

UNITED STATES BANKRUPTCY COURT  
NORTHERN DISTRICT OF OHIO

IN RE: \*  
\*  
ROBERT R. FOX, \*  
\* CASE NUMBER 03-46394  
\*  
Debtor. \*  
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\*  
CASH AMERICA FINANCIAL \*  
SERVICES, INC., \*  
\* ADVERSARY NUMBER 04-4072  
\*  
Plaintiff, \*  
\*  
vs. \*  
\*  
ROBERT R. FOX, \*  
\* THE HONORABLE KAY WOODS  
\*  
Defendant. \*  
\*

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M E M O R A N D U M O P I N I O N  
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This cause came before the Court for a bench trial on March 1, 2006. Plaintiff Cash America Financial Services, Inc. ("Plaintiff") was represented by John W. Becker, Esq. Defendant Robert R. Fox ("Debtor/Defendant") was present and represented by Richard G. Zellers, Esq. The Court received the testimony of Debtor/Defendant, Wayne Gerlosky, Logan Duane Clark, Joseph Lee Duarte, and Kathy Plant.

The Court has jurisdiction over this matter pursuant to 28 U.S.C. § 1334. Venue in this Court is proper pursuant to 28 U.S.C. §§ 1391(b), 1408, and 1409. This is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(I). The following constitutes the Court's findings of fact and conclusions of law pursuant to FED. R. BANKR. P. 7052.

At all times relevant to the above-captioned case, Debtor/Defendant served as both President and Chief Operating Officer for the now defunct R.R. Fox, Incorporated ("R.R. Fox"). In its Complaint, Plaintiff alleges that Debtor/Defendant is personally liable for the debt incurred by R.R. Fox as the result of its contractual relationship with Plaintiff, and that the debt is non-dischargeable based upon the exceptions to dischargeability set forth in 11 U.S.C. § 523(a)(4) (debts for defalcation while Debtor/Defendant was acting as Plaintiff's fiduciary<sup>1</sup> and embezzlement) and 11 U.S.C. §§ 523(a)(6) (debts for willful and malicious injury).

#### **I. FACTS**

The following facts are taken from the trial transcript ("Tr.") unless otherwise noted. Plaintiff is in the business of providing short-term loans, also referred to as "pay day loans," to consumers who may not have access to traditional credit sources. (Tr. at 19.) Consumers complete an application and provide to Plaintiff their most recent pay stub and proof of an established bank account. (Tr. at 19.) After Plaintiff verifies the information, consumers enter into an agreement to repay Plaintiff the loan amount on a specific date by way of an electronic debit from their bank account. (Tr. at 19.)

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<sup>1</sup>Although Plaintiff alleges that Debtor/Defendant committed both fraud and defalcation while he was acting as Plaintiff's fiduciary in Count II of the Complaint, Plaintiff abandons its fraud claim in its Post-Trial Brief by dedicating the entirety of its argument to defalcation. See Plaintiff's Post-Trial Brief at 5 ("[Debtor/Defendant], as president and CEO directly and personally participated in acts that constitute defalcation, embezzlement, and conversion of the property of [Plaintiff]") (Dkt. #73), see generally Plaintiff's Post-Trial Brief at 6-9.

When an electronic request for payment is returned for insufficient funds, Plaintiff initially attempts to collect the debt through its internal collection agency. (Tr. at 20.) At some point, however, Plaintiff determines that the loan will be taken as a loss and the obligation is assigned to a third-party agency for collection. (Tr. at 20.)

Plaintiff commonly enters into written agreements with third-party debt collection agencies for the purpose of recouping some percentage of the defaulted loan amounts. (Tr. at 20.) In January 2003, R.R. Fox was one such third-party debt collection agency.

A brief history of the events that led to R.R. Fox's entry into the third-party debt collection business in January 2003 is instructive. R.R. Fox was incorporated in 1990 and was owned in equal shares by Debtor/Defendant, his wife, and his mother and father. In 1993, after his mother passed away, Debtor/Defendant and his wife assumed his parents' shares.

Debtor/Defendant met Duane Logan Clark and Joseph Lee Duarte in 2000 when they were all employed by Extera Credit Recovery, Inc. (Tr. at 80.) At the time, Debtor/Defendant ran Extera's collection facility in Youngstown, Ohio. (Tr. at 48.) When Extera was sold to OSI in late 2001/early 2002, Clark and Duarte left Extera to form the California-based Compass Recovery, a company which provided portfolio management services to third-party debt collection agencies. (Tr. at 81.)

Clark defined the term of art "portfolio" as a collection of defaulted accounts that may be purchased or collected on contingency. (Tr. at 51.) The portfolio management services provided by Compass Recovery included "scrubbing" portfolios, which

involves weeding out uncollectible loans and prioritizing the remaining loans based upon their projected likelihood of collection, as well as formatting and loading the portfolio information into the computerized collection systems of the third-party debt collection agencies. (Tr. at 50-51, 53.)

On May 23, 2002, Clark, individually and as a corporate representative of Compass Recovery, entered into a contract to provide consulting services to Plaintiff. (Pl. Ex. HH.) According to Clark, since it was Compass Recovery's business to "help[] companies do better on their collection efforts," Compass Recovery approached Plaintiff "to do an analysis and to implement a program for them to improve their collection efforts." (Tr. at 62.)

According to Debtor/Defendant's testimony, Clark and Duarte approached him with the idea of R.R. Fox becoming a third-party debt collection agent for Plaintiff. (Tr. at 151.) As a consequence, on December 13, 2003, R.R. Fox purchased a portion of the assets of OSI and sublet a portion of OSI's office space in downtown Youngstown. (Tr. at 109-111.)

On December 14, 2002, R.R. Fox entered into a portfolio management services contract with Compass Recovery. (Tr. at 50, 112.) The contract required Compass Recovery to provide a variety of services to R.R. Fox including portfolio and dialer campaign management, technological support of the computer systems, collector training and compliance monitoring, reporting, strategy, sales and marketing support. (Tr. at 65.)

Pursuant to Compass Recovery's obligations under the contract, Duarte traveled to Youngstown between Christmas 2002 and New Year's

Day 2003 in order to set up the Atlas computer system acquired by R.R. Fox from OSI. (Tr. at 85.)

Duarte testified that he brought with him on behalf of Plaintiff a contract entitled "Agreement for Collection" ("Agreement") for Debtor/Defendant's signature. (Tr. at 89.) Debtor/Defendant signed the Agreement in his representative capacity as President of R.R. Fox. (Pl. Ex B at 4.) After Debtor/Defendant signed the Agreement, Duarte forwarded the partially-executed contract to Leigh-An Kennedy, a third party administrator acting on behalf of Plaintiff. (Tr. at 37, 93-94, 98.)

The contract between Compass Recovery and R.R. Fox and the Agreement between Plaintiff and R.R. Fox created an interrelationship between the parties, which may be summarized as follows: Compass Recovery was responsible for converting or reformatting the Account information provided by Plaintiff to R.R. Fox in order to make the information compatible with the Atlas system. (Tr. at 53-54, 87, 100-101.) In fact, Clark testified that all of the Accounts received by Compass Recovery from Plaintiff for conversion or reformatting were earmarked for R.R. Fox. (Tr. at 70.) Compass Recovery was also responsible for preparing and providing weekly collection reports to Plaintiff and its agents regarding R.R. Fox's collections of Plaintiff's Accounts. (Tr. at 53-54, 87, 100-101.)

Plaintiff and Debtor/Defendant entered into several stipulations regarding the Agreement between Plaintiff and R.R. Fox prior to the commencement of the trial. Both parties concede that, on or about January 10, 2003, Plaintiff and R.R. Fox entered into the Agreement, wherein Plaintiff agreed to provide information related to Accounts owed to Plaintiff in exchange for R.R. Fox's agreement

to serve as a collection agent for those Accounts. Stipulations at ¶ 1.

The Agreement entitled R.R. Fox to a fee equal to one-quarter (25%) of the total amount collected upon each Account ("Fee"). Stipulations at ¶ 2; see also Agreement at ¶ 4a. The Agreement further provided that R.R. Fox was to deliver to Plaintiff, on or before the 5th day of each calendar month, all sums received by R.R. Fox in connection with the Accounts during the previous calendar month, less the Fee. Stipulations at ¶ 3; see also Agreement at ¶ 3. Pursuant to the terms of the Agreement, it is to be construed in accordance with the laws of Texas. Agreement at ¶ 18.

The parties further stipulate that, during the period January 10, 2003 through June 18, 2003, R.R. Fox collected on many of Plaintiff's Accounts, which resulted in net proceeds of \$351,726.65 to Plaintiff pursuant to the Agreement. Stipulations at ¶ 4. The parties agree that R.R. Fox paid \$89,614.27 to Plaintiff, and that the balance of \$262,112.38 remains due and owing. Stipulations at ¶¶ 5-6.

Three provisions in the Agreement are relevant to the arguments before this Court. Paragraph 3, captioned "Surety Bond," reads, in its entirety:

[R.R. Fox] agrees that it will maintain a surety bond in the amount of \$10,000.00 or other such amount as may be required by [Plaintiff] (provided, however, that the amount of the surety bond will not exceed the total sum of the Accounts then in the possession of [R.R. Fox]). Such bond shall be renewable annually on January first of each year, shall be approved by [Plaintiff] as to form and content, and shall be executed by [R.R. Fox] as principal and by a surety company as surety. The bond shall run to and be for the benefit of [Plaintiff] as obligee and conditioned that [R.R. Fox] shall faithfully and truly perform all of its obligations under the Agreement, and shall, within five (5) days after the close of

each calendar month, account to and pay to [Plaintiff] the net proceeds of all collections made during the preceding calendar month. [R.R. Fox] shall provide [Plaintiff] with a copy of the bond upon [Plaintiff's] request.

Agreement at ¶ 3.

Paragraph 6, captioned, "Trust Account," reads, in its entirety:

[R.R. Fox] shall hold all sums that it collects for the benefit of [Plaintiff] in a trust account ("Trust Account") until such time as the funds are paid to [Plaintiff] pursuant to paragraph 7. The Trust Account shall be maintained separate and apart from [R.R. Fox's] operating accounts. The Trust Account shall be maintained at a bank, savings and loan association, savings bank, or credit union insured by the Federal Deposit Insurance Corporation or the National Credit Union Administration. All sums received by [R.R. Fox] in connection with the Accounts shall be placed in the Trust Account within two (2) business days after their receipt by [R.R. Fox]. All sums held by [R.R. Fox] in the Trust Account for the benefit of [Plaintiff] shall be free of any right of offset or security interest in favor of the depository institution or any other person or entity.

Agreement at ¶ 6.

Paragraph 13, captioned "Nature of Relationship," reads in its entirety:

This Agreement does not constitute any party hereto as an agent, legal representative, fiduciary, joint venturer, partner, employee, or servant of the other for any purpose whatsoever. [Plaintiff] and [R.R. Fox] agree that [R.R. Fox] is an independent contractor. Nothing in this Agreement authorizes [R.R. Fox] to make any contract, agreement, warranty, or representation on [Plaintiff's] behalf, or to incur any debt or other obligation in [Plaintiff's] name; and [Plaintiff] shall in no event assume liability for, or be deemed liable hereunder, as a result of any such action.

Agreement at ¶ 13.

Wayne Gerlosky, Vice President of Plaintiff's Pay Day Lending Division, testified that each of the foregoing provisions were included in the Agreement exclusively for Plaintiff's benefit and

to make certain that R.R. Fox "live[d] up to the terms and conditions of [the Agreement]." (Tr. at 30.) Gerlosky testified more specifically that paragraph 6 was included in the Agreement "[t]o make sure that [Plaintiff's] funds were not commingled with any other of [Plaintiff's] operating funds of any other organization [Plaintiff does] business with, including R.R. Fox." (Tr. at 30.) Gerlosky further testified that paragraph 13 was included "[t]o ensure that [Plaintiff was] not bound by any actions that R.R. Fox took outside of [the Agreement]." (Tr. at 31.)

Although Debtor/Defendant testified that he "thought" he had a surety bond, and that he attempted to open a trust account, it is undisputed that Debtor/Defendant neither acquired a surety bond nor set up a trust account. (Tr. at 118-119.)

According to Debtor/Defendant's testimony, Duarte called him on the Friday before the first Accounts were scheduled to be downloaded by Plaintiff in order to ascertain whether the surety bond and the trust account were in place. (Tr. at 119.) Neither Debtor/Defendant nor his "business banker," Perry Chiconowski, knew what a trust account was. (Tr. at 120.) Debtor/Defendant and Chiconowski attempted to set up a trust account at Bank One that day, but the branch manager at Bank One (whose name Debtor/Defendant could not recall) "had no idea what [he] was talking about." (Tr. at 119.) Debtor/Defendant testified that the trust account that the bank manager wanted to set up was "maybe for an heir, as a child or future generation." (Tr. at 120.)

Debtor/Defendant testified that when he returned from the bank, he contacted Duarte who told him to fax over the surety bond. (Tr. at 119.) Instead, Debtor/Defendant faxed the "dec page" of R.R.

Fox's commercial insurance policy. (Tr. at 119-120.) Despite the fact that Debtor/Defendant faxed the declaration page of his insurance policy instead of a surety bond, R.R. Fox received the Account download on the following Monday. (Tr. at 120.)

Although Duarte stated that he discussed the surety bond requirement with Debtor/Defendant, he denied ever having a discussion with Debtor/Defendant about his obligation to set up a trust account for Plaintiff's funds or reviewing a copy of R.R. Fox's commercial insurance policy. (Tr. at 91-92, 101-102.)

Clark testified that he had a number of conversations with Debtor/Defendant regarding the necessity of setting up a trust account. (Tr. at 59.) Clark stated that he repeatedly asked Debtor/Defendant for proof of the existence of the trust account – not only to protect his own relationship with Plaintiff, but also to keep the relationship between R.R. Fox and Plaintiff "upfront as much as possible." (Tr. at 59-60.)

According to Clark's testimony, Debtor/Defendant assured him that he had set up a trust account, but never produced any documentary evidence that such a trust existed. (Tr. at 60-61.) On cross-examination, however, Clark admitted that his first inquiry regarding the trust account occurred after R.R. Fox's first remittance to Plaintiff, which occurred on March 6, 2003. (Tr. at 72.)

Gerlosky testified that Plaintiff assigns the responsibility for determining whether third-party debt collection agencies have set up trust accounts, as well as the monitoring of those accounts through regular reports of collection activity, to third party administrators. (Tr. at 36, 38.) He further testified that

Leigh-An Kennedy was the third party administrator assigned to R.R. Fox, and that R.R. Fox's collection reports were sent to Debtor/Defendant, Kennedy, and Clark. (Tr. at 82, 37.)

During the course of Gerlosky's testimony regarding Kennedy and her responsibilities, he conceded that he had been made aware that R.R. Fox had not set up a trust account. (Tr. at 38.) Gerlosky testified that he would normally follow up on a debt collection agency's failure to hold proceeds of Plaintiff's Accounts in trust through the third party administrator, and that he recalled having such a conversation with Kennedy. (Tr. at 38-39.) Gerlosky further testified that he would act on such a situation, but that he never contacted Debtor/Defendant about opening a trust account. (Tr. at 40.)

According to the testimony at trial, despite the knowledge that R.R. Fox did not have the requisite trust account in place, Plaintiff downloaded Accounts to R.R. Fox in January and February 2003.

Debtor/Defendant testified that Plaintiff sent Accounts totaling approximately \$5 million dollars to R.R. Fox in February, 2003. (Tr. at 154.) Debtor/Defendant further testified R.R. Fox was in the midst of a hiring campaign in February 2003, apparently in response to the substantial download of Accounts that month. (Tr. at 154.) As a consequence, Debtor/Defendant stated that the payroll alone at R.R. Fox was in the \$60,000.00 to 80,000.00 range. (Tr. at 154.) In addition, he cited taxes, benefits, and ancillary costs like parking for employees, which added to R.R. Fox's already substantial overhead. (Tr. at 154.) He stated that his intention at that time was to grow the corporation and that he was

"aggressively pursuing as much business as [he] humanly could get . . . ." (Tr. at 154-155.)

During the first two months of R.R. Fox's operation as a third-party debt recovery agency, the boundaries between Compass Recovery's duties to Plaintiff and its duties to R.R. Fox under its respective contracts with the parties often blurred. For instance, Clark acknowledged that discussions he had with Debtor/Defendant regarding amendments to the Agreement were part of Compass Recovery's consulting services with R.R. Fox. (Tr. at 55.) Clark stated that he and Debtor/Defendant agreed that R.R. Fox should be permitted to retain 35% of the collection on Plaintiff's older paper,<sup>2</sup> and to move the remittance date from the 5th of each month to the 15th or 20th of each month in order to resolve NSF problems inherent in accepting payments by check. (Tr. at 54-55, 57.)

Clark conceded that he raised these issues on behalf of R.R. Fox with Darrold Keach, a representative of Plaintiff, but that Keach did not respond to his comments. (Tr. at 56.) On cross-examination, Clark denied that there existed any conflict of interest created by the interrelationship between R.R. Fox, Plaintiff, and Compass Recovery, and characterized his discussions with Keach as an effort to "forward[] R.R. Fox's concerns to [Plaintiff.]" (Tr. at 66-67.)

At some point prior to March 6, 2003, Plaintiff stopped downloading accounts to R.R. Fox. (Tr. at 153.) The uncontested evidence at trial establishes that R.R. Fox did not remit any payment to Plaintiff on February 5, 2006, but remitted payment for

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<sup>2</sup>According to Clark, Plaintiff was providing R.R. Fox with older Accounts, which are more difficult to collect than debts "fairly young in write-off age." (Tr. at 55.)

its January collections to Plaintiff in the amount of \$30,693.70 on March 6, 2003. (Pl. Ex. H at 3, Pl. Ex I at 4.) However, despite the payment on March 6, 2003, R.R. Fox did not remit payment on March 6, 2003 for its February collections.

The failure to make payments on February 5, 2003 (the January remittance) and March 5, 2003 (the February remittance), however, did not appear to be fatal to the business relationship between Plaintiff and R.R. Fox, because Gerlosky testified that there was some flexibility afforded to new collection agencies with respect to reporting and remittance requirements under the Agreement. In fact, Gerlosky testified that Plaintiff typically extends reporting and remittance requirements for forty-five days. (Tr. at 40.)

Approximately one week after remitting R.R. Fox's first payment, Debtor/Defendant visited Plaintiff's headquarters in an effort to convince Plaintiff to resume sending Accounts to R.R. Fox. (Tr. at 153.) Debtor/Defendant stated that Plaintiff's representatives told him there were no Accounts available to download. (Tr. at 153.)

Debtor/Defendant testified that R.R. Fox's substantial overhead, coupled with Plaintiff's failure to send additional Accounts, led to the filing of R.R. Fox's Chapter 11 Petition on April 4, 2003. (Tr. at 154.) R.R. Fox 's bankruptcy case was voluntarily converted to a Chapter 7 proceeding on June 18, 2003.

Because no trust account was ever opened, all of Plaintiff's collections were deposited into R.R. Fox's general operating account. (Tr. at 121.) Debtor/Defendant testified that although a number of employees were responsible for making deposits to the general operating account, he was solely responsible for the

decision to deposit all of the proceeds collected on Plaintiff's behalf into the general operating account. (Tr. at 123.)

Debtor/Defendant personally received \$60,000.00, in three \$20,000.00 increments, from R.R. Fox's general operating account on January 3, 2006, February 3, 2003 and March 6, 2003. (Tr. at 125-126.) At trial, Debtor/Defendant represented to the Court that the \$60,000.00 was a "return[] on [his] investment and [consultant] pay." (Tr. at 129.)

According to Debtor/Defendant, he gave up a \$30,000.00-per-month consulting job in 2002 to buy R.R. Fox. (Tr. at 129.) He further stated that the \$60,000.00 came from two sources – financing which included loans from Bank One and the Small Business Administration, and a collection of defaulted accounts that he had purchased on his own behalf and contributed as capital to R.R. Fox prior to downloading the first set of Plaintiff's Accounts. (Tr. at 152.)

Debtor/Defendant testified that he borrowed approximately \$2.1 million to capitalize R.R. Fox. (Tr. at 152.) The balance of R.R. Fox's general operating account on January 1, 2003 was \$193,968.84. (Pl. Ex D at 1.) However, Debtor/Defendant conceded that he could not produce any documentation of the assignment of the defaulted accounts that he purchased and subsequently contributed to R.R. Fox. (Tr. at 129-131.)

Debtor/Defendant's testimony at trial regarding the nature of the three \$20,000.00 payments contradicted the testimony he provided at his deposition on October 17, 2005. In his deposition testimony, Debtor/Defendant stated that, although he was an independent contractor for R.R. Fox, he was never compensated for his consulting

services. (Deposition of Robert R. Fox at 20-21.) He stated that he was owed approximately \$120,000.00 for his services by R.R. Fox, but he believed that he lost his claim for compensation when he filed his individual Chapter 7 petition. (Fox Depo. at 21-23.) Debtor/Defendant and his wife filed a joint Chapter 7 Petition on December 15, 2003. Debtor/Defendant conceded that he did not file a claim in the R.R. Fox bankruptcy proceeding. (Fox Depo. at 21.)

## II. LAW

In order to except the debt at issue in this case from discharge, Plaintiff must first prove that R.R. Fox committed a corporate tort. After establishing the commission of the corporate tort, Plaintiff must next demonstrate that Debtor/Defendant, as a corporate officer, is personally liable for that tort.

"Ohio law provides that a corporate officer can be held personally liable for a tort committed while acting in the scope of his employment." *Yo-Can, Inc. v. The Yogurt Exchange*, 149 Ohio App.3d 513, 526, 778 N.E.2d 80, 90 (7th Dist. 2002) (quoting *Atram v. Star Tool and Die Corp.*, 64 Ohio App.3d 388, 393, 581 N.E.2d 1110 (8th Dist. 1989)). Furthermore, in the absence of an officer's direct commission of a tort, personal liability will attach when an officer or director "*specifically directed the particular act to be done, or participated, or cooperated therein.*" *City of Springfield v. O'Sesco, Inc.*, 1994 WL 730547 at \*4 (Ohio App. 7th Dist.) (emphasis in original).

If Plaintiff can establish the commission of a corporate tort and demonstrate that Debtor/Defendant committed or participated in the commission of the tort, Section 523(a) provides several

exceptions to the general rule that pre-petition debts are dischargeable under the Code.

Plaintiff bears the burden of proving by a preponderance of the evidence that a debt is excepted from discharge. See *Meyers v. Internal Revenue Service (In re Meyers)*, 196 F.3d 622, 624 (6th Cir. 1999) (citing *Grogan v. Garner*, 498 U.S. 279, 290-91, 111 S.Ct. 654, 661 (1991)). Exceptions to discharge are narrowly construed. See *id.* (citing *Grogan*, 498 U.S. at 286-87, 111 S.Ct. at 654).

**A. 11 U.S.C. § 523(a)(4)**

Section 523(a)(4) of the Bankruptcy Code provides that "a discharge under [the Bankruptcy Code] does not discharge an individual debtor from any debt . . . for . . . defalcation while acting in a fiduciary capacity, embezzlement. . . ." 11 U.S.C. § 523(a)(4).

The elements of a § 523(a)(4) claim based upon defalcation are: (1) a pre-existing fiduciary relationship; (2) breach of that fiduciary relationship; and (3) a resulting loss. *Commonwealth Land Title Co. V. Blaszak (In re Blaszak)*, 397 F.3d 386, 390 (6th Cir. 2005) (citing *R.E. America, Inc. v. Garver (In re Garver)*, 116 F.3d 176, 178-79 (6th Cir. 1997)). Defalcation need not be intentional. *Capitol Indemnity Corp. v. Interstate Agency Inc. (In re Interstate)*, 760 F.2d 121, 125 (6th Cir. 1985).

For purposes of section 523(a)(4), the term "fiduciary relationship," is defined by federal, not state, law. *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.").

The term "fiduciary capacity" in the defalcation provision is defined more narrowly than the term is used in other circumstances. *In re Blaszak*, 397 F.3d at 391. For instance, an agent-principal relationship standing alone is insufficient to establish the type of fiduciary duty contemplated by § 523. *In re Interstate Agency*, 760 F.2d at 125. The same is true of an attorney-client relationship. *In re Garver*, 116 F.3d at 179. The Sixth Circuit Court of Appeals has likewise declined to apply § 523(a)(4) to trustees who simply fail to meet an obligation under a common law fiduciary relationship. *Id.* at 178-79.

To satisfy § 523(a)(4) in the context of a defalcation, the debtor must hold funds in trust for a third party pursuant to an express or technical trust. *In re Blaszak*, 397 F.3d at 391 (*citing Davis v. Aetna Acceptance Co.*, 293 U.S. 328, 333, 55 S.Ct. 151, 79 L.Ed. 393 (1934)).

Four requirements are necessary to establish the existence of an express or technical trust: (1) an intent to create a trust; (2) a trustee; (3) a trust *res*; and (4) a definite beneficiary. *Graffice v. Grim (In re Grim)*, 293 B.R. 156, 166 (Bankr. N.D. Ohio 2003).

Consequently, in order to establish that the debt at issue in this case is nondischargeable under the Code, Plaintiff must demonstrate the existence of an express or technical trust, a breach of the fiduciary duty created by that trust, and damages.

A fiduciary relationship, however, is not required to prove "embezzlement" in 11 U.S.C. 523(a)(4). *Goodmar, Inc. v. Hamilton*

(*In re Hamilton*) , 306 B.R. 575, 582 (Bankr. W.D. Ky. 2004). Therefore, the Court need not find a fiduciary relationship existed to hold the debt nondischargeable on the grounds of embezzlement. *Id.*

"Federal law defines 'embezzlement' under section 523(a)(4) 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 showing that he entrusted his property to the debtor, the debtor appropriated the property for a use other than that for which it was entrusted, and the circumstances indicate fraud." *Id.* at 1173.

**B. 11 U.S.C. § 523(a)(6)**

Section 523(a)(6) of the Bankruptcy Code provides that "a discharge under [the Bankruptcy Code] does not discharge an individual debtor from any debt . . . for willful and malicious injury by the debtor to another entity or to the property of another entity." 11 U.S.C. § 523.

The Supreme Court has held that only acts done with intent to cause injury, and not merely acts done intentionally, rise to the level of willful and malicious injury for the purposes of satisfying § 523(a)(6). *Kawaauhau v. Geiger*, 523 U.S. 57, 57-58, 118 S.Ct. 974, 975 (1998). In *Markowitz v. Campbell (In re Markowitz)*, 190 F.3d 455 (6th Cir. 1999), the Sixth Circuit Court of Appeals expanded the definition of "willfulness" to include the debtor's subjective belief that the injury is "substantially certain to result" from his actions. *Id.* at 464.

A person acts maliciously when that person acts in conscious disregard of his or her duties or without just cause or excuse. See *Heyne v. Heyne (In re Heyne)*, 277 B.R. 364, 368 (Bankr. N.D. Ohio 2002) (citing *Murray v. Wilcox (In re Wilcox)*, 229 B.R. 411, 419 (Bankr. N.D. Ohio 1998)); see also *Abdel-Hak v. Saad (In re Saad)*, 319 B.R. 147, 156 (2004) (citing *Tinker v. Colwell*, 193 U.S. 473, 485-86, 24 S.Ct 505 (1904) (defining "malice" under § 17(a)(2) of the former Bankruptcy Act [now § 523(a)(6) as "a wrongful act, done without just cause or excuse") (internal quotation marks and citations omitted)).

As the requirements of the statute are set forth in the conjunctive, a creditor must establish both willfulness and malice in order to prevail in a § 523(a)(6) action. However, two bankruptcy courts in this district have recognized that, in the great majority of cases, the same factual events giving rise to a finding of willfulness will likewise be indicative of malice. *Superior Metal Products v. Martin (In re Martin)*, 321 B.R. 437, 442 (Bankr. N.D. Ohio 2004); *CMEA Title Agency v. Little (In re Little)*, 335 B.R. 376, 383 (Bankr. N.D. Ohio 2005) ("Although the 'willful' and 'malicious' requirements will be found concurrently in most cases, the terms are distinct, and both requirements must be met under § 523(a)(6).") Both courts, however, acknowledge that the "malice" element requires "a heightened level of culpability transcending mere willfulness." *In re Martin*, 321 B.R. at 442, *In re Little*, 335 B.R. at 384.

Therefore, the elements of a § 523(a)(6) claim are: (1) Debtor/Defendant caused injury to Plaintiff or his property; (2) Debtor/Defendant intended to cause the injury or that such injury was substantially certain to occur as a result of Debtor/Defendant's actions; and (3) Debtor/Defendant acted in conscious disregard of his duties or without just cause or excuse.

### **III. ANALYSIS**

In its post-trial brief, Plaintiff predicates its defalcation, embezzlement, and willful and malicious injury claims on the following facts: (1) Debtor/Defendant failed to maintain a trust account, and, as a consequence, Debtor/Defendant commingled Plaintiff's funds with R.R. Fox's general operating account funds in violation of the Agreement; (2) Debtor/Defendant advanced an implausible explanation for his failure to maintain a trust account; (3) Debtor/Defendant lied to Clark about the existence of a trust account in order to purposefully take Plaintiff's proceeds; and (4) Debtor/Defendant provided conflicting explanations regarding the nature of the \$60,000.00 he received from R.R. Fox's general operating account.

Debtor/Defendant, in his post-trial brief, argues that no fiduciary relationship was created by the Agreement, because Paragraph 16 effectively disclaims any such relationship between the parties. As a consequence, Debtor/Defendant concludes that Plaintiff cannot demonstrate the first element of its defalcation claim. Debtor/Defendant further argues that Plaintiff has failed to evince the requisite showing of fraud to establish embezzlement on the part of R.R. Fox. Finally, Debtor/Defendant contends that

there is no evidence before the Court that R.R. Fox willfully and maliciously converted the proceeds of Plaintiff's Accounts.

**A. Defalcation**

The existence of a fiduciary relationship between Plaintiff and R.R. Fox is essential to Plaintiff's defalcation claim. Plaintiff relies exclusively upon Paragraph 6 of the Agreement to establish that an express or technical trust, and, therefore, a fiduciary relationship existed between the parties. Debtor/Defendant argues, on the other hand, that Paragraph 16 forecloses Plaintiff's conclusion that Paragraph 6 creates the requisite fiduciary relationship between Plaintiff and R.R. Fox.

Although federal law defines the fiduciary relationship for purposes of Plaintiff's defalcation claim, the Court must resort to Texas law to determine whether Paragraph 16 of the Agreement prevents Plaintiff from proving the existence of a fiduciary relationship between itself and R.R. Fox.

In Texas, the first step in contract interpretation is to determine whether it is possible to enforce a contract as written, without resort to parol evidence. *J.M. Davidson, Inc. v. Webster*, 128 S.W.3d 223, 229 (Tex. 2003). Deciding whether a contract is ambiguous is a question of law for the court. *Id.* (citing *Coker v. Coker*, 650 S.W.2d 391, 394 (Tex. 1983)).

The Court must examine and consider the entire writing in an effort to harmonize and give effect to all the provisions of the contract so that none will be rendered meaningless. *Id.* (citing *Universal C.I.T. Credit Corp. v. Daniel*, 150 Tex. 513, 243 S.W.2d 154, 158 (1951)). No single provision taken alone will be given controlling effect; rather, all the provisions must be considered

with reference to the whole instrument. *Id.* (citing *Myers v. Gulf Coast Minerals Mgmt. Corp.*, 361 S.W.2d 193, 196 (Tex. 1962) and *Citizens Nat'l Bank v. Tex. & P. Ry. Co.*, 136 Tex. 333, 150 S.W.2d 1003, 1006 (1941)).

A contract is unambiguous if it can be given a definite or certain legal meaning. *Id.* (*Columbia Gas Transmission Corp. v. New Ulm Gas, Ltd.*, 940 S.W.2d 587, 589 (Tex. 1996)). However, if the contract is subject to two or more reasonable interpretations after applying the pertinent rules of construction, the contract is ambiguous, creating a fact issue concerning the parties' intent. *Id.*

Plaintiff first argues that Paragraph 6 and Paragraph 16 do not conflict. In the alternative, Plaintiff argues that Debtor/Defendant's interpretation of Paragraph 16 effectively nullifies Paragraph 6. Finally, Plaintiff argues that if Paragraph 16 does impact Paragraph 6, it creates an ambiguity in the Agreement. Plaintiff contends that any ambiguity must then be interpreted in favor of Plaintiff, because the uncontroverted testimony at trial establishes that Paragraph 16 was included in the contract for the sole purpose of protecting Plaintiff and preventing R.R. Fox from acting as Plaintiff's agent.

Although the Court agrees with Plaintiff's first conclusion, that Paragraphs 6 and 16 do not create an ambiguity in the Agreement, the Court does not agree with Plaintiff's interpretation of the two provisions. Plaintiff's interpretation misses the mark because it is premised upon the patently unreasonable argument that Paragraph 6, which Plaintiff relies upon to demonstrate a fiduciary relationship between the parties, does not conflict with Para-

graph 16, which unambiguously forecloses the creation of a fiduciary relationship between the parties based upon the Agreement.

Simply stated, Paragraph 6 creates a *contractual* obligation on the part of R.R. Fox to maintain a trust account and to segregate funds collected on behalf of Plaintiff. In the absence of Paragraph 16, of course, Paragraph 6 would also create the requisite fiduciary relationship to demonstrate the first element of defalcation by R.R. Fox. See *In re Grim, supra*. (setting forth the elements of an express or technical trust). However, Paragraph 16 plainly precludes either party from relying upon the Agreement to establish a fiduciary relationship. Paragraph 16 reads, "This Agreement does not constitute *any party hereto as an agent, legal representative, fiduciary, joint venturer, partner, employee, or servant of the other for any purpose whatsoever.*" (Emphasis added.)

On the other hand, even though Paragraph 16 strips Paragraph 6 of its legal effect with respect to creating a fiduciary relationship, Paragraph 6 (read in conjunction with Paragraph 16) can still be given a "definite or certain legal meaning," *J.M. Davidson*, 128 S.W.3d at 229. Paragraph 6 creates a contractual obligation for R.R. Fox to segregate the proceeds of Plaintiff's Accounts and to hold them in trust. Consequently, Paragraph 16 does not nullify Paragraph 6, it merely forecloses the parties from relying on the obligations created by that paragraph to create a fiduciary relationship. Therefore, the Agreement is not ambiguous according to Texas law.

As a result, Plaintiff's reliance on Gerlosky's testimony at trial to establish that Paragraph 16 was included in the Agreement

for the sole protection of Plaintiff is wholly misplaced. While Texas law permits the Court to rely upon testimonial evidence to unlock the meaning of an ambiguous contract provision, the same is not true for an unambiguous contract provision. In fact, the evidence advanced by Plaintiff *directly contradicts* the plain language of the Agreement, that *neither* party shall be constituted to be a fiduciary of the other party *for any purpose whatsoever* based upon the Agreement.

Accordingly, based upon the plain and unambiguous language of Paragraph 16, the Court finds that no fiduciary relationship existed between the parties based upon the terms of the Agreement. As a consequence, although the violation of Paragraph 6 may create a cause of action for breach of contract, it does not create a cause of action for breach of fiduciary duty. Likewise, Plaintiff may not rely upon Paragraph 6 to demonstrate the existence of a fiduciary relationship between the parties for the purposes of the defalcation statute. Because Plaintiff cannot establish the existence of a fiduciary relationship between itself and R.R. Fox, the Court cannot sustain Plaintiff's defalcation claim.

#### B. Embezzlement

Although a fiduciary relationship is not an essential element of the tort of embezzlement, Plaintiff must demonstrate fraud on the part of R.R. Fox in order to prevail on its embezzlement claim. In other words, in addition to showing that Plaintiff entrusted the proceeds of its Accounts to R.R. Fox and that R.R. Fox appropriated those proceeds for a use other than that for which they were

entrusted, Plaintiff must also prove fraud. *In re Brady*, 101 F.3d at 1173.

Plaintiff relies on a number of facts adduced at trial to demonstrate fraud on the part of R.R. Fox, including Debtor/Defendant's failure to open a trust account, his failure to acquire a surety bond, and his representations to Clark that a trust account was in place. However, the facts advanced by Plaintiff in its post-trial brief simply do not establish fraud on the part of R.R. Fox.

In *Burr v. Stark Cty. Bd. of Commrs.*, 23 Ohio St.3d 69, 73 (1986), the Ohio Supreme Court set forth the elements of fraud: (1) a representation or, where there is a duty to disclose, concealment of a fact; (2) which is material to the transaction at hand; (3) made falsely, with knowledge of its falsity, or with such utter disregard and recklessness as to whether it is true or false that knowledge may be inferred; (4) with the intent of misleading another into relying upon it; (5) justifiable reliance upon the representation or concealment; and (6) a resulting injury proximately caused by the reliance.

Plaintiff relies upon Debtor/Defendant's representations to Clark that a trust account was in place to demonstrate fraud under Ohio law. Although Clark testified that he made repeated inquiries to Debtor/Defendant about the existence of the trust account, he admitted on cross-examination that he made those inquiries after R.R. Fox's first payment to Plaintiff on March 6, 2006. The uncontroverted testimony at trial establishes that Plaintiff stopped downloading accounts to R.R. Fox at some point prior to March 6, 2003. As a consequence, Plaintiff cannot demonstrate that it relied

upon Debtor/Defendant's statements to Clark because they occurred after Plaintiff had already stopped downloading accounts to R.R. Fox.

Of equal importance is the fact that Gerlosky admitted that he knew R.R. Fox never opened a trust account for the purpose of segregating the proceeds from Plaintiff's accounts. To the extent that Plaintiff relies upon Debtor/Defendant's concealment of the fact that he was depositing the proceeds from Plaintiff's Accounts into R.R. Fox's general operating account during the months of January and February 2003, Plaintiff simply cannot prove that it justifiably relied on Debtor/Defendant's silence when a representative of the company testified that he was aware that no trust account was in place.

As with Plaintiff's defalcation claim, Plaintiff attempts to bootstrap R.R. Fox's simple breach of contract into the non-dischargeable tort of embezzlement. However, Plaintiff has failed to demonstrate the elements of fraud essential to its embezzlement claim, and, as a consequence, the Court cannot sustain such a claim against R.R. Fox or Debtor/Defendant.

#### C. Willful and Malicious Injury

"Ohio law defines conversion as 'an unauthorized act of control or exercise of dominion by one party over the personal property of a second party which deprives the second party of possession of said property in denial of, or under a claim inconsistent with, the rights of the second party.'" *In re Heyne*, 277 B.R. at 368 (quoting *Saydell v. Gepepetto's Pizza & Ribs Franchise Sys. Inc.*, 100 Ohio App.3d 111, 652 N.E. 2d 218, 227 (1994)).

In order to demonstrate the willful and malicious conversion of Plaintiff's proceeds by R.R. Fox, Plaintiff must not only show that R.R. Fox converted the proceeds from Plaintiff's Accounts, but that R.R. Fox did so with the intent to cause injury to Plaintiff or with the knowledge that injury was likely to occur. *O'Brien v. Sintobin (In re Sintobin)*, 253 B.R. 826, 829 (Bankr. N.D. Ohio 2000).

As stated earlier, Plaintiff must demonstrate both willful and malicious conduct on the part of R.R. Fox in order to prevail on its § 523(a)(6) claim. Judge Richard L. Speer, in *In re Martin, supra*, recently recognized that a debtor, in certain limited circumstances, may be found to have willfully converted a creditor's property, but not to have acted in a malicious manner. *In re Martin*, 321 B.R. at 442. Judge Speer wrote, "[W]hen, although motivated by self-interest, a debtor undertakes actions that are also intended, even if incidentally, to confer a benefit on the injured party, willfulness, but not malice, may be found to exist." *Id.*

Turning to the facts in the case *sub judice*, Plaintiff again relies on R.R. Fox's failure to segregate and hold its funds in trust, coupled with Debtor/Defendant's withdrawal of \$60,000.00 from R.R. Fox's general operating account between January 3, 2006 and March 6, 2003, to demonstrate that R.R. Fox's conversion of Plaintiff's proceeds was willful and malicious.

Plaintiff asks this Court to find that the entire debt is nondischargeable, not just the \$60,000.00 that Debtor/Defendant personally withdrew from R.R. Fox's general operating account. In other words, Plaintiff relies upon the periodic withdrawals from R.R. Fox's general operating account by Debtor/Defendant to

be circumstantial evidence of willful and malicious conversion. However, because Plaintiff relies on supposition, rather than fact, to demonstrate Debtor/Defendant's state of mind when he converted Plaintiff's property, Plaintiff cannot prevail on its § 523(a)(6) claim.

For instance, Plaintiff contends that Debtor/Defendant's explanations for his failure to open a trust account and acquire a surety bond are "not plausible." (Pl. Post-Trial Br. at 12.) However, the uncontroverted testimony at trial establishes that Debtor/Defendant attempted to open a trust account and thought he had a surety bond. The testimony further establishes that Plaintiff downloaded Accounts to R.R. Fox despite its knowledge that no trust account was in place, which supports Debtor/Defendant's errant conclusion that he had sufficiently complied with the terms of the Agreement.

Without any contrary evidence, the Court must accept Debtor/Defendant's version of the January 2003 events. Although Plaintiff has the burden of proof in this case, it has failed to produce any evidence to controvert Debtor/Defendant's testimony. Instead, Plaintiff asks this Court to rely solely on the presumption that every branch manager at every bank would be able, based upon Debtor/Defendant's description, to understand that Debtor/Defendant simply wanted to open a separate bank account rather than establish a trust fund. In fact, the more logical conclusion based upon the facts is that Debtor/Defendant's own confusion regarding the type of account he was required to open created similar confusion in the mind of the branch manager.

Likewise, Plaintiff provides no evidence to demonstrate that Debtor/Defendant's withdrawal of \$60,000.00 from R.R. Fox's general

operating account was undertaken to cause injury to Plaintiff or with knowledge that such injury would occur. Plaintiff relies upon Debtor/Defendant's inconsistent explanations at deposition and at trial for the source of those withdrawals to prove a purposeful taking of Plaintiff's proceeds.

Although Debtor/Defendant's contradictory testimony creates credibility issues for the Court, it by no means demonstrates the requisite intent to cause injury or knowledge that such injury would likely occur to hold the resulting debt to be non-dischargeable in this case. Plaintiff again ignores its burden of proof, relying instead on the overarching presumption that Debtor/Defendant's conflicting testimony regarding the source of his withdrawals is evidence of his intent to injure Plaintiff.

As a matter of fact, the only testimony before the Court regarding R.R. Fox's general operating account was provided by Kathy Plant, R.R. Fox's payroll and accounting manager. (Tr. at 136.) Plant testified that the general operating account had a positive balance at the end of January 2003 but that she did not recall the balance of the account at the end of February or March 2003. (Tr. at 145.) Plant's inconclusive testimony, considered with several other facts, contravene Plaintiff's conclusion that Debtor/Defendant's withdrawal of \$60,000.00 from R.R. Fox's general operating account is evidence of Debtor/Defendant's willful and malicious conversion of the proceeds of Plaintiff's Accounts.

Plaintiff made no effort to establish the amount of the proceeds from its Accounts collected by R.R. Fox on the dates of Debtor/Defendant's withdrawals. As a matter of fact, the testimony at trial reveals that the first withdrawal was made at a time prior

to the first download of Accounts. (Tr. at 131.) Similarly, according to Debtor/Defendant's uncontroverted testimony at trial, his February 2003 withdrawal was based upon the accounts that he owned personally. (Tr. at 131.)

Next, R.R. Fox's March 2003 Bank One statement indicates a beginning balance of \$159,145.98. (Pl. Ex H at 1.) Plaintiff did not produce any testimony regarding the amount of Plaintiff's Accounts collected by R.R. Fox in February 2003. As a consequence, there is no way to determine whether Debtor/Defendant willfully converted Plaintiff's proceeds when he withdrew \$20,000.00 from R.R. Fox's general operating account on March 6, 2003.

Furthermore, the manner in which Debtor/Defendant withdrew the \$60,000.00, that is, in \$20,000.00 increments at the beginning of each month, is consistent with Debtor/Defendant's testimony that he believed he was progressively recouping the capital contribution he made to R.R. Fox. In its post-trial brief, Plaintiff underscores that Debtor/Defendant was unable to document the collection of the accounts that he donated as capital to R.R. Fox. Once again, it is Plaintiff who has the burden of proof in this case to prove that the money withdrawn by Debtor/Defendant represented the proceeds of Plaintiff's Accounts.

The remainder of the debt owed by R.R. Fox to Plaintiff, *i.e.*, \$202,112.38, was evidently spent in an effort to keep R.R. Fox in operation. Simply stated, the facts taken as a whole reveal that, although Debtor/Defendant converted Plaintiff's funds, he did so with the intent of keeping R.R. Fox afloat, and, incidentally, benefitting Plaintiff by continuing to collect on its Accounts. See *John Deere Credit Service v. McLaughlin (In re McLaughlin)*, 109 B.R.

14 (Bankr. D.N.H. 1989) (action by the debtor converting proceeds to try to make business work that he believed would be successful enough to pay off creditor).

Clark's testimony indicated that Debtor/Defendant was working to correct problems encountered in the early months of running the collection agency to improve operations and increase cash flow. Debtor/Defendant testified that he expected Plaintiff to continue downloading Accounts and that it was Plaintiff's decision to stop downloading Accounts that resulted in the corporate bankruptcy. Debtor/Defendant's testimony is consistent with the testimony of Clark, who stated that during his discussions with Debtor/Defendant regarding the future operation of R.R. Fox, Debtor/Defendant stated that he intended to "get more paper," rather than reduce his operation. (Tr. at 75.) Moreover, Plaintiff's conclusion that Debtor/Defendant knew that he would injure Plaintiff by taking its proceeds is contradicted by Debtor/Defendant's trip to Texas to convince Plaintiff to continue to download accounts. That evidence supports Debtor/Defendant's testimony that his intention was to continue soliciting business for R.R. Fox rather than to injure Plaintiff by paying other outstanding debts from R.R. Fox's general operating account.

Finally, Gerlosky's testimony regarding Plaintiff's leniency in their reporting and collection requirements for new agencies calls into question Plaintiff's knee-jerk reaction in refusing to continue downloading Accounts to R.R. Fox. There was no testimony at trial to suggest that R.R. Fox was guilty of reporting or disclosure errors, or that said reports revealed problems with the agency. As a matter of fact, Gerlosky provided no explanation for

Plaintiff's cessation of business with R.R. Fox. Although R.R. Fox did not remit its February collections on March 5, 2003, Gerlosky's testimony reveals that, by Plaintiff's standards, R.R. Fox was not considered to be delinquent with its payment.

At most, the testimony at trial established negligence on the part of Debtor/Defendant in the manner in which he conducted business at R.R. Fox. However, the policy goal of § 523(a)(6) is to except from a bankruptcy discharge those debts incurred by morally reprehensible conduct. *Murray v. Wilcox (In re Wilcox)*, 229 B.R. 411, 418 n. 7 (Bankr. N.D. Ohio 1998). "The (a)(6) formulation triggers . . . the category 'intentional torts,' as distinguished from negligent or reckless torts." *Kawaauhau*, 523 U.S. at 61, 118 S.Ct. 974, 977. Otherwise, every failed corporate venture would expose its officers to personal liability for unpaid corporate debts.

Because Plaintiff cannot establish that Debtor/Defendant converted Plaintiff's proceeds with the intent or knowledge that said conversion would injure Plaintiff, the Court cannot sustain Plaintiff's willful and malicious injury claim.

An appropriate order will follow.

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HONORABLE KAY WOODS  
UNITED STATES BANKRUPTCY JUDGE

UNITED STATES BANKRUPTCY COURT  
NORTHERN DISTRICT OF OHIO

IN RE: \*  
\*  
ROBERT R. FOX, \*  
\* CASE NUMBER 03-46394  
\*  
Debtor. \*  
\*  
\*\*\*\*\*  
\*  
CASH AMERICA FINANCIAL \*  
SERVICES, INC., \*  
\* ADVERSARY NUMBER 04-4072  
\*  
Plaintiff, \*  
\*  
vs. \*  
\*  
ROBERT R. FOX, \*  
\* THE HONORABLE KAY WOODS  
\*  
Defendant. \*  
\*

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O R D E R  
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For the reasons set forth in this Court's memorandum opinion entered on this date, the Court enters judgment in favor of the Defendant and against the Plaintiff on all three counts set forth in the Complaint. Debtor/Defendant is not liable for the debt in the amount of \$262,112.38 incurred by R.R. Fox as the result of its contractual relationship with Plaintiff.

IT IS SO ORDERED.

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HONORABLE KAY WOODS  
UNITED STATES BANKRUPTCY JUDGE