lost its
15 business relationship with Century Tel and YDI, the exclusive
16 entities from which AboutMontana had access to internet service.
17 In the face of its inability to move forward with expansion,
18 AboutMontana sold its ISP assets, consisting primarily of its
19 customer accounts, to Montana Sky Networks, Inc. ("Montana Sky")
20 on June 2, 2005, for the sale price of \$141,733.10. Payment of
21 this amount is reflected by two deposits to AboutMontana's
22 checking account at MW Bank: \$30,000 on June 24, 2005, and
23 \$111,733.10 on July 1, 2005. In conjunction with the sale of
24 AboutMontana's ISP assets, Mr. Long entered into a noncompetition
25 agreement with Montana Sky.

26 Mr. Long did not notify Montana Sky of the existence of MW
27 Bank's security interest in the ISP assets, nor did he notify MW
28 Bank of the sale of the ISP assets. Most important for purposes

1 of this appeal, Mr. Long did not pay over the proceeds of the
2 sale to MW Bank after the disposition of its collateral.
3 Instead, he continued to make regular monthly payments on
4 AboutMontana's debt to MW Bank through January 2006, by which
5 time all of the sale proceeds were gone, and after which no
6 further payments to MW Bank were made.

7 B. After the Sale

8 1. Further Options for AboutMontana

9 Mr. Long testified that following the sale of the ISP
10 assets, AboutMontana continued as a travel-related business under
11 two different business models developing MC Travel, an electronic
12 magazine, and a tourist database, both targeting motorcycle
13 enthusiasts between the ages of 48 and 68. Long further
14 testified that AboutMontana, in effect, suspended business when
15 oral commitments for funding from two venture capitalists failed
16 to materialize.⁴

17 The record reflects that after the sale of the ISP assets,
18 AboutMontana generated no income. Subsequent to the July 1,
19 2005, deposit of sale proceeds, the following deposits were made
20 to AboutMontana's checking account:

21 2005

22	July 5	\$ 43.88
	July 5	930.25
23	July 20	204.00
	July 28	242.97
24	August 17	12.00
	October 19	13.00
25	November 21	13.00
	December 16	1,800.00
26	December 19	13.00

27
28 ⁴Mr. Long testified at his deposition that he still was seeking business opportunities for AboutMontana.

1 2006

2 January 3 \$1,700.00
3 January 19 13.00

4 The deposits made December 16, 2005, and January 3, 2006, were
5 checks written on Mr. Long's personal checking account at Wells
6 Fargo Bank.

7 2. Disposition of the Sale Proceeds

8 At his § 341(a) Meeting of Creditors, Mr. Long testified in
9 response to the trustee's questioning that he had spent all of
10 the sale proceeds to pay debts of the business.

11 Q: Was all of the hundred and thirty [thousand dollars]
12 used to satisfy company debt?

13 A: Yes.

14 Further, in response to questioning by MW Bank's attorney at the
15 § 341(a) Meeting of Creditors about how he determined which debts
16 to pay from the sale proceeds, Mr. Long testified that he made
17 ongoing monthly payments until the money was gone.

18 Q: Why were unsecured creditors paid but not secured
19 creditors, such as . . . Mountain West Bank, paid from
 those proceeds?

20 A: Everybody was paid equally. Per note schedules. On a
21 monthly basis, I made payments.

22 Q: So you're saying you just made monthly payments until
 the money was gone?

23 A: Yes, ma'am.

24 The record reflects otherwise.

25 a. Payments Not Made To Satisfy AboutMontana Debt

26 On July 5, 2005, four days after the final sale proceeds
27 were deposited to AboutMontana's checking account, Mr. Long wrote
28 check 3515 on that account, payable to Leann Devine in the amount

1 of \$16,233.10. Without the sale proceeds, there would not have
2 been sufficient funds in AboutMontana's checking account to make
3 this payment. In the memo line of check 3515, Mr. Long wrote
4 "settlement agreement payoff." The settlement agreement ("Devine
5 Agreement") referred to was entered into in October 2003 by Mr.
6 Long, personally, with his then common-law wife, Leann S. Devine,
7 terminating their common law marriage and dividing assets. At
8 the time the Devine Agreement was executed, Ms. Devine was an
9 employee of AboutMontana. The Devine Agreement required Mr. Long
10 to make the following payments to or on behalf of Ms. Devine:
11 lease payments in the amount of \$506.25 on Ms. Devine's vehicle,
12 which was used for AboutMontana business purposes; monthly
13 salary, based on a guarantee of Ms. Devine's continued employment
14 by AboutMontana through November 1, 2005⁵; and a monthly
15 consulting fee each month for a period of three years. Putting
16 aside the issue of whether the Devine Agreement constituted an

17
18 ⁵Interestingly, AboutMontana's agreement with Montana Sky
19 for the purchase of AboutMontana's ISP assets contained the
20 following language:

21 Buyer agrees to hire Ms. Leann Devine, a current
22 [A]bout[M]ontana.net, Inc. employee for a minimum
23 period of 12 months, subject to conditions contained
24 herein.

24 Buyer will pay Ms. Devine a gross monthly pay check of
25 \$2,430.00. In addition, Montana Sky will pay Ms. Devine
26 \$322.00 for Blue Cross & Blue Shield Health Insurance
27 during this employment contract. This 12 month term
28 for employment is not meant to imply Ms. Devine may not
be dismissed for good cause due to poor work practices;
should Ms. Devine be dismissed for poor work practices
buyer will continue to pay Ms. Devine a gross monthly
pay check of \$2,430 through November 2005.

1 obligation of AboutMontana, and although no accounting was
2 provided at trial or otherwise of the payments made under the
3 terms of the Devine Agreement, it is clear that the payoff amount
4 was not a regular monthly payment.

5 On November 28, 2005, Mr. Long opened a personal checking
6 account, in his name only, at Wells Fargo Bank, using as his
7 opening deposit check 3676 in the amount of \$5,000 written to
8 himself on AboutMontana's checking account. On the following
9 day, Mr. Long deposited to his Wells Fargo Bank account check
10 3677 in the amount of \$30,000 written to himself on
11 AboutMontana's checking account. After these two checks cleared,
12 AboutMontana's checking account balance was reduced to \$3,111.54.
13 On December 2, 2005, Mr. Long made two withdrawals from the funds
14 now available in his Wells Fargo Bank account, one in the amount
15 of \$4,160.50 and the other in the amount of \$1,839.50. At trial,
16 Mr. Long testified that the \$4,160.50 withdrawn on December 2,
17 2005, was used to pay his tuition to Sage Technical Schools, a
18 truck driving school in Missoula, Montana, and that he believed
19 the \$1,839.50 withdrawn December 2, 2005, was used to pay for his
20 books and lodging expense while he attended the truck driving
21 school.

22 Also on December 2, 2005, Mr. Long wrote check 00093 on his
23 Wells Fargo Bank account in the amount of \$1,000 to James
24 Cossitt, with the name "Michael Long" in the memo line. Mr.
25 Cossitt is Mr. Long's bankruptcy attorney. This payment to
26 counsel is reflected in response to question 9 of Mr. Long's
27 Statement of Financial Affairs. Nevertheless, at trial, during
28 questioning by Mr. Cossitt with respect to attorneys fees Mr.

1 Long had incurred in defense of the adversary proceeding, Mr.
2 Long testified within the span of a few minutes that the \$1,000
3 fee was for personal legal services, that it was for business
4 legal services, and that it was for both:

5 Q: Do you know, are either of those checks business
6 or personal?

7 A: Excuse me, I've got to look at the ---
(inaudible). The first, 93, would be personal to
8 [Mr. Cossitt].

9 Q: Okay.

10 A: And the second one is personal.

11 Q: Mr. Long, you just testified that Check No. 93 was
12 paid to me as a personal matter?

13 A: Pardon? I'm sorry, that would be business.

14 Q: What were you seeking legal services for, sir?

15 A: Because I hadn't received the funding for a new
16 business model, and I was running out of capital.

17 . . .

18 Q: Okay. Let's move on to the next one, which is
19 Check No. 93 to myself. Do you recall what that
20 was for?

21 A: That was for legal services.

22 Q: Okay. Was that for you or for the business or for
23 both?

24 A: Both.

25 b. Payments to or for the Benefit of Mr. Long

26 Although Mr. Long testified repeatedly that AboutMontana
27 utilized the sale proceeds to attempt to remain in business, he
28 conceded that as much as \$55,000 (including the \$35,000 he
deposited to his Wells Fargo Bank account) of the sale proceeds
had been paid to himself by checks written on AboutMontana's
account. These payments include:

	<u>Check No.</u>	<u>Date</u>	<u>Amount</u>
1			
2	3504	June 28, 2005	\$3,000.00
3	3523	July 9, 2005	2,500.00
	3543	July 15, 2005	3,000.00
4	3561	July 30, 2005	1,000.00
	3571	August 15, 2005	1,000.00
5	3595	September 1, 2005	3,000.00
	3615	September 23, 2005	500.00
6	3641	October 17, 2005	3,000.00
	3661	November 4, 2005	600.00
7	3675	November 21, 2005	2,000.00
	3684	November 29, 2005	1,000.00
8			

9 Additionally, Mr. Long wrote several checks on the
10 AboutMontana account which were for his own benefit. These
11 payments include:

	<u>Check No.</u>	<u>Date</u>	<u>Creditor</u>	<u>Amount</u>
12				
13	3519	07/15/05	Northwestern Energy	\$ 105.68
14	3559	07/28/05	Home Depot	300.00
15	3655	10/31/05	Countrywide (Mortgage payment)	1,528.23
16	3659	11/01/05	U.S. Bank (Mortgage Payment and driving insurance)	649.87
17				

18 Mr. Long also wrote numerous checks for the payment of credit
19 cards in his name, although he testified that he used the cards
20 largely, though not exclusively, for business purposes. In
21 commenting on the credit card use, the bankruptcy court stated
22 that "[Mr. Long] explained that he mixed his personal and
23 corporate dealings to the point that it was 'hard to distinguish'
24 between the personal and corporate affairs."

	<u>Check No.</u>	<u>Date</u>	<u>Creditor</u>	<u>Amount</u>
25				
26	3518	07/09/05	MBNA America	\$1,000.00
27	3538	07/20/05	Chase Mastercard	500.00
	3558	07/28/05	American Express	800.00
28	3585	08/30/05	American Express	800.00
	3635	10/10/05	Discover Card	300.00

1	3643	10/24/05	Chase Mastercard	500.00
	3652	10/31/05	American Express	600.00
2	3668	11/14/05	Discover Card	300.00
	3665	11/14/05	MBNA America	500.00

3

4 c. Business Payments

5 The payments made to Ms. Devine, to Mr. Long, and for the
6 clear benefit of Mr. Long total \$74,416.88 of the sale proceeds.
7 The credit card payments for which Mr. Long may have derived some
8 benefit total \$5,300. Mr. Long testified that, except for the
9 checks identified above, all checks were written for payment of
10 business expenses. After the non-business payments were made,
11 \$62,016.22, or approximately 43%, of the sale proceeds remained.

12 From this remaining amount, \$15,000 was paid to Montana Sky,
13 representing prepayments received by AboutMontana on the ISP
14 accounts sold to Montana Sky. Among the payments AboutMontana
15 made on its business debt were payments on the MW Bank loan.

16 These payments include:

17	Check 3501	June 27, 2005	\$ 956.02
	Check 3548	July 28, 2005	956.02
18	Check 3592	August 30, 2005	956.02
	Check 3623	September 30, 2005	956.02
19	Check 3648	October 30, 2005	956.02
	Check 3683	November 29, 2005	956.02
20	Check 3696	December 31, 2005	956.02

21 In order to make the December 31, 2005 payment, Mr. Long
22 returned, via a \$1,700 deposit to the AboutMontana checking
23 account, some of the funds he previously had transferred to his
24 Wells Fargo Bank account.

25 AboutMontana also made numerous payments to First Interstate
26 Bank ("FIB") with respect to several obligations. FIB held a
27 security interest in some of AboutMontana's assets that had
28 priority over the security interest held by MW Bank.

1 Other payments made by AboutMontana after the asset sale
2 included payroll to employees through the time of the sale, rent
3 for the business premises until vacated in August or September of
4 2005, utilities, medical insurance premiums, and shareholder
5 dividends in the amount of \$225 per investor per quarter through
6 December 2005.

7 3. The Bankruptcy Proceedings

8 On January 9, 2007, after MW Bank obtained a judgment
9 against AboutMontana, and while summary judgment proceedings were
10 pending against him with respect to liability on the personal
11 guaranty, Mr. Long filed his voluntary chapter 7 petition. MW
12 Bank initiated an adversary proceeding to object to the discharge
13 of Mr. Long's debt to MW Bank pursuant to § 523(a)(4) and (a)(6),
14 and to object to Mr. Long's discharge pursuant to § 727(a)(3) and
15 (a)(4)(A).⁶ MW Bank contended that Mr. Long engaged in a course
16 of conduct, which began with the failure to notify MW Bank of the
17 sale of AboutMontana's ISP assets, including his depletion of the
18 sale proceeds in large part for his own benefit, and continued
19 with false testimony at the § 341(a) Meeting of Creditors, which
20 established that Mr. Long is not the "honest but unfortunate
21 debtor" for whom the Bankruptcy Code provides a discharge.

22 Following a two-day trial and post-trial briefing, the
23 bankruptcy court ruled that MW Bank had failed to carry its
24 burden to show Mr. Long's fraudulent intent to permanently
25 deprive MW Bank of its property as required by § 523(a)(4);

27 ⁶MW Bank did not include in its § 523(a)(4) claim, a claim
28 for relief based on fraud or defalcation while acting in a
fiduciary capacity.

1 failed to satisfy its burden of proof under § 523(a)(6) to show
2 willful and malicious injury by Mr. Long to MW Bank; failed to
3 show that a single false oath made by Mr. Long at his § 341(a)
4 Meeting of Creditors was made knowingly and with fraudulent
5 intent as required to deny Mr. Long his discharge under
6 § 727(a)(4)(A); and failed to prove that Mr. Long failed to
7 maintain and preserve adequate records to support a denial of Mr.
8 Long's discharge under § 727(a)(3). The bankruptcy court entered
9 judgment in favor of Mr. Long on all claims for relief. MW Bank
10 has appealed that judgment.⁷

11 12 **II. JURISDICTION**

13 The bankruptcy court had jurisdiction pursuant to 28 U.S.C.
14 §§ 1334 and 157(b)(2)(A) and (J). We have jurisdiction pursuant
15 to 28 U.S.C. § 158.

16 17 **III. ISSUES**

18 Whether the bankruptcy court erred when it determined that
19 Mr. Long expended the sale proceeds in a good faith effort to
20 continue the business of AboutMontana.

21 Whether the bankruptcy court erred when it concluded that
22 Mr. Long's actions were not willful and malicious within the
23 meaning of § 523(a)(6).

24 Whether the bankruptcy court erred when it concluded that
25 Mr. Long's actions did not constitute larceny or embezzlement
26 within the meaning of § 523(a)(4).

27 _____
28 ⁷ MW Bank did not appeal the bankruptcy court's
determination of the § 727(a)(3) claim for relief.

1 exists when, on the entire evidence, the reviewing court is left
2 with the definite and firm conviction that a mistake was
3 committed. Hoopai v. Countrywide Home Loans, Inc. (In re
4 Hoopai), 369 B.R. 506, 509 (9th Cir. BAP 2007).

6 V. DISCUSSION

7 A. Threshold Matters

8 1. The Burden of Proof

9 In light of the bankruptcy court's determination that MW
10 Bank failed to carry its burden of proof on each of its claims
11 which sought to deny Mr. Long the right to discharge either his
12 debt to MW Bank or any of his debts, we begin this discussion
13 with an overview of the burden of proof generally applicable to
14 adversary proceedings brought pursuant to § 523 and § 727.

15 The bankruptcy discharge and its opportunity for a financial
16 fresh start are available only to the "honest but unfortunate
17 debtor." See Cohen v. De La Cruz, 523 U.S. 213, 217 (1998),
18 citing Grogan v. Garner, 498 U.S. 279, 286-87 (1990). Denial of
19 a debtor's discharge

20 . . . is an act of mammoth proportions, and must not be
21 taken lightly. In light of this gravity . . . Section
22 727 must be construed liberally in favor of the debtor
and against the objector.

23 In re Goldstein, 66 B.R. 909, 917 (Bankr. W.D. Pa. 1986). See
24 First Beverly Bank v. Adeeb (In re Adeeb), 787 F.2d 1339, 1342
25 (9th Cir. 1986); Devers v. Bank of Sheridan (In re Devers), 759
26 F.2d 751, 754 (9th Cir. 1985). To implement the liberal
27 construction in favor of the debtor, the burden is on the party
28 objecting to discharge to establish by a preponderance of the

1 evidence that the debtor's actions or conduct fall within one of
2 the exceptions to discharge set forth in § 523(a). Grogan v.
3 Garner, 498 U.S. at 289. The same burden of proof applies in
4 § 727 actions. Khalil, 379 B.R. at 171.

5 Although MW Bank presented evidence to establish a prima
6 facie case against Mr. Long with respect to its claim for relief
7 under § 523(a)(6), thereby creating a presumption of entitlement
8 to relief on that claim for relief, the bankruptcy court, based
9 in large part on its finding that Mr. Long's testimony was
10 credible, determined that Mr. Long's evidence was sufficient to
11 rebut the presumption, to the end that MW Bank failed to carry
12 its burden of proof when it failed, in effect, to "disprove" the
13 efforts Mr. Long made to implement a new business plan.

14 2. Credibility Determination

15 Rule 8013 provides in relevant part:

16 Findings of fact, whether based on oral or documentary
17 evidence, shall not be set aside unless clearly
18 erroneous, and due regard shall be given to the
19 opportunity of the bankruptcy court to judge the
20 credibility of the witnesses.

21 When findings are based, as in this case, on determinations
22 regarding the credibility of witnesses, we give even greater
23 deference to the bankruptcy court's findings, because the
24 bankruptcy court, as the trier of fact, had the opportunity to
25 note "variations in demeanor and tone of voice that bear so
26 heavily on the listener's understanding of and belief in what is
27 said." See Anderson v. City of Bessemer City, N.C., 470 U.S. at
28 575. Provided that a finding that a witness is credible is (1)
based on testimony which tells a coherent and facially plausible
story that is not contradicted by extrinsic evidence and (2) is

1 not internally inconsistent, that credibility finding "can
2 virtually never be clear error." Id. at 575-76.

3 B. The § 523(a)(6) Claim for Relief

4 MW Bank sought to have Mr. Long's debt to MW Bank excepted
5 from Mr. Long's general bankruptcy discharge based upon Mr.
6 Long's actions in the dissipation of the sale proceeds which
7 represented MW Bank's collateral. MW Bank relies on § 523(a)(6).
8 At the outset we note that MW Bank's customer was AboutMontana,
9 not Mr. Long. It was AboutMontana that was contractually bound
10 to pay MW Bank the proceeds of the collateral. Mr. Long
11 guaranteed the debt of AboutMontana, so he is contractually
12 liable for the debt that AboutMontana did not pay. This
13 liability is a dischargeable breach of contract, unless Mr.
14 Long's conduct was tortious and "willful and malicious" for
15 purposes of § 523(a)(6). See Lockerby v. Sierra, 535 F.3d 1038,
16 1040-43 (9th Cir. 2008).

17 Section 523(a)(6) provides in relevant part as follows:

18 (a) A discharge under section 727 . . . of this title
19 does not discharge an individual debtor from any debt-

20 (6) for willful and malicious injury by the
21 debtor to another entity or to the property
of another entity.

22 The elements of a § 523(a)(6) claim for relief are (1) willful
23 and (2) malicious (3) injury to the complaining party from the
24 acts of the debtor defendant. MW Bank asserts that Mr. Long
25 converted to his own use the sale proceeds in AboutMontana's
26 checking account, and that conversion constitutes a willful and
27 malicious tortious act sufficient to except Mr. Long's debt to MW
28

1 Bank from discharge. Willfulness and malice are separate
2 elements, each with its own standards.

3 1. Willfulness

4 In order to find that an injury was "willful," the evidence
5 must establish that Mr. Long acted with either a subjective
6 intent to harm or a subjective belief that harm was substantially
7 certain to result from his conduct. See Carillo v. Su (In re
8 Su), 290 F.3d 1140, 1144-46 (9th Cir. 2002); and Petralia v.
9 Jercich (In re Jercich), 238 F.3d 1202 (9th Cir. 2001).

10 As noted by the bankruptcy court, "[s]ubjective intent may
11 be gleaned from objective factors and circumstantial evidence
12 which tends to establish what the debtor must have actually known
13 when taking the injury-producing action." Su, 290 F.3d at 1146
14 n.6.

15 The bankruptcy court found that MW Bank established only
16 that Mr. Long intentionally breached the loan agreements.
17 Although acknowledging that Mr. Long spent sale proceeds on his
18 personal obligations, the bankruptcy court found no subjective
19 intent to harm MW Bank because he was also spending sale proceeds
20 "on business trying to develop his motorcycle travel magazine and
21 computer data base." Acknowledging that Mr. Long transferred
22 loan proceeds to himself, the bankruptcy court lauded Mr. Long
23 for not absconding with the proceeds, and found no subjective
24 intent to harm MW Bank because Mr. Long made loan payments to MW
25 Bank after the ISP asset sale. The bankruptcy court
26 characterized Mr. Long's use of MW Bank's collateral in his
27 unsuccessful business ventures as "imprudent, unrealistic and
28 perhaps reckless," but not willful.

1 In its intent findings, the bankruptcy court relied on the
2 Ninth Circuit's decision in Transamerica Comm'l Fin. Corp. v.
3 Littleton (In re Littleton), 942 F.2d 551 (9th Cir. 1991).

4 The debtors in the Littleton case were the officers,
5 directors, and shareholders of Jacob's Appliance and TV, Inc.
6 ("Jacob's"), the primary business of which was the service and
7 sale of appliances. Transamerica provided inventory financing to
8 Jacob's. The security agreement Jacob's granted to Transamerica
9 gave Transamerica a security interest in both the inventory
10 purchased by Jacob's and the proceeds from the sale of the
11 inventory. The security agreement provided that the cash
12 proceeds for each sale of inventory would be held in a segregated
13 account. Jacob's never established a segregated account, and it
14 paid Transamerica by checks drawn from its general business
15 account. Transamerica knew of this arrangement. Further,
16 although the security agreement required Jacob's to pay
17 Transamerica the cost price of the financed inventory as each
18 sale occurred, in actuality Jacob's paid Transamerica either (1)
19 with a weekly report of sales or (2) at the time of
20 Transamerica's regular monthly inspection of the inventory
21 located on Jacob's premises, if Transamerica determined at that
22 time that inventory had been sold without payment of the cost
23 price. The security agreement defined a default as, inter alia,
24 a failure to pay amounts to Transamerica as they became due.

25 When Jacob's filed for chapter 11 relief, Jacob's owed
26 Transamerica \$70,068.02 from the sale of financed inventory.
27 Although they had not guaranteed Jacob's debts to Transamerica,
28 when the corporate officers filed personal bankruptcy cases,

1 Transamerica filed adversary proceedings to hold them personally
2 responsible and to preclude discharge of those debts, either
3 because the corporate officers converted proceeds of the
4 inventory sales, or because they embezzled those proceeds.

5 As reflected in Littleton, the bankruptcy court had found
6 that "at all times the debtors acted with the intent to benefit
7 the corporation by securing financing so that the company could
8 pay all its debts . . . [Their conduct] negates any contention
9 that the debtors intended to defraud Transamerica," and the Ninth
10 Circuit held, in light of the findings that the debtors' dominant
11 motivation was to make the business survive and they applied
12 their entire efforts and resources to that end, that we did not
13 err when we affirmed the bankruptcy court's decision. Littleton,
14 942 F.2d at 556.

15 MW Bank contends that the bankruptcy court erred when it
16 applied Littleton to preclude findings of willfulness and malice
17 based upon Mr. Long's stated efforts to continue AboutMontana's
18 business. MW Bank asserts that Mr. Long's actions are more akin
19 to those of the debtors in U-Save Auto Rental of Am. v. Mickens
20 (In re Mickens), 312 B.R. 666, 680 (Bankr. N.D. Ca. 2004).

21 In Mickens, the debtor spouses each owned one-quarter of a
22 limited liability company ("Automart"), formed in March 1997, and
23 engaged in the business of selling used vehicles. About five
24 months after its formation, Automart expanded its business to
25 include a vehicle rental franchise with U-Save Auto Rental of
26 America ("U-Save"). Under the franchise agreement, Automart
27 could lease vehicles from U-Save for the limited purpose of
28 renting those vehicles to Automart customers. At the end of a

1 lease term, Automart had the option of returning the vehicle to
2 U-Save, or selling it to an Automart customer and paying U-Save
3 the "book value" of the vehicle. By March 1998, Automart was
4 delinquent in its lease payments to U-Save. In August 1998, when
5 the lease payments remained in arrears and Automart's telephone
6 was not being answered, U-Save sent a representative to visit
7 Automart's lot. The representative found neither vehicles nor
8 people at the lot. U-Save terminated the franchise agreement
9 with Automart. Thirteen of U-Save's vehicles were not accounted
10 for, although U-Save ultimately recovered all or part of three
11 vehicles' book value.

12 In July 1998, an investigator with the California DMV
13 visited Mr. Mickens at the Automart lot based on several
14 complaints the DMV had received from customers who had purchased
15 vehicles but not been provided either registration or title
16 documents. On July 6, Mr. Mickens assured the investigator that
17 he would complete the necessary vehicle transfer paperwork within
18 a reasonable time. At a further meeting on July 29, Mr. Mickens
19 told the investigator he had applied for a new DMV dealer license
20 for a Nevada corporation he had formed on June 6. At that time
21 he assured the investigator he would not be leaving California
22 and that he would process all vehicle transfers. Shortly
23 thereafter, the investigator received a letter from Mr. Mickens,
24 dated July 31, stating that Automart had ceased doing business.

25 When the Mickens filed for bankruptcy protection, U-Save
26 brought a nondischargeability adversary proceeding based upon
27 larceny. Relying on Littleton, the Mickens defended on the basis
28 that no circumstances of fraud were present since they were

1 merely trying to salvage a failing business and hoped to pay U-
2 Save in the future. The bankruptcy court disagreed, finding that
3 the Mickens knowingly transferred U-Save's vehicles to third
4 parties and received proceeds in exchange, which they knew they
5 were required to turn over and intentionally did not. Mickens,
6 312 B.R. at 681.

7 We agree with MW Bank that the facts of this case are more
8 analogous to Mickens than to Littleton with respect to the good
9 faith effort to continue in business. In Littleton, the debtors
10 cooperated with Transamerica by seeking additional financing that
11 would allow Jacob's to stay in business. Here, Mr. Long
12 concealed the asset sale from MW Bank. Far from cooperating with
13 MW Bank, when MW Bank attempted to communicate with Mr. Long
14 concerning AboutMontana's payment default and the apparent
15 depletion of collateral proceeds, Mr. Long never answered his
16 telephone. The Littleton debtors offered Transamerica a third
17 trust deed on their residence as additional security. Mr. Long
18 offered no additional security to MW Bank. Finally, in the
19 Littleton case there was no evidence either that the debtors used
20 sale proceeds for personal benefit, or that they paid any other
21 creditor other than in the ordinary course of business. Here,
22 Mr. Long not only paid in full a personal obligation to his
23 former common law wife, but he also spent a significant portion
24 of the sale proceeds for his personal benefit.

25 The bankruptcy court found credible Mr. Long's testimony
26 that he spent the sale proceeds in an attempt to continue
27 AboutMontana's business so that he ultimately could pay all of
28 AboutMontana's debts. As we noted above, when findings are based

1 on a determination regarding the credibility of witnesses, we
2 give great deference to that determination provided that it is
3 (1) based on testimony which tells a coherent and facially
4 plausible story that is not contradicted by extrinsic evidence
5 and (2) is not internally inconsistent. To be blunt, Mr. Long's
6 testimony, in light of the overall record, does not tell a
7 consistent, facially plausible story: Mr. Long testified,
8 consistent with his § 341(a) meeting testimony, that he spent the
9 ISP asset sale proceeds for purposes of maintaining
10 AboutMontana's business and applied them to pay AboutMontana's
11 debts, when he actually diverted most of the funds for his
12 personal use and personal obligations, outside the ordinary
13 course of AboutMontana's business.

14 We conclude that the bankruptcy court clearly erred in its
15 characterization of the use of the sale proceeds. First, even
16 crediting Mr. Long's testimony that he spent some of the sale
17 proceeds pursuing other business ventures, the fact is that he
18 spent far more for his own benefit. Second, each check Mr. Long
19 wrote for his personal benefit constituted a conversion of that
20 portion of the sale proceeds. It strains credulity beyond the
21 breaking point not to find that Mr. Long acted with a subjective
22 belief that harm was substantially certain to result from his
23 conduct when, for example, he transferred \$35,000 to his new
24 Wells Fargo Bank account two days before he consulted with his
25 bankruptcy attorney. The withdrawals of funds for his truck
26 driving training were not part of any good faith effort to
27 continue the business of AboutMontana for the benefit of its
28

1 creditors. They were an attempt to secure a livelihood for
2 himself.

3 Based on this record, we conclude that the bankruptcy court
4 clearly erred when it determined, in the face of the sale of the
5 ISP assets and the lack of any income to AboutMontana thereafter,
6 that Mr. Long was engaged in a course of conduct to "continue"
7 AboutMontana's business. The record establishes that Mr. Long
8 totally failed in his attempt to establish a new venture, while
9 covering for his dissipation of MW Bank's collateral.

10 2. Malice

11 A "malicious" injury is "one involving (1) a wrongful act,
12 (2) 'done intentionally, (3) which necessarily causes injury, and
13 (4) is done without just cause or excuse'." Murray v. Bammer (In
14 re Bammer), 131 F.3d 788, 791 (9th Cir. 1997) (citing Impulsora
15 Del Territorio Sur, S.A. v. Cecchini (In re Cecchini), 780 F.2d
16 1440, 1443 (9th Cir. 1986)). See Su, 290 F.3d at 1146-47. Under
17 Cecchini, malice may be inferred from the nature of the wrongful
18 act. Littleton, 942 F.2d at 554. It is not necessary to show
19 that Mr. Long intended to injure MW Bank; it is only necessary to
20 show that Mr. Long committed a wrongful act which necessarily
21 produced harm and was without just cause or excuse. Id.

22 The bankruptcy court found that MW Bank satisfied the first
23 two elements of malice by providing evidence of the numerous
24 intentional breaches by AboutMontana in default of the loan
25 agreements. These findings are not challenged on appeal. We
26 note, however, that the malice that must be demonstrated is the
27 malice of Mr. Long, not that of AboutMontana. The record
28 reflects that Mr. Long engaged in wrongful acts which were done

1 intentionally, i.e., conversion of MW Bank's sale proceeds
2 collateral for his personal use and payment of personal
3 obligations.

4 With respect to the third element, the bankruptcy court
5 found that the intentional taking of the sale proceeds would not
6 "necessarily" cause injury to MW Bank had Mr. Long succeeded in
7 his new business venture and kept making loan payments. The
8 bankruptcy court's interpretation of the term "necessarily"
9 renders this element impossible to prove under any set of facts.
10 Money might always somehow be paid; we are limited only in our
11 ability to determine how. Under the bankruptcy court's
12 construction, a plaintiff could never establish that a wrongful
13 taking of money would "necessarily" cause harm. At the time of
14 decision on a § 523(a)(6) claim for relief, the bankruptcy court
15 is bound by the facts before it. Mr. Long did not succeed in his
16 new business ventures and did not continue making loan payments.
17 Thus, the taking of the sale proceeds in fact, i.e.,
18 "necessarily," caused injury to MW Bank. Additionally, we
19 previously have stated that "the words 'necessarily produces
20 harm' . . . mean that the act must be targeted at the creditor,
21 *at least in the sense that the act is certain or almost certain*
22 *to cause financial harm."* Littleton, 942 F.2d at 555 (emphasis
23 in original), quoting In re Littleton, 106 B.R. 632, 637 (9th
24 Cir. BAP 1989). Mr. Long's actions were certain or almost
25 certain to cause MW Bank financial harm.

26 The bankruptcy court conceded that it was a "close question"
27 whether Mr. Long's attempts at new business ventures were made
28 with just cause or excuse. Faulting MW Bank for failing to offer

1 any evidence at trial disproving Mr. Long's testimony at his
2 deposition, which corroborated his trial testimony, the
3 bankruptcy court found that the failure of the business ventures
4 was beyond Mr. Long's control. This misses the point. While
5 Littleton may establish, under appropriate facts, that a good
6 faith effort to continue in business with the purpose of paying
7 the creditor constitutes "just cause or excuse" for spending an
8 inventory financier's collateral proceeds, it does not establish
9 that an effort to start a new business with the proceeds of the
10 sale of a prior business constitutes "just cause or excuse,"
11 particularly where the secured creditor has not been advised of
12 the sale of its collateral, and does not know that its proceeds
13 are being dissipated. In light of his noncompete agreement with
14 Montana Sky, Mr. Long was precluded from "continuing"
15 AboutMontana's previous business. Additionally, Mr. Long can
16 establish no "just cause or excuse" for spending the sale
17 proceeds either to pay off the Devine Agreement or for his own
18 benefit.

19 In these circumstances, we find that the bankruptcy court
20 committed clear error when it determined that the "malice"
21 element of § 523(a)(6) was not satisfied.

22 C. The § 523(a)(4) and § 727(a)(4)(A) Causes of Action: No
23 Finding of Fraudulent Intent

24 As relevant to this appeal, § 523(a)(4) provides that a
25 discharge under § 727 does not discharge an individual debtor
26 from any debt for embezzlement or larceny. Under § 523(a)(4),
27 embezzlement requires proof of three elements:

- 28 (1) property rightfully in the possession of a

1 nonowner; (2) nonowner's appropriation of the property
2 to a use other than which [it] was entrusted; and (3)
3 circumstances indicating fraud.

4 In re Littleton, 942 F.2d at 555 (internal citation omitted).

5 "The elements of a claim based on larceny differ from those of a
6 claim based on embezzlement only in that a larcenous bankruptcy
7 debtor has come into possession wrongfully." In re Mickens, 312
8 B.R. at 680.

9 The bankruptcy court found that the ISP asset sale proceeds
10 were wrongfully in the possession of Mr. Long, thus precluding an
11 embezzlement determination, and that Mr. Long appropriated at
12 least a portion the ISP asset sale proceeds to a use other than
13 that for which they were entrusted. Specifically, the bankruptcy
14 court found that Mr. Long admitted he transferred ISP asset sale
15 proceeds to his personal account and use, and that he used ISP
16 asset sale proceeds to pay personal credit card debts and other
17 personal obligations.

18 In finding in favor of Mr. Long on the larceny claim for
19 relief, the bankruptcy court ruled that MW Bank failed to satisfy
20 its burden to prove the third element, i.e., "circumstances
21 indicating fraud." The fraud element of common law larceny
22 requires a showing that property was taken wrongfully "without
23 consent . . . and with intent to permanently deprive [the
24 rightful owner] of possession." United States v. Sellers, 670
25 F.2d 853, 854 (9th Cir. 1982). In finding in favor of Mr. Long
26 on the larceny claim for relief, the bankruptcy court ruled that
27 MW Bank failed to satisfy its burden to establish fraudulent
28 intent. In support of that conclusion, the bankruptcy court
determined that Mr. Long lacked a clear understanding of what

1 constituted a business obligation and what constituted a personal
2 obligation. The bankruptcy court also relied on Mr. Long's
3 unrefuted testimony that he attempted to find new business
4 opportunities for AboutMontana for the purpose of generating
5 funds to pay AboutMontana's bills. The findings which support
6 the bankruptcy court's determination that Mr. Long did not act
7 with fraudulent intent are adequately supported in the record
8 before us.

9 To prevail on a § 727(a)(4)(A) claim based on a false oath,
10 the plaintiff must show: "(1) the debtor made a false oath in
11 connection with the case; (2) the oath related to a material
12 fact; (3) the oath was made knowingly; and (4) the oath was made
13 fraudulently." Roberts v. Erhard (In re Roberts), 331 B.R. 876,
14 882 (9th Cir. BAP 2005), aff'd, 241 Fed. Appx. 420 (9th Cir.
15 2007); see also Fogal Legware of Switz., Inc. v. Wills (In re
16 Wills), 243 B.R. 58, 62 (9th Cir. BAP 1999).

17 The bankruptcy court determined that Mr. Long made a false
18 oath or statement at his § 341(a) Meeting of Creditors when he
19 answered "Yes" to the trustee's question whether all of the sale
20 proceeds were used to satisfy AboutMontana debt. The bankruptcy
21 court also found that the false statement was material because it
22 bore a relationship to Mr. Long's business transactions or to the
23 existence and disposition of Mr. Long's property. Neither
24 finding is challenged on appeal.

25 MW Bank does appeal the bankruptcy court's finding that MW
26 Bank failed to carry its burden to show that Mr. Long made the
27 false oath knowingly and fraudulently.

1 A debtor acts knowingly for purposes of § 727(a)(4)(A) if he
2 or she acts "deliberately and consciously." Roberts, 331 B.R. at
3 883. Further, although "[a] false oath is complete when
4 made . . . [t]he fact of prompt correction of an inaccuracy or
5 omission may be evidence probative of lack of fraudulent intent."
6 In re Searles, 317 B.R. at 377 (citations omitted).

7 The bankruptcy court determined that the one word answer
8 Mr. Long gave at his § 341(a) Meeting of Creditors when asked
9 whether all of the sale proceeds were used to satisfy company
10 debt reflected Mr. Long's nervousness, confusion, and perhaps a
11 careless and reckless approach to the Trustee's question, but
12 that it did not support a finding that Mr. Long "deliberately and
13 consciously" testified falsely with actual fraudulent intent.
14 This determination is adequately supported by the record before
15 us.

16 17 **VI. CONCLUSION**

18 The bankruptcy court did not err when it determined that MW
19 Bank failed to meet its burden of proof that Mr. Long acted
20 fraudulently or with fraudulent intent for purposes of the causes
21 of action asserted pursuant to § 523(a)(4) and § 727(a)(4)(A).

22 However, with respect to the § 523(a)(6) claim for relief,
23 the bankruptcy court did err as a matter of law when it
24 concluded, in light of the sale of the ISP assets, and the lack
25 of any income to AboutMontana thereafter, that Mr. Long was
26 engaged in a good faith effort to "continue" AboutMontana's
27 business, and that such effort constituted "just cause and
28 excuse" for Mr. Long's use of the sale proceeds. In addition,

1 the bankruptcy court erred when it concluded that MW Bank did not
2 satisfy its burden of proof that Mr. Long's acts in converting
3 the sale proceeds to his own use did not "necessarily" cause MW
4 Bank harm. Finally, the bankruptcy court erred when it concluded
5 that MW Bank did not satisfy its burden of proof as to the
6 "willful" and "malice" elements of § 523(a)(6). Accordingly, we
7 REVERSE the bankruptcy court's judgment in favor of Mr. Long on
8 MW Bank's claim for relief under § 523(a)(6). Since the
9 bankruptcy court did not make any findings as to the extent of MW
10 Bank's damages resulting from Mr. Long's conversions of the ISP
11 asset sale proceeds, we REMAND for a determination of the amount
12 of MW Bank's claim to be excepted from Mr. Long's discharge.

13
14
15
16
17
18
19
20
21
22
23
24
25
26
27
28