IN THE UNITED STATES DISTRICT COURT

FOR THE WESTERN DISTRICT OF WISCONSIN

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IN RE
JOHN J. AND MARGARET DeROUIN,

Debtors.

OPINION AND ORDER

00-C-566-C

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JEFF AND JUDY MILLIKIN
AND INNOVATIVE BUILDING CONCEPTS INC.,

Creditors-appellants,

v.

JOHN J. AND MARGARET DeROUIN,

Debtors-appellees.

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This is an appeal brought pursuant to 28 U.S.C. § 158(a). Creditors Jeff and Judy Millikin contend that the United States Bankruptcy Court for the Western District of Wisconsin erred when it dismissed their claim and discharged the debt at issue, after determining that debtors John J. and Margaret DeRouin had not made false representations under 11 U.S.C. § 523(a)(2)(A). Creditors assert also that the bankruptcy judge erred when he did not grant relief under 11 U.S.C. § 523(a)(6), which provides that debts are not dischargeable when they result from malicious injury by the debtor to property of another. I conclude that the bankruptcy judge's finding that debtors had no intent to deceive was not clearly erroneous. Further, I conclude that the bankruptcy judge did not err by not addressing creditors' § 523(a)(6) claim on his own motion because he had no affirmative duty to raise and decide the claim. The decision of the bankruptcy court dismissing the complaint of creditors will be affirmed.

From the briefs submitted by the parties and the record on appeal, I find the following facts solely for the purpose of ruling on creditors' appeal.

FACTS

In early 1998, creditors and debtors founded Innovative Building Concepts Inc., a building contracting company specializing in installing roofing materials. Creditors provided the capital and debtors contributed the tools, the technical knowledge and the bookkeeping skills.

During the start-up phase, creditors made personal loans to debtors totaling over $11,000. Although many of the loans were general in nature, two loans were made for specific purposes: a truck and a medical procedure. Creditors lent debtors $2,000 to purchase a truck on the condition that the vehicle be titled in all of their names. Debtors purchased a truck that cost only $800. When debtors discovered that the truck needed significant repairs, they returned the truck for the sale price but kept the full amount of the loan. Similarly, debtors borrowed $1,200 for a medical procedure and kept the balance when the procedure turned out to cost less than $500.

Meanwhile, Innovative Building Concepts Inc. was struggling to get off the ground. On June 14, 1999, debtors filed a Chapter 7 bankruptcy petition. On August 16, 1999, creditors filed an adversary complaint, charging that debtors had fraudulently induced them to make the truck and medical loans. During the course of the final hearing on March 28, 2000, debtors admitted that they had possessed a corporate tool (a screw gun) and had destroyed it intentionally. Debtors had never admitted this fact prior to the hearing. Creditors had never pleaded a claim for destruction of property in their adversary complaint or included such a claim in the parties' joint pretrial statement. Moreover, they never suggested to the judge that it could be a basis for nondischargeability, even after hearing debtors' admission at the hearing.

At the close of the hearing, the bankruptcy judge determined that debtors had not intended to mislead creditors by their representations and that creditors did not rely upon those representations justifiably. Therefore, he concluded, § 523(a)(2)(A) did not apply and debtors were entitled to a discharge of the debts at issue. On May 3, 2000, the bankruptcy court entered a written order reflecting the decision announced at the March 28, 2000 hearing, dismissing the case and discharging the debt.

OPINION

A. Standard of Review

Rule 8013 of the Federal Rules of Bankruptcy Procedure states: "On an appeal, the district court . . . may affirm, modify, or reverse a bankruptcy judge's judgment, order, or decree or remand with instructions for further proceedings." A bankruptcy court's factual findings are reviewed for clear error; its conclusions of law are reviewed de novo. See In re Thirtyacre, 36 F.3d 697, 700 (7th Cir. 1994).

B. Order Dismissing Debtors' Claim for Fraudulent Inducement

"Although Chapter 7 affords a fresh start to individual debtors after bankruptcy, some debts can survive whole despite a general discharge." In re Meyer, 120 F.3d 66, 68 (7th Cir. 1997). Section 523(a) of Chapter 11 specifies certain kinds of debts that are exceptions to a general discharge for an individual debtor. "Among them are those that a debtor incurred with the aid of fraud and deceit." Meyer, 120 F.3d at 68; see 11 U.S.C. §§ 523(a)(2)(A)-(B), (a)(4) and (a)(6). However, even these debts are discharged "unless, on request of the creditor to whom such debt is owed, and after notice and hearing, the court determines such debt to be excepted from discharge." 11 U.S.C. § 523(c)(1).

On appeal, creditors dispute the dischargeability of two loans on the ground that they were fraudulently induced. Under 11 U.S.C. § 523(a)(2)(A), debts are not dischargeable when obtained by "false pretenses, a false representation, or actual fraud . . .". § 523(a)(2)(A). This cause of action requires proof of three elements. The creditor must establish that (1) the debtor obtained the money through representations that the debtor either knew to be false or made "with such reckless disregard for the truth as to constitute willful representation"; (2) the debtor possessed actual intent to defraud; and (3) the creditor relied on the false representation and that reliance was justified under the circumstances. In re Maurice, 21 F.3d 767, 774 (7th Cir. 1994). If the creditor fails to establish any one of the elements, the debt remains dischargeable. When determining the debtor's intent, the standard is subjective. The debtor must have been aware that the statement was false. It is irrelevant whether a person of ordinary care would have recognized the statement to be false. See In re Briese, 196 B.R. 440, 451 (Bankr. W.D. Wis. 1996). Similarly, the analysis of the creditor's reliance is subjective; it does not depend upon a community standard of conduct. See Field v. Mans, 516 U.S. 59, 70-71 (1995).

The bankruptcy court found that debtors did not intend to deceive creditors and that creditors did not justifiably rely upon those representations. These are findings of fact to be evaluated on appeal under the clearly erroneous standard. See Fed. R. Bankr. P. 8013. Under this standard, when two permissible views of the evidence exist, the factfinder's choice between them cannot be clearly erroneous. See Anderson v. City of Bessemer City, N.C., 470 U.S. 564, 574 (1985). Although the facts could be viewed in a different light, the findings are clearly erroneous only when the appellate court is left with the firm conviction that a mistake has been made. See United States v. Gypsum Co., 333 U.S. 364, 395 (1948).

1. Intent to deceive

The bankruptcy court found that creditors failed to establish the second element of § 523(a)(2)(A): intent to deceive. This was a permissible finding in light of the lack of evidence indicating that debtors' intent when they borrowed the money was not just what they said it was. That it turned out later that they did not use the money for the purpose for which they borrowed it does not mean that they had the necessary intent at the time they asked for the loans. Although it is true that debtors borrowed $1200 for a medical procedure that cost less than $500 in the end, the bankruptcy court found that when debtors sought the loan, they knew only that their daughter was in pain and needed money in order to receive care. In short, the bankruptcy court found that the truck loan was used to purchase a truck and the medical loan was used to obtain medical care.

Given these findings of fact, I cannot say that the bankruptcy court was clearly erroneous when it found that debtors lacked the intent to deceive. The record supports the bankruptcy judge's view of the facts. He did not commit clear error when it determined that debtors borrowed the money without any intention of committing fraud.

2. Justifiable reliance

In addition to finding that creditors failed to meet the second element of § 523(a)(2)(A), the bankruptcy court determined that they had failed to establish the third element, that they were justified in relying on debtor's representations. Under § 523(a)(2)(A), the creditor must establish all three elements in order to revoke the discharge of debt. Because I am affirming the bankruptcy court's determination that creditors failed to establish the second element, they cannot succeed on their claim under § 523(a)(2)(A). Therefore, I need not address the final element of reasonable reliance.

C. Debtors' New Claim under § 523(a)(6)

Creditors' second claim is unusual. They acknowledge that they never asked the bankruptcy court to find the debts for the screw gun and the truck non-dischargeable under § 523(a)(6), but they contend it was error for the court not to act on its own.

Under 11 U.S.C. § 523(a)(6), debts are not dischargeable when they arise from "willful and malicious injury by the debtor to another entity or to the property of another entity." Creditors contend that § 523(a)(6) is broad enough to include the intentional destruction of property (the smashing of the corporate screw gun), as well as willful and malicious conversion (the misuse of the truck loan) and therefore that the corresponding debts should not be dischargeable.

Creditors' contention that the bankruptcy court erred in this instance is misguided. Federal courts have an affirmative duty to raise issues of justiciability sua sponte. See FW/PBS, Inc. v. City of Dallas, 493 U.S. 215, 231 (1990). In general, however, courts have no affirmative duty to identify issues for the parties. The role of advocacy is reserved to the parties. Regardless what the evidence at the adversary proceeding revealed, the bankruptcy court did not err when it did not raise and decide creditors' § 523(a)(6) claim on its own.

Creditors suggest that this court should remand the matter to the bankruptcy court where creditors can amend their pleadings to include this claim and the bankruptcy judge can engage in fact-finding. That is not the way litigation works. Parties have just one chance to raise every issue relevant to their case. Only in the unusual case, such as Cates v. Morgan Portable Bldg. Corp., 780 F.2d 683 (7th Cir. 1984), in which the lower court was reversed and the case was remanded, do they have the opportunity to raise a new issue.

ORDER

IT IS ORDERED that the decision of the United States Bankruptcy Court for the Western District of Wisconsin dismissing the complaint of creditors Jeff and Judy Millikin is AFFIRMED.

Entered this 4th day of December, 2000.

BY THE COURT:

BARBARA B. CRABB
District Judge