Dated: May 25 2005

Mary Ann Whipple
United States Bankruptcy Judge

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF OHIO
WESTERN DIVISION

In Re:	)	Case No.: 03-39670
	)	
Donald J. McLeod, Sr.	)	Chapter 7
Carol A. McLeod,	)	
	)	Adv. Pro. No. 04-3091
Debtors.	)	
	)	Hon. Mary Ann Whipple
Green Tree Servicing, LLC,	)	
	)	
Plaintiff,	)	
v.	)	
	)	
Donald J. McLeod, Sr., et al.,	)	
	)	
Defendants.	)	

MEMORANDUM OF DECISION

This adversary proceeding is before the court for decision after trial on a complaint filed by Plaintiff Green Tree Servicing, LLC, fka Conseco Finance Servicing Corp., to determine the dischargeability of a debt allegedly owed to it by Defendants Donald J. McLeod, Sr., and Carol McLeod. Plaintiff alleges that the debt should be

excepted from discharge under 11 U.S.C. § 523(a)(2), (a)(4) and/or (a)(6).

Hastings Mutual Insurance Company filed a similar complaint in Case No. 04-3090. Because both cases are based upon the same operative facts, these cases were tried together. However, separate decisions will be entered in each case.

The court has jurisdiction over this adversary proceeding under 28 U.S.C. §1334(b) and the general order of reference entered in this district. Proceedings to determine dischargeability of debts are core proceedings that the court may hear and decide. 28 U.S.C. § 157(b)(1) and (b)(2)(I). This Memorandum of Decision constitutes the court's findings of fact and conclusions of law under Fed. R. Civ. P. 52, made applicable to this adversary proceeding by Fed. R. Bankr. P. 7052. Regardless of whether specifically referred to in this Memorandum of Decision, the court has examined the submitted materials, weighed the credibility of the witnesses, considered all of the evidence, and reviewed the entire record of the case. Based upon that review, and for the reasons discussed below, the court finds that the debt owed by Defendants to Plaintiff, if any debt is in fact owed, is dischargeable.

FINDINGS OF FACT

In 1998, Donald and Carol McLeod (the "McLeods") refinanced their home located at 4112 North Haven, Toledo, Ohio. They signed a note secured by a mortgage on their home in the amount of $72,000 in favor of Decision One Mortgage Company, LLC. The mortgage was then assigned to Green Tree Servicing, LLC, fka Conseco Finance Servicing Corporation ("Conseco").[1] As required under the mortgage, the McLeods obtained insurance on the North Haven home through Hastings Mutual Insurance Company ("Hastings"). Conseco was named as a loss payee on the policy.

On or about August 26, 2000, the North Haven home was destroyed in a fire, the second fire at the home in less than a week. At the time of the fire, the McLeods' son, his wife and his children lived in the home. According to Carol McLeod, they had previously "switched" homes with their son. As a result, the McLeods were living in their son's home on Mayfair in Toledo. Nevertheless, the McLeods had maintained the insurance on the North Haven home and had continued to make the mortgage payments on the home. However, according

[1] Both Plaintiff and Defendants referred to Green Tree Servicing, LLC, as "Conseco" throughout the trial. Although apparently a former name of Green Tree Servicing, LLC, for the sake of consistency, the court will also refer to Plaintiff as "Conseco." The court notes, however, that the exhibits attached to the Complaint and admitted by Defendants indicate that the mortgage was assigned to Green Tree Financial Servicing, LLC, not Conseco. [Doc. # 1, ¶ 9 and Ex. A and B].

to Carol McLeod, at some point after the fire had destroyed the North Haven home, they decided to stop making payments on the Conseco mortgage (in her words, "to stop paying on a dead horse") and began making the mortgage payments on the Mayfair home where they were living.

The McLeods and Hastings were unable to arrive at an insurance settlement with respect to the fire. Therefore, the McLeods filed a lawsuit in state court in 2001 naming as defendants both Hastings and Conseco, which held the first mortgage on the North Haven property. At the time the lawsuit was filed, the McLeods understood that any insurance proceeds paid on account of the fire destroying the North Haven home would be used first to pay the Conseco mortgage. Carol McLeod testified that they owed Conseco at least $70,000 at that time.

On August 23, 2002, the McLeods entered into an agreement with Hastings in settlement of the state court lawsuit. The settlement negotiations took place at the Lucas County Common Pleas Court. Although their lawyer periodically conferred with them, the McLeods remained in the hall while counsel for the parties negotiated the agreement in another room. The terms of the settlement agreement, in relevant part, were entered into the record in state court as follows:[2]

> Hastings Mutual also agrees to pay Donald J. McLeod, Sr. and Carol McLeod, $63,500 representing the full and complete settlement of any and all claims of – any and all claims that may exist by those plaintiffs and against Hastings Mutual Insurance Company and that sum is to the payment of the dwelling with the understanding that Donald J. McLeod, Sr. and Carol McLeod make no claims whatsoever of any personal property at all allegedly involved in the fire.
>
> It is further agreed that the plaintiffs are agreeing to fully and completely indemnify, defend and hold harmless Hastings Mutual Insurance Company from any and all claims which *may* exist of all or any type or nature by CONSECO Finance Company itself and the McLeods have the sole and only responsibility to resolve any issues that *may be remaining* between themselves and CONSECO Finance as would relate to the property or any insurance claims associated with the property.

[Plaintiffs' Ex. 1, p. 4-5; emphasis added].

The McLeods, along with their counsel, counsel for Hastings and counsel for Conseco, were present while

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[2] The McLeods' son and his wife, Donald J. McLeod, Jr. and Mary McLeod, were also plaintiffs in the state court action, having made claims under the Hastings insurance policy for the contents of the home. That portion of the settlement agreement addressing payment for loss of the contents of the home is not at issue in this case.

the terms of the settlement agreement were read into the record in state court. The McLeods were then each duly sworn and asked if they heard and understood the settlement agreement, to which they both responded, "Yes." Their lawyer then stated that "[o]n behalf of the plaintiffs, we would dismiss the complaint at this time with prejudice." Thereafter, the following colloquy took place:

> THE COURT: Are you dismissing the complaint as to both defendants [Hastings and Conseco]?
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> [Counsel for McLeods]: Yes
>
> THE COURT: Have your clients entered into any settlement agreement with the defendant CONSECO Finance?
>
> [Counsel for McLeods]: No, Your Honor.
>
> THE COURT: I don't know if there is anything from CONSECO.
>
> [Counsel for Conseco]: If he's dismissed we'll refile or refile on CONSECO's behalf.
>
> THE COURT: That would be a separate action. I'll indicate that the parties – at least I should say that the plaintiffs and defendant Hastings Mutual Insurance Company have entered into a settlement agreement, placed it on the record and that plaintiffs are dismissing this matter with prejudice as to all defendants or both defendants. . . .

[*Id.* at p. 7-8].

Approximately two weeks after the settlement was agreed upon, Hastings sent a check in the amount of $63,500 to the McLeods' counsel. The settlement check was made payable to the McLeods and their attorney. Conseco was not included as a payee on the check. [Complaint, ¶8; Answer, ¶8]. The McLeods received approximately $47,000 in a check issued by their attorney after counsel deducted his attorney fees of $15,875.00 from the settlement proceeds. [Complaint, ¶11; Answer, ¶ 11]. Although they held the check for a couple weeks, they eventually cashed the check. They gave $5,000 to their daughter to repair a truck that she used for work. They also took a trip to a Michigan casino at which they lost approximately $13,000. Approximately $25,000 was left in a safe deposit box that the McLeods opened at the time the check was cashed. Carol McLeod testified that they have no savings account.

Although the McLeods clearly understood that one of the purposes of the property insurance was to protect

their lender, they made no payment to Conseco after receiving the insurance proceeds. The McLeods testified regarding their understanding of their obligation to Conseco after the state lawsuit was dismissed. Carol McLeod testified that their attorney explained, both at the time the lawsuit was settled and again when they received the check representing Hastings' payment under their policy, that Conseco was not entitled to any of the insurance proceeds due to its failure "to file something necessary" with the court and that, as a result, the insurance proceeds received from Hastings belonged to the McLeods. Similarly, Donald McLeod testified that counsel told them that "Conseco had made a mistake" and that the insurance proceeds therefore belonged to the McLeods. Although counsel also advised them that Conseco would likely file a lawsuit against them, according to Carol McLeod, counsel's explanation made clear to them that Conseco would not win the case.

Carol McLeod also testified regarding her understanding of their agreement to indemnify Hastings as indicated in their settlement agreement. She testified that, at the time of the settlement, counsel did not explain what it meant "to indemnify" Hastings and her understanding was that Hastings was released from any further claim the McLeods might have against it. Although she testified that counsel in this adversary proceeding had just explained to her the meaning of "indemnify" the day before trial, she was still unable to explain correctly what their agreement to indemnify Hastings actually meant.

The court finds the McLeods testimony regarding their understanding of the settlement agreement and their obligation to Conseco to be credible. Based on observation of them at trial and their testimony, the court notes that the McLeods are not sophisticated debtors. The McLeods are retired and collect social security and a pension. They have a checking account but no savings account. Carol McLeod testified that she has a high school education. Although she worked at a bank posting checks during high school, she worked as a waitress during most of her working life.

The McLeods' testimony regarding their understanding of their obligation to Conseco and what their attorney told them regarding that obligation is supported by the fact that their attorney deducted his own fees from the total amount of the insurance proceeds before paying the balance to the McLeods. Since he was entitled to do so only if the insurance proceeds belonged to the McLeods, it appears that he believed that was the case, as the McLeods testified he explained to them, and that Conseco had no claim to the proceeds. No testimony or other evidence was offered contradicting the McLeods' testimony that counsel told them that, even though Conseco

would probably sue them, the insurance proceeds belonged to them.

The McLeods' testimony is further supported by the fact that counsel for Conseco was present at the time the settlement agreement was read into the record. Although the state court docket and pleadings are not part of the record in this case, and it is unclear exactly what Conseco failed to file in the state court proceeding, Conseco clearly did not object to the settlement agreement providing for payment to the McLeods (rather than jointly to the McLeods and Conseco) and leaving to the McLeods the sole responsibility to resolve any issues that may exist with Conseco relating to "the property or any insurance claim associated with the property." [Plaintiff's Ex. 1, p. 4-5]. Conseco also did not object to the case being dismissed with prejudice as to both Hastings and Conseco. Conseco's failure to object at least suggests that it too did not believe it could assert a direct claim against the insurance proceeds in that case.

Nevertheless, Conseco did file a lawsuit against the McLeods in state court as counsel had anticipated. A temporary restraining order was entered enjoining the McLeods from further spending of the insurance proceeds. As a result of the court order, the McLeods retained the $25,000 still in their possession. The court finds Carol McLeod's testimony credible that the balance of the insurance proceeds that they had spent was spent before they had notice of the temporary restraining order.

The McLeods filed their Chapter 7 bankruptcy petition on December 2, 2003. They turned over the entire $25,000 to the Chapter 7 trustee at the first meeting of creditors.

LAW AND ANALYSIS

I. 11 U.S.C. § 523(a)(2)(A)

Under § 523(a)(2)(A), a debt is excepted from discharge to the extent it was obtained by "false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition." In order to except a debt from discharge on the basis of a false representation, a plaintiff must prove the following elements by a preponderance of the evidence: (1) the debtor obtained money or services through a material misrepresentation that, at the time, the debtor knew was false or made with gross recklessness as to its truth; (2) the debtor intended to deceive the creditor; (3) the creditor justifiably relied on the false representation; and (4) its reliance was the proximate cause of loss. *Rembert v. AT&T Universal Card Services, Inc. (In re Rembert)*, 141 F.3d 277, 280-81 (6th Cir. 1998). A debtor's intent to defraud a creditor is measured by a

subjective standard and must be ascertained by the totality of the circumstances of the case at hand. *Id.* at 281-82. "If there is room for an inference of honest intent, the question of nondischargeability must be resolved in favor of the debtor." *ITT Fin'l Servs. v. Szczepanski (In re Szczepanski),* 139 B.R. 842, 844 (Bankr. N.D. Ohio 1991).

For purposes of § 523(a)(2)(A), "false representations and false pretenses encompass statements that falsely purport to depict current or past facts." *Peoples Sec. Fin. Co., Inc. v. Todd (In re Todd),* 34 B.R. 633, 635 (Bankr. W.D. Ky. 1983). "'False pretense' involves implied misrepresentation or conduct intended to create and foster a false impression, as distinguished from a 'false representation' which is an express misrepresentation." *Ozburn v. Moore (In re Moore),* 277 B.R. 141, 148 (Bankr. M.D. Ga. 2002)(quoting *Sears Roebuck & Co. v. Faulk (In re Faulk),* 69 B.R. 743, 750 (Bankr. N.D. Ind. 1986)).

In addition, § 523(a)(2)(A) also addresses "actual fraud," a concept that is broader than misrepresentation. *See McClellan v. Cantrell*, 217 F.3d 890 (7th Cir. 2000); *Mellon Bank, N.A. v. Vitanovich (In re Vitanovich),* 259 B.R. 873 (B.A.P. 6th Cir. 2001). "Actual fraud has been defined as intentional fraud, consisting in deception intentionally practiced to induce another to part with property or to surrender some legal right, and which accomplishes the end designed. It requires intent to deceive or defraud." *Vitanovich*, 259 B.R. at 877 (quoting *Gerad v.Cole (In re Cole),* 164 B.R. 951, 953 (Bankr. N.D. Ohio 1993)). In this case, Conseco bases its § 523(a)(2)(A) claim on the following arguments: (1) the McLeods accepted the insurance proceeds and spent at least a portion of those proceeds knowing that the funds should be applied to the mortgage debt allegedly owed to Conseco but without satisfying that debt; and (2) that the McLeods represented in the settlement agreement with Hastings that they would pay the balance of the mortgage debt to Conseco and that such representation was false. For several reasons, Conseco's arguments must fail.

First, the insurance proceeds disbursed to the McLeods were obtained by them from Hastings, not from Conseco. The McLeods obtained funds from Conseco in 1998, at which time the mortgage debt at issue was incurred. There is no allegation or evidence of a misrepresentation or fraud at that time. Thus, Conseco cannot show that it was induced to part with property at the time the mortgage debt was incurred as a result of an intentional deception by the McLeods. Nor has it proved that the McLeods used any of the insurance proceeds knowing that the funds should be applied to the mortgage debt owed to Conseco. As discussed above, the McLeods believed they were entitled to the insurance proceeds. Whether that belief was correct is irrelevant in

determining whether they intended to defraud Conseco when they spent a portion of the proceeds as such intent is measured by a subjective standard.

In addition, Conseco offered no evidence that it surrendered any legal right it might have had with respect to the insurance proceeds as the result of any misrepresentation or deceptive practice by the McLeods. Conseco misconstrues and overstates the language of the settlement agreement to the extent it argues that the McLeods intentionally misrepresented in their agreement with Hastings that they would pay the mortgage debt allegedly owed to Conseco. In the settlement agreement read into the state court record by Hastings' attorney, the McLeods simply agreed that they would have sole responsibility "to resolve any issues *that may be remaining"* between themselves and Conseco that relates to the North Haven property or to any insurance claim associated with the property. [Plaintiff's Ex. 1, p. 5]. That language does not constitute an agreement to pay anything to Conseco and is not inconsistent with the McLeods' understanding, as explained to them by their attorney, that Conseco had no claim to the insurance proceeds due to its failure to take some required action in the state case.[3] Thus, Conseco has failed to identify any false representation made by the McLeods. Furthermore, there is no testimony or evidence that Conseco relied on any representation in failing to assert any rights it may have had in the state court proceeding brought by the McLeods. The court finds it more likely than not that, at the time the state case was settled and judgment was entered, Conseco did not assert any rights it may have otherwise had as a result of its own failure to take some required action in that case and not as the result of reliance on the agreement between the McLeods and Hastings. As such, Conseco has not met its burden under § 523(a)(2)(A) and the McLeods are entitled to judgment in their favor on this claim.

II. 11 U.S.C. § 523(a)(4)

Under § 523(a)(4), a debtor is not discharged from any debt "for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny." Conseco has not identified which of these circumstances it believes is applicable under the facts of this case. The court, therefore, considers each in turn.

The Sixth Circuit has adopted a narrow interpretation of "fiduciary" as used in § 523(a)(4). *R.E. America,*

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[3] As indicated earlier, the record is silent regarding what matter Conseco failed to address in the state court proceeding brought by the McLeods or what the effect of that failure is on its claim against the McLeods with respect to the mortgage debt or the insurance proceeds. But the court notes that the state court judge confirmed that the McLeods' action was being dismissed *with prejudice* against Conseco. While it is not clear that any debt is still owed to Conseco, the court will assume for the purpose of this order that the mortgage debt is still owed by the McLeods.

Inc. v. Garver (In re Garver), 116 F.3d 176, 178 (6th Cir. 1997). In order to trigger the fraud or defalcation provision in § 523(a)(4), a debtor must hold funds in a trust for the benefit of a third party. *Id.* at 179. Furthermore, the types of trusts that will trigger the fraud or defalcation provision of § 523(a)(4) are limited to those situations involving "an express or technical trust relationship." *Id.*

In this case, no express or technical trust relationship exists. The court looks to state law in determining the existence of a trust. *Carlisle Cashway, Inc. v. Johnson (In re Johnson)*, 691 F.2d 249, 251 (6th Cir. 1982) ("The question of who is a fiduciary for purposes of section 17(a)(4) [the predecessor section to § 523(a)(4)] is one of federal law, although state law is important in determining when a trust relationship exists."). Four requirements are necessary to establish the existence of an express trust: (1) an intent to create a trust; (2) a trustee; (3) a trust res; and (4) a definite beneficiary. *Commonwealth Land Title Co. v. Blaszak (In re Blaszak)*, 397 F.3d 386, 391 (6th Cir. 2005).

Conseco fails to explain how these requirements are met in this case. There is no indication that the parties to the settlement agreement intended to create a trust. Language contained in the agreement that it was the McLeods' responsibility to resolve any issues that may exist between themselves and Conseco relating to any insurance claims associated with the North Haven property is insufficient evidence of an intent to create a trust with respect to the insurance proceeds, especially since the McLeods believed that Conseco was no longer even entitled to any of the insurance proceeds. There is no basis for finding that a trust relationship existed between Conseco and the McLeods. Moreover, as discussed above, the McLeods did not intend to defraud Conseco when they spent the insurance proceeds; they believed the money was theirs.

Embezzlement and larceny, unlike fraud under § 523(a)(4), do not require the existence of a fiduciary relationship. *Chapman v. Pomainville (In re Pomainville)*, 254 B.R. 699, 704 (Bankr. S.D. Ohio 2000). For purposes of § 523(a)(4), embezzlement is defined as "the fraudulent appropriation of property by a person to whom such property has been entrusted or into whose hands it has lawfully come." *Brady v. McAllister (In re Brady)*, 101 F.3d 1165, 1172-73 (6th Cir. 1996). A creditor proves embezzlement by establishing that (1) he entrusted his property to the debtor or debtor lawfully obtained the property, (2) the debtor appropriated the property for a use other than that for which it was intended, and (3) the circumstances indicate fraud. *Id.* at 1173. However, as indicated above, the circumstances of this case do not indicate fraud. Thus, Conseco cannot prevail on an

embezzlement theory.

Larceny is defined as "the fraudulent and wrongful taking and carrying away of the property of another with intent to convert such property to the taker's use without the consent of the owner." *Graffice v. Grim (In re Grim)*, 293 B.R. 156, 165-66 (Bankr. N.D. Ohio 2003) (citing *Schreibman v. Zanetti-Gierke (In re Zanetti-Gierke)*, 212 B.R. 375, 381 (Bankr. D. Kan. 1997)). It differs from embezzlement in that the debtor's original acquisition of possession of the property was unlawful. Thus, larceny is inapplicable where, as in this case, the debtors lawfully obtained the property allegedly converted. In this case, the settlement check representing the insurance proceeds due under the McLeods' policy was made payable to the McLeods and their attorney. Conseco was not included as a payee on the check. Acquisition of the funds by the McLeods was thus lawful.

In light of the foregoing, Conseco has not met its burden under § 523(a)(4) and the McLeods are entitled to judgment on this claim.

III. 11 U.S.C. 523(a)(6)

Conseco's final claim is based on "conversion" under 11 U.S.C. § 523(a)(6), which provides that a debt "for willful and malicious injury by the debtor to another entity or to the property of another entity" is not dischargeable. In order to be entitled to a judgment under § 523(a)(6), Conseco must prove by a preponderance of the evidence that the injury from which the debt arises was both willful and malicious. *Markowitz v. Campbell (In re Markowitz)*, 190 F.3d 455, 463, 465 n. 10 (6th Cir. 1999); *J & A Brelage, Inc. v. Jones (In re Jones)*, 276 B.R. 797, 801-2 (Bankr. N.D. Ohio 2001).

Addressing the "willful" requirement, the Supreme Court explained in *Kawaauhau v. Geiger*, 523 U.S. 57 (1998), that nondischargeability under § 523(a)(6) "takes a deliberate or intentional *injury*, not merely a deliberate or intentional *act* that leads to injury." *Id.* at 61. After *Geiger*, the Sixth Circuit reexamined § 523(a)(6) in *Markowitz* and adopted a subjective formulation of the willfulness standard. The court observed that "the mere fact that [the debtor] should have known his decisions and actions put [the creditor] at risk is also insufficient to establish a 'willful and malicious injury,'" concluding that instead "he must will or desire harm or believe injury is substantially certain to occur as a result of his behavior." *Markowitz*, 190 F.3d at 464 (internal citation omitted). Based on *Geiger* and *Markowitz*, the McLeod's subjective mind set is central to whether their actions rise to the level of being "willful and malicious" and thus actionable under § 523(a)(6).

Under Ohio law, conversion is defined as a wrongful or unauthorized act of control or exercise of dominion over the personal property of another which deprives the owner of possession of his property. *Taylor v. First Nat. Bank of Cincinnati* , 31 Ohio App. 3d 49, 52 (1986). Unlike a claim under § 523(a)(6), in order to prevail on a state law conversion claim, a plaintiff need not demonstrate intent or wrongful purpose. *Id.* As *Geiger* instructs, however, a debt will be excepted from discharge due to conversion of the insurance proceeds only if done with the requisite intent to cause harm.

As an initial matter, the court notes that claims under § 523(a)(6) are based on tort principles rather than on contract principles. Thus, the debt in issue on the § 523(a)(6) claim is not necessarily the underlying contract amount due on the promissory note and mortgage, but an amount equal to the injury caused by the debtor. *In re Modicue,* 926 F.2d 452, 453 (5th Cir. 1991); *Steier v. Best*, 287 B.R. 671, 674-75 (W.D. Ky. 2002). In other words, the injury for purposes of § 523(a)(6) is the amount of the insurance proceeds denied Conseco because of any "willful and malicious" actions by the McLeods.

In order to prevail on this claim, Conseco must demonstrate that the McLeods knew the insurance proceeds belonged to Conseco and spent the money anyway. As already determined by the court, however, the McLeods did not believe that any of the insurance proceeds belonged to Conseco. Thus, the fact that they spent a portion of the proceeds cannot be construed as an act done deliberately to deprive Conseco of funds to which it was entitled. This is true even though they were told that Conseco was likely to file suit against them, since they understood that Conseco would not prevail in such a lawsuit.

For the same reasons, Conseco has failed to prove that any debt owed to them was the result of a "malicious" injury. Under § 523(a)(6), "'[m]alicious' means in conscious disregard of one's duties or without just cause or excuse." *Monsanto Co. v. Trantham (In re Trantham),* 304 B.R. 298, 308 (B.A.P. 6th Cir. 2004) (quoting *Wheeler v. Laudani*, 783 F.2d 610, 615 (6th Cir. 1986). The McLeods did not "consciously disregard" their duty, to the extent they had a duty, to turn over the insurance proceeds to Conseco since they understood that no duty existed due to Conseco failing to file some necessary document in the state court proceeding. Again, the settlement check did not include Conseco as a payee. The court therefore finds that Conseco has not met its burden under § 523(a)(6).

CONCLUSION

Finding that Conseco has not met its burden of proof on its claims under 11 U.S.C. § 523(a)(2)(A), (a)(4), or (a)(6), judgment on the complaint will be entered in favor of the McLeods. A separate judgment in accordance with this Memorandum of Decision will be entered by the court.