IN THE UNITED STATES BANKRUPTCY COURT
FOR THE SOUTHERN DISTRICT OF MISSISSIPPI
JACKSON DIVISION

IN RE: JAMES CHRISTOPHER SPARKMAN — CASE NO. 93-01929JC

TRUSTMARK NATIONAL BANK — PLAINTIFF

VS. — ADVERSARY NO. 930146JC

JAMES CHRISTOPHER SPARKMAN — DEFENDANT

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Edward Ellington, Bankruptcy Judge

MEMORANDUM OPINION

This adversary proceeding is before the Court for consideration on the Complaint filed by Trustmark National Bank against the Debtor, James Christopher Sparkman. In its complaint, Trustmark seeks an order denying the discharge of the Debtor pursuant to § 727(a)(2) of the Bankruptcy Code[1] or, in the alternative, an order of nondischargeability as to Trustmark's

[1] Hereinafter, all code sections refer to the United States Bankruptcy Code found at Title 11 of the United States Code unless specifically noted otherwise.

claim against the Debtor based on § 523(a)(2)(A), § 523(a)(4) and § 523(a)(6). The parties have requested for the Court to decide the case based on a stipulation of facts and memorandum briefs submitted to the Court.

After considering the pleadings, the evidence presented by stipulation and the arguments of counsel, the Court finds that Trustmark has failed to prove the elements necessary to support a general denial of the Debtor's discharge pursuant to § 727(a)(2) of the Bankruptcy Code, and the relief requested in that portion of Trustmark's complaint should be denied. The Court also finds that Trustmark has not proved its claims of nondischargeability based on § 523(a)(2)(A), § 523(a)(4) or § 523(a)(6). Therefore, Trustmark's request for a judgment of nondischargeability should also be denied. In so holding, the Court makes the following findings of fact and conclusions of law.

FINDINGS OF FACT

As previously stated, the Court's findings of fact are based on the pleadings filed in this case and a stipulation of facts submitted to the Court by agreement of the parties. The stipulation provides essentially as follows.

In May of 1991, the Debtor, James Christopher Sparkman, executed a promissory note in favor of Trustmark National Bank in the amount of $23,000. The amount payable under the note became due in 90 days. As security for the loan, the Debtor's mother and the Debtor's brother pledged to Trustmark 2909 shares of Pilgrim

Prime Rate Trust Common Stock, which they owned as joint tenants with right of survivorship. The stock certificates were delivered to Trustmark. In connection with the pledge of stock, the Debtor's mother and brother jointly executed a document entitled "Borrowed Collateral Certificate." Additionally, both executed separate documents entitled "Irrevocable Stock/Bond Transfer."

In August of 1991, the Debtor executed a renewal note for $25,000 which became due in September, 1992. In connection with and to secure the renewal note, The Debtor's mother and brother delivered an additional 1088 shares of Pilgrim Prime Rate Trust Common Stock to Trustmark. From the documents presented to the Court, it does not appear that a borrowed collateral certificate was executed by the Debtor's mother and brother, the owners of the additional stock. However, the parties stipulate that the Debtor's mother and brother pledged the additional stock as collateral and delivered it to Trustmark to hold as additional collateral securing the Debtor's indebtedness to Trustmark.

In September of 1992 a renewal note again was executed by the Debtor, listing as collateral the entire 3997 shares of stock. In.February of 1993, the Debtor executed the last renewal note for $ 29,773.73. At the time of the February 1993 renewal, the Debtor also executed an assignment of his rights in the stock and also executed an irrevocable stock/bond power.

On March 8, 1993, Trustmark inadvertently returned the stock certificates to the Debtor. Trustmark called the Debtor three times requesting the return of the stock certificates. The

Debtor did not return the stock certificates to Trustmark, but instead gave them to his mother who sold them on May 6, 1993 for approximately $35,000 - $ 36,000. Although the Debtor did not return the stock certificates to Trustmark, he continued to make monthly payments on the indebtedness until April 30, 1993.

On June 14, 1993, James Christopher Sparkman filed a petition for relief under Chapter 7 of the Bankruptcy Code. On September 14, 1993, Trustmark commenced the present adversary proceeding.

CONCLUSIONS OF LAW

Burden of Proof

Trustmark carries the burden of proving its claims under both § 727 and § 523 by a preponderance of the evidence. Grogan v. Garner, 498 U.S. 279, 111 S.Ct. 654, 112 L.Ed.2d 755 (1991). Additionally, the issue of whether a particular debt is nondischargeable under the Bankruptcy Code is a matter of federal law. Id.; Allison v. Roberts (Matter of Allison), 960 F.2d 481, 483 (5th Cir. 1992).

Denial of Discharge under § 727(a)(2)

Section 727 of the Bankruptcy Code sets forth certain circumstances under which a chapter 7 debtor may be denied a discharge from indebtedness. Trustmark asserts that the Debtor's actions fall within § 727(a)(2) and, therefore, the Debtor should be denied a discharge. Section 727(a)(2) provides as follows:

11 USC § 727
§ 727. Discharge.

(a) The court shall grant the debtor a discharge, unless-

. . .

(2) the debtor, with intent to hinder, delay, or defraud a creditor or an officer of the estate charged with custody of property under this title, has transferred, removed, destroyed, mutilated, or concealed, or has permitted to be transferred, removed, destroyed, mutilated, or concealed -

(A) property of the debtor, within one year before the date of the filing of the petition; or

(B) property of the estate, after the date of the filing of the petition;

Subsection (A) of § 727(a)(2) pertains to *property of the debtor* prior to the filing of a bankruptcy petition. Subsection (B) pertains to *property of the estate* after filing. The parties have stipulated that the stock certificates in question were property of the Debtor's mother and his brother. Therefore, the Debtor's return of the stock certificates to his mother did not amount to a transfer of the Debtor's property under § 727(a)(2)(A). Likewise, if the stock certificates were not property of the Debtor, then they could not have become property of the Debtor's estate, to which § 727(a)(2)(B)[2] applies.

Trustmark has failed to prove its claim for relief under § 727(a)(2). Accordingly, Trustmark's request for relief under § 727 of the Bankruptcy Code will be denied.

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[2] Additionally, § 727(a)(2)(B) would not apply to the present case even if the stock certificates were property of the Debtor since the transfer in question took place prior to the Debtor's filing of his petition for relief.

Nondischargeability under § 523(a)(2)(A)

Trustmark alternatively seeks a judgment of nondischargeability as to its claim against the Debtor, claiming that the Debtor committed fraud within the meaning of § 523(a)(2)(A), which provides in relevant part as follows:

> **11 USC § 523**
> **§ 523. Exceptions to discharge.**
> (a) A discharge under section 727, ... of this title does not discharge an individual debtor from any debt -
>
> ...
>
> (2) for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by -
> (A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition;

Trustmark alleges that the Debtor committed fraud by giving the stock certificates to his mother rather than returning them to the bank. In order for the bank to prevail on its § 523(a)(2)(A) claim, Trustmark must show that the Debtor obtained money, property, services or an extension, renewal, or refinancing of credit through use of misrepresentations that were: "1) knowing and fraudulent falsehoods, 2) describing past or current facts, 3) that were relied upon by the other party." Allison v. Roberts (Matter of Allison), 960 F.2d 481, 483 (5th Cir. 1992); Recoveredge L.P. vs. Pentecost, 44 F.3d 1284, 1293 (5th Cir. 1995). Trustmark could also prevail by showing actual fraud, which is more difficult to prove. *See* Recoveredge L.P. vs. Pentecost, 44 F.3d at 1293.

However, Trustmark has offered no evidence showing that the Debtor obtained the loans in question by use of a misrepresentation or other fraud. Trustmark has offered only evidence showing that the Debtor did not return the stock certificates to the bank after being asked to do so. Section 523(a)(2) deals with fraud committed in order to obtain money or credit. It does not pertain to actions committed by the Debtor after the borrowing transaction is completed.

Trustmark has failed to meet its burden of proof under § 523(a)(2)(A). Therefore, Trustmark's claim for relief under § 523(a)(2)(A) should be denied.

Nondischargeability under § 523(a)(4)

Trustmark also asserts that its claim against the Debtor falls within § 523(a)(4), which excepts from discharge any debt "for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny."

In order for a debt to be nondischargeable based on the "fraud or defalcation while acting in a fiduciary capacity" exception there must be a fiduciary relationship arising out of an express trust. An implied trust is insufficient to render a debt nondischargeable under § 523(a)(4). Furthermore, the trust must have been in existence prior to the act of wrongdoing. Boyle v. Abilene Lumber, Inc.(Matter of Boyle), 819 F.2d 583, 588 (5th Cir. 1987); Murphy & Robinson Investment Co. v. Cross (Matter of Cross), 666 F.2d 873, 881 (5th Cir. 1982); Carey Lumber Co. v. Bell, 615

F.2d 370, 374 (5th Cir. 1980); Angelle v. Reed (Matter of Angelle), 610 F.2d 1335, 1341 (5th Cir. 1980).

No evidence is before the Court regarding the existence of an express consensual fiduciary relationship between the Debtor and Trustmark. Certainly the promissory notes executed by the Debtor contained no provisions whereby the Debtor agreed to act in a fiduciary manner with regard to Trustmark.

Likewise, Trustmark has not offered any evidence that the Debtor committed embezzlement or larceny. "Under federal law, embezzlement has often been defined as `the fraudulent appropriation of property by a person to whom such property has been entrusted or into whose hands its has lawfully come.'" Transamerica Commercial Finance Corp. v. Littleton (In re Littleton, 942 F.2d 551, 555(9th Cir. 1991). "Larceny is proven, for § 523(a)(4) purposes if debtor has willfully and with fraudulent intent taken property from its owner." Matter of Rose, 934 F.2d 901, 903 (7th Cir. 1991)(citations omitted). The Court finds that Trustmark has not offered any evidence that the Debtor either embezzled or stole the stock certificates from the bank.

Since Trustmark has failed to meet its burden under § 523(a)(4) by showing either the existence of an express fiduciary relationship between the Debtor and Trustmark, or that the Debtor committed embezzlement or larceny, its claim for relief under § 523(a)(4) should be denied.

Nondischargeability under § 523(a)(6)

Finally, Trustmark claims that the Debtor's actions in giving the stock certificates to his mother rather than returning them to the bank are sufficient to render Trustmark's claim nondischargeable under § 523(a)(6), which provides in pertinent part as follows:

> **11 USC § 523**
>
> **§ 523. Exceptions to discharge.**
> (a) A discharge under section 727 ... of this title does not discharge an individual debtor from any debt-
>
> ...
>
> (6) for willful and malicious injury by the debtor to another entity or to the property of another entity;
>
> ....

"Section 523(a)(6) is based on tort principles rather than contract. It is designed to compensate the injured party for the injury suffered while not allowing the debtor to escape liability for a 'willfull [sic] and malicious' injury by resort to the bankruptcy laws." Friendly Finance Service v. Modicue (In re Modicue), 926 F.2d 452 (5th Cir. 1991)(citations omitted). Thus § 523(a)(6) does not except from discharge damages arising out of a breach of contract, but instead excepts from discharge only those damages caused by willful and malicious conduct. Id. at 453. Section 523(a)(6) "encompasses the wrongful sale or conversion or encumbered property of the debtor." Id. Therefore, the issue is whether the Debtor's actions in giving the stock certificates to

his mother rather than returning them to Trustmark amounted to a conversion of the bank's collateral or was otherwise wrongful so that his actions constituted willful and malicious conduct.

The controlling standard for determining whether the Debtor's conduct was "willful and malicious" within the meaning of § 523(a)(6) is the interpretation of the term contained in Collier on Bankruptcy which has been adopted by the United States Fifth Circuit Court of Appeals:

> In order to fall within the exception of section 523(a)(6), the injury to an entity or property must have been willful and malicious. An injury of an entity or property may be a malicious injury within this provision if it was wrongful and without just cause or excessive [sic], even in the absence of personal hatred, spite or ill-will. The word `willful' means `deliberate or intentional,' a deliberate and intentional act which necessarily leads to injury. **Therefore, a wrongful act done intentionally, which necessarily produces harm and is without just cause or excuse, may constitute a willful and malicious injury.**

Kelt v. Quezada (Matter of Quezada), 718 F.2d 121, 123 (5th Cir. 1983) cert. denied, 467 U.S. 1217 (1984)(citing 3 Collier on Bankruptcy, 523.16 at 523-128 (15th ed. 1983)(emphasis added). See also Garner v. Lehrer (Matter of Garner), 56 F.3d 677, 681 (5th Cir. 1995); Seven Elves, Inc. v. Eskenazi, 704 F.2d 241, 245 (5th Cir. 1983); Petty v. Dardar (Matter of Dardar), 620 F.2d 39, 40 (5th Cir. 1980); Vickers v. Home Indemnity Co., 546 F.2d 1149, 1150 (5th Cir. 1977); Federal Deposit Insurance Corp. v. Lefeve (In re Lefeve), 131 B.R. 588, 602 (Bankr. S.D. Miss. 1991); Guaranty Corp. v. Fondren (In re Fondren), 119 B.R. 101, 105 (Bankr. S.D. Miss.

1990); Meridian Production Ass'n. v. Hendry (In re Hendry), 77 B.R. 85 (Bankr. S.D. Miss. 1987); Berry v. McLemore (In re McLemore), 94 B.R. 903, 906 (Bankr. N.D. Miss. 1988).

Since there is no dispute that the Debtor's return of the stock to his mother was a deliberate action on his part, the "willful" element of § 523(a)(6) is easily met. The harder question is whether the Debtor's actions amounted to a wrongful act done "without just cause or excuse."

In order to answer whether the Debtor's return of the stock to his mother was a wrongful act, "without just cause or excuse," the Court must look at each party's interest in the stock certificates. If the Debtor converted the bank's interest in the stock, then the damage suffered by the bank in losing its collateral would be nondischargeable. If, however, the bank no longer had any legal right to the stock certificates, then the Debtor's return of the stock certificates to his mother could not have been "without just cause or excuse."

Pursuant to the stipulation filed with the Court, there is no dispute that the Debtor's mother and his brother were the owners of the stock certificates in question. The Debtor was not the owner of the stock certificates. The parties have also stipulated that the Debtor's mother and brother granted Trustmark a security interest in the stock certificates in order to secure the Debtor's obligation to the bank.

The attachment, enforceability and termination of a security interest in an investment security is governed by Article

8 of the Uniform Commercial Code found at Miss. Code Ann. §75-8-101 through 408 (1972 & Supp. 1995). The attachment and enforceability of a security interest in most other types of collateral is governed by Article 9 of the Uniform Commercial Code found at Miss. Code Ann. § 75-9-101 through 507 (1972 & Supp. 1995)[3].

Miss. Code Ann. § 75-8-321 (Supp. 1995), which is applicable to the present case, provides in pertinent part as follows:

> **§ 75-8-321. Enforcement of security interest in a security; termination of security interest; effective date.**
>
> (1) A security interest in a security is enforceable and can attach only if it is transferred to the secured party or a person designated by him pursuant to a provision of Section 75-8-313(1).
>
> (2) a secured interest so transferred pursuant to agreement by a transferror who has rights in the security to a transferee who has given value is a perfected secured interest, ...

Since § 75-8-321 provides that a security interest in stock certificates attaches only if the interest is transferred to a secured party pursuant to a provision of § 75-8-313(1), reference to the relevant portions of Miss. Code Ann. § 75-8-313(1) is necessary.

> **§ 75-8-313. When transfer of security or limited interest occurs.**
>
> (1) Transfer of a security or a limited interest (including a security interest) therein to a purchaser occurs only:
>
> (a) at the time he or a person designated by him acquires possession of a certificated security;
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> ....

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[3] *See* Miss. Code Ann. § 75-9-203 (Supp. 1995).

Pursuant to the above code sections, Trustmark's security interest in the stock certificates arose and became perfected upon delivery of the stock certificates to the bank. Having determined that Trustmark did possess a perfected security interest in the stock certificates in question, the Court must next determine what effect Trustmark's return of the stock certificates to the Debtor had on the bank's perfected security interest.

Miss. Code Ann. § 75-8-321(4)(Supp. 1995) governs the termination of a security interest in stock certificates, providing as follows:

> **§ 75-8-321. Enforcement of security interest in a security; termination of security interest; effective date.**
>
> ....
>
> (4) Unless otherwise agreed, a secured interest in a security is terminated by transfer to the debtor or a person designated by him pursuant to a provision of Section 75-8-313(1). If a security is thus transferred, the security interest, if not terminated, becomes unperfected unless the security is certificated and is delivered to the debtor for the purpose of ultimate sale of exchange or presentation, collection, renewal, or registration of transfer. In that case, the security interest becomes unperfected after twenty-one (21) says unless, within that time, the security (or securities for which it has been exchanged) is transferred to the secured party or a person designated by him pursuant to a provision of Section 75-8-313(1).

Trustmark contends that § 75-8-321 has no application to the present situation because the transfer of the stock certificates to the Debtor was through inadvertence and mistake and, therefore, did not amount to a transfer within the meaning of § 75-8-321. In support of its position, Trustmark offers language

from Raiton v. G & R Properties (In re Raiton), 139 B.R. 931 (9th Cir. B.A.P. 1992), wherein the court stated, "[t]o hold that simple loss of possession by the secured party per se invalidates the security interest would invite uncertainty if not injustice: a secured creditor would automatically lose its security interest which is dependent on possession whenever collateral is misplaced, converted, or wrongfully surrendered ..." Id. at 937.

While the above language, standing alone, may appear to support Trustmark's position, it is necessary to read the court's entire ruling to understand the context of the language that Trustmark offers:

> We conclude that once a debtor has parted with possession of the collateral and the secured party, personally or through an agent, obtains possession, perfection continues until the debtor exerts or regains control over the collateral. Here, there is no evidence the Debtor gained such control. To hold that simple loss of possession by the secured party per se invalidates the security interest would invite uncertainty if not injustice: a secured creditor would automatically lose its security interest which is dependent on possession whenever collateral is misplaced, converted, or wrongfully surrendered by the bailee to whom the collateral is entrusted.

In re Raiton, 139 B.R. at 937. Additionally, Raiton was decided on California's enactment of the Uniform Commercial Code, which differs from Mississippi's version.

Raiton involved stock certificates which, pursuant to a dissolution of marriage agreement, were being held in escrow for the benefit of an ex-wife/secured party. Without permission from the ex-wife/secured party, the stock certificates were delivered to

the IRS pursuant to a levy on the ex-husband/stock owner's property. The ex-husband/stock owner filed a chapter 11 petition for relief and then sought to avoid the ex-wife's security interest in the stock, arguing that under California law, delivery of the stock certificates to the IRS destroyed perfection of the ex-wife's security interest. The bankruptcy court granted the Debtor's motion for summary judgment avoiding the ex-wife's security interest. On appeal, the Bankruptcy Appellate Panel reversed the bankruptcy court's grant of summary judgment, holding that issues of fact existed regarding whether the debtor/stock owner regained control over the stock by virtue of its transfer to the IRS.

Raiton differs from the present case in several ways. The court's decision in Raiton was based on California law, which differs from Mississippi law. In Raiton a court order created the security interest. In the present case, Trustmark's security interest was created by transfer of the stock certificates to the bank. Under California law, the issue was whether transfer to the IRS destroyed perfection. In the present case, the issue is whether loss of possession destroyed the entire security interest under Mississippi law. Raiton involved a bailee of the stock certificates who transferred the stock without permission of the secured party. In the present case, Trustmark, the secured party, transferred the stock certificates to the Debtor. In Raiton the transfer of stock was to the IRS, an unrelated third party. In the present case, the stock certificates were transferred back to the Debtor.

In United States of America v. BCCI Holdings (Luxembourg), S.A., 822 F. Supp. 1 (D. D.C. 1993), a trustee, appointed by the court to dispose of shares of stock, sought an order compelling a bailee of a party with a security interest in the shares to turn over the stock certificates to the trustee for disposal. In denying the trustee's motion, the court held that under both the Virginia and New York enactment of the Uniform Commercial Code delivery of the stock certificates to the trustee would be tantamount to delivery of the stock certificates to the debtor, and would thereby destroy the perfected security interest in the shares.

Various treatises on the Uniform Commercial Code also support the proposition that Trustmark's security interest in the stock certificates was terminated upon return of the stock to the Debtor.

"Unless otherwise agreed, a security interest in a security is terminated if the creditor transfers the security back to the debtor or to a person designated by the debtor pursuant to UCC § 8-313(1)." 8 Ronald A. Anderson, Anderson on the Uniform Commercial Code § 8-321:9 (3rd ed. 1985).

"With the exception of situations in which the collateral is returned for a special purpose, such as presentation, collection, renewal, registration, and so forth, the security interest is terminated by returning the pledge to the pledgor." William D. Hawkland et. al., Hawkland, Alderman & Schneider U.C.C. Series § 8-321:01(1986).

"[J]ust as a security interest is created (8-321(1)) and perfected (8-321(2)) by the transfer of possession of a certificated security (8-313(1)(a)) to the secured party, for example, so too a delivery back to the debtor terminates the security interest (8-321(4), 8-313(1)(a)). Thomas M. Quinn, Quinn's Uniform Commercial Code Commentary and Law Digest ¶ 8-321[A][4] (2nd ed. 1991).

In light of the foregoing authority, the Court holds that the bank's security interest in the stock certificates terminated pursuant to Miss. Code Ann. § 75-8-321(4) upon return of the stock to the Debtor. Since Trustmark's security interest was terminated upon return of the stock to the Debtor, the Debtor could not have committed a conversion of a security interest that no longer existed by subsequently giving the stock certificates to his mother. Trustmark, through inadvertence, destroyed its security interest, and thereby caused damage to itself. While the outcome to Trustmark may seem onerous, a security interest in stock certificates is unique from a security interest in other types of collateral governed by Miss. Code Ann. § 75-9-203 where a security agreement is executed and the existence of the security interest is not contingent upon possession of the collateral by the secured party.

The Court holds the Debtor's actions in returning the stock certificates to his mother do not meet the second element of § 523(a)(6), "without just cause of excuse." Therefore, Trustmark

has failed to meet its burden of proof under § 523(a)(6), and this final portion of the complaint should also be denied.

A separate judgment consistent with this opinion will be entered in accordance with Rules 7054 and 9021 of the Federal Rules of Bankruptcy Procedure.

This the 3rd day of Nov., 1995.

Edward Leighton
UNITED STATES BANKRUPTCY JUDGE

IN THE UNITED STATES BANKRUPTCY COURT
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FINAL JUDGMENT

Consistent with the Court's opinion dated contemporaneously herewith, it is hereby ordered and adjudged that Trustmark has failed to meet its burden of proof under § 727(a)(2) and § 523(a)(2)(a), § 523(a)(4) and § 523(a)(6) of the Bankruptcy Code and, therefore, its complaint should be, and hereby is, dismissed with prejudice.

This is a final judgment for the purposes of Rules 7054 and 9021 of the Federal Rules of Bankruptcy Procedure.

SO ORDERED this the 3rd day of Nov., 1995.

UNITED STATES BANKRUPTCY JUDGE