UNITED STATES BANKRUPTCY COURT
CENTRAL DISTRICT OF ILLINOIS

IN RE: **GARY A. KLIMESH,** **Debtor.**	)	**No. 98-82355**
DENNIS W. PECINOVSKY, FRANCIS A. PECINOVSKY, DONALD B. LENSING and NORMA LENSING, **Plaintiffs,**	)	
vs.	)	**Adv. No. 99-8041**
GARY A. KLIMESH, **Defendant.**	)	

O P I N I O N

In 1987, the Debtor, GARY A. KLIMESH (DEBTOR), purchased a 120-acre tract of real estate, giving a note and mortgage to the Federal Land Bank (BANK). In October, 1990, the DEBTOR sold a portion of this real estate consisting of eighty acres to DONALD B. LENSING and NORMA LENSING (LENSINGS). Under the terms of the real estate contract, the LENSINGS made a down payment of $8,000 and were to make annual payments of principal until March 1, 1996, with payments of accrued interest being made twice each year. The following month, the DEBTOR entered into a contract with DENNIS W. PECINOVSKY and FRANCES A. PECINOVSKY (PECINOVSKYS), to sell the remaining forty acres of the 120-acre tract he purchased in 1987. This contract called for a down payment of $4,800; a principal payment of $9,600 on March 1, 1991; annual payments of $1,680 beginning on March 1, 1992, and continuing until the contract was paid in full, with semi-annual payments of accrued interest each September 1st and March 1st.

The LENSINGS completed their contract and received a deed to the property in 1996. The PECINOVSKYS made complete and timely payments to the DEBTOR. The DEBTOR also made some payments to the BANK on the mortgage according to the schedule. However, after making his payment in October of 1997, the DEBTOR defaulted. The BANK notified the LENSINGS and the PECINOVSKYS of its intent to foreclose. At that time, the balance due the BANK on the mortgage was $51,762.59. The PECINOVSKYS owed the DEBTOR $23,296.24. In order to avoid foreclosure, the PECINOVSKYS issued an additional check to the DEBTOR and the BANK for the amount due on their contract and issued a check to the BANK for $9,488.79. The LENSINGS paid the BANK $18,977.56. The result was that the LENSINGS and the PECINOVSKYS had to pay $18,977.56 and $9,488.79, respectively, more than their contracts with the DEBTOR required in order to satisfy the BANK's mortgage lien.

The DEBTOR filed a Chapter 7 petition in Bankruptcy on June 24, 1998. The LENSINGS and the PECINOVSKYS brought this adversary proceeding, seeking to recover the monies they paid to the BANK in excess of the amounts required to be paid under their contracts with the DEBTOR. A trial was held on December 6, 1999, and the matter was taken under advisement.

In their brief filed after the trial in this adversary proceeding, the LENSINGS and the PECINOVSKYS identify the sole issue to be determined as whether the DEBTOR's conduct in failing to apply the full payments he received under the real estate contracts to the BANK's mortgage constitutes conversion pursuant to 11 U.S.C. 523(a)(6) of the Bankruptcy Code, 11 U.S.C. § 523(a)(6). Pointing to the decisions which hold that a debtor's unauthorized sale of collateral constitutes a willful and malicious injury to the secured creditor, the LENSINGS and the PECINOVSKYS assert that the DEBTOR's failure to satisfy the lien on the property in

accordance with the real estate contracts resulted in an incumbrance on the property they were purchasing which, although the inverse of the scenario in the decisions, harms them just the same, as instead of depriving a creditor of a lien, the DEBTOR impressed their property with a lien.

Vital to this contention is the LENSINGS' and the PECINOVSKYS' interpretation that the real estate contracts required the DEBTOR to pass through the full amounts of the payments he received from them to the BANK in payment of the mortgage. The contract provisions are not identical. The contract with the LENSINGS provided:

> **MORTGAGE.** Any mortgage or encumbrance of a similar nature against the said property shall be timely paid by Sellers so as not to prejudice the Buyers' equity herein. Should Sellers fail to pay, Buyers may pay any such sums in default and shall receive credit on this contract for such sums so paid. MORTGAGE BY SELLERS. Sellers, their successors in interest or assigns may, and hereby reserve the right to at any time mortgage their right, title or interest in such premises or to renew or extend any existing mortgage for any amount not exceeding ___100%__ of the then unpaid balance of the purchase price herein provided. The interest rate and amortization thereof shall be no more onerous than the installment requirements of this contract. Buyers hereby expressly consent to such a mortgage and agree to execute and deliver all necessary papers to aid Sellers in securing such a mortgage which shall be prior and paramount to any of Buyers' then rights in said property. DEED FOR BUYERS SUBJECT TO MORTGAGE. If Buyers have reduced the balance of this contract to the amount of any existing mortgage balance on said premises, they may at their option, assume and agree to pay said mortgage according to its terms, and subject to such mortgage shall receive a deed to said premises; or Sellers, at their option, any time before Buyers have made such a mortgage commitment, may reduce or pay off such mortgage. ALLOCATED PAYMENTS. Buyers, in the event of acquiring this property from an equity holder instead of a holder of the fee title, or in the event of a mortgage against said premises, reserve the right, if reasonably necessary for their protection to divide or allocate the payments to the interested parties as their interests may appear. SELLERS AS TRUSTEES. Sellers agree that they will collect no money hereunder in excess of the amount of the unpaid balance under the terms of this contract less the total amount of the encumbrance on the interest of Sellers or their assigns in said real estate; and if the Sellers shall hereafter collect or receive any moneys hereunder beyond such

> amount, they shall be considered and held as collecting and receiving said money as the agent and trustee of the Buyers for the use and benefit of the Buyers. *The parties acknowledge that the seller has a real estate mortgage at Federal Land Bank and in the event of any default by the seller, the buyer has the right to make his payments directly to Federal Land Bank to reduce the amount of said mortgage.*

Both the figure "100%" and the last sentence, in italics, were typed in on the preprinted form.

The provision governing mortgages in the PECINOVSKYS' contract, also a preprinted form, contained no typewritten additions, and provided, in pertinent part:[1]

> MORTGAGE. Any mortgage or encumbrance of a similar nature against the said property shall be timely paid by Sellers so as not to prejudice the Buyers' equity herein. Should Sellers fail to pay, Buyers may pay any such sums in default and shall receive credit on this contract for such sums so paid. MORTGAGE BY SELLERS. Sellers, their successors in interest or assigns may, and hereby reserve the right to at any time mortgage their right, title or interest in such premises or to renew or extend any existing mortgage for any amount not exceeding _____% of the then unpaid balance of the purchase price herein provided. The interest rate and amortization thereof shall be no more onerous than the installment requirements of this contract. Buyers hereby expressly consent to such a mortgage and agree to execute and deliver all necessary papers to aid Sellers in securing such a mortgage which shall be prior and paramount to any of Buyers' then rights in said property....

Focusing only on the first sentence, the LENSINGS and the PECINOVSKYS assert that it requires the DEBTOR to pass through all payments received by the purchasers to the mortgagee. The LENSINGS and the PECINOVSKYS would rewrite the sentence to define "timely" in terms of payments required to protect the buyer's equity, rather than in terms of payments due on the mortgage. Alternatively, the LENSINGS and the PECINOVSKYS claim that the provision requires a seller to guard against any defects in title by insuring that the outstanding balance be kept at a lower amount than the balance due from the buyers to insure that the purchaser's equity is not subject to the mortgagee's lien.

This Court cannot accept either of those interpretations. The language is plain. The

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[1] Like the LENSINGS' contract, this paragraph of the PECINOVSKYS' contract also contained subheadings "DEED FOR BUYERS SUBJECT TO MORTGAGE," "ALLOCATED PAYMENTS" and "SELLERS AS TRUSTEES".

provision requires that "any mortgage .... shall be timely paid by the Sellers ...." with the result that the Buyer's equity will not be prejudiced. There is no broad duty upon the Sellers to do more and apply all payments received from the Buyers so as to protect the Buyer's equity. This meaning is apparent from a reading of the entire provision governing mortgages. The contract with the LENSINGS, in the subheading "MORTGAGE BY SELLERS," specifically provides that any future mortgage by the sellers cannot exceed the unpaid balance of the purchase price and that the interest rate and the amortization could not be in excess of the installment requirements of the contract. The PECINOVSKYS' contract contains the same language, though the percentage is left blank. Accepting the LENSINGS and the PECINOVSKYS' interpretation would require that differently worded provisions in the contracts be given precisely the same meaning, in complete disregard of the basic principles of statutory construction.

Because this Court determines that the real estate contracts did not require the DEBTOR to pass through the full amounts of the payments to the BANK, the analogy drawn by the LENSINGS and the PECINOVSKYS to conversion of collateral is inapposite. Moreover, the LENSINGS and the PECINOVSKYS ignore the United States Supreme Court's holding in *Kawaauhau v. Geiger,* 523 U.S. 57, 118 S.Ct. 974, that nondischargeability under § 523(a)(6) requires a deliberate or intentional injury and that a deliberate or intentional act that leads to injury is insufficient. Consistent with the Court's ruling, recent decisions have limited the exception to injuries resulting from egregious and reprehensible conduct by the debtor. While that is not to say that an act of conversion can never be determined to be a willful and malicious injury, a creditor must show that a debtor, when converting collateral, did so with the specific intent of depriving the creditor of its collateral. There was no such showing in the present case.

The most that was shown was a breach of contract.

In *In re Jercich,* 243 B.R. 747 (9th Cir. BAP 2000), the court discussed whether a breach of contract can constitute a willful and malicious injury. In concluding that a debtor's conduct must constitute an independent tort apart from the debtor's contractual liability in order to be nondischargeable under § 523(a)(6), the court stated:

> Historically, the exception from discharge for debts arising from willful and malicious injury has been applied to tort claims, not contract claims. (Citations) That continues to be the majority approach and is the rule followed in the Ninth Circuit. *In re Riso,* 978 F.2d 1151, 1154 (9th Cir.1992); *In re Itule,* 114 B.R. 206, 211 n. 5 (9th Cir. BAP 1990). *See also* 4 Lawrence P. King, et al., *Collier on Bankruptcy* ¶ 523.12 (15th ed. Rev.1998); 3 William L. Norton, *Norton Bankruptcy Law and Practice* 2d § 47:44 (Rev.1998). Torts have traditionally been defined as obligations giving rise to liability that are imposed by law apart from and independent of enforcement of promises made between parties to a contract. W. Page Keeton et al., *Prosser and Keeton on Torts* § 92, at 655-56 (5th ed. 1984). In contrast, contract obligations are created to enforce promises to do or not to do something and are obligations "based on the manifested intention of the parties to a bargaining transaction." *Id.*
>
> The problem in this case arises because the distinction between tort and contract liability is not always clear. In certain cases, a debtor's conduct may constitute both a breach of contract and a tort. The Ninth Circuit has made it clear that "[a]n intentional breach of contract is excepted from discharge under § 523(a)(6) only when it is accompanied by malicious and willful tortious conduct." *Riso*, 978 F.2d at 1154.
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>> [S]ection 523(a)(6) does not encompass a breach of contract claim unless the same act constitutes an intentional tort such as conversion.... Indeed, the Court of Appeals in *In re Geiger,* 113 F.3d 848 (8th Cir.1997) (en banc), aff'd 523 U.S. 57, 118 S.Ct. 974, 140 L.Ed.2d 90 (1998), rejected the broader definition of wilfulness, in part, because it would sweep breach of contract claims within the exception. *See id.* at 852 ("Indeed, we see no reason that a knowing breach of contract would not result in a judgment that would be exempt from discharge under this legal principle. Surely this proves too much.").
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> *In re Mitchell,* 227 B.R. 45, 52 (Bankr.S.D.N.Y.1998) (citations omitted).
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> In the present case, the evidence shows only that the PECINOVSKYS' and the

LENSINGS' contracts, although standard in nature, did not eliminate all risk associated with buying real estate subject to an outstanding mortgage. The DEBTOR complied with the provisions of the contracts he had with the LENSINGS and the PECINOVSKYS, and the contract he had with the BANK, until he encountered financial difficulties. It is well settled that a court cannot rewrite the terms of a contract to fix an improvident bargain or cure an oversight. Unfortunate as it may be, the debts to the LENSINGS and the PECINOVSKYS are not nondischargeable under §523(a)(6).

This Opinion is to serve as Findings of Fact and Conclusions of Law pursuant to Rule 7052 of the Rules of Bankruptcy Procedure.

See written Order.

DATED: March 21, 2000.

WILLIAM V. ALTENBERGER
UNITED STATES BANKRUPTCY JUDGE

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	)	
GARY A. KLIMESH,	)	
	)	
Defendant.	)	

O R D E R

For the reasons stated in an Opinion filed this day, IT IS HEREBY ORDERED that Judgment is entered in FAVOR of the DEFENDANT, Gary A. Klimesh, and AGAINST the PLAINTIFFS, Dennis W. Pecinovsky, Frances A. Pecinovsky, Donald B. Lensing and Norma Lensing, and the debts are declared to be DISCHARGEABLE.

DATED: March 21, 2000.

WILLIAM V. ALTENBERGER
UNITED STATES BANKRUPTCY JUDGE

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