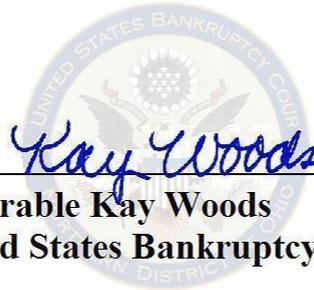


IT IS SO ORDERED.



Dated: July 24, 2007
09:59:44 AM

Honorable Kay Woods
United States Bankruptcy Judge

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF OHIO

IN RE:

CLAYTON D. CLINE,
Debtor.

CASE NUMBER 06-40484

GENERAL MOTORS ACCEPTANCE
CORPORATION,

Plaintiff,

ADVERSARY NUMBER 06-4141

vs.

CLAYTON D. CLINE,

Defendant.

THE HONORABLE KAY WOODS

MEMORANDUM OPINION

This matter was before the Court for an evidentiary hearing on damages on June 13, 2007. 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.

I. Procedural History

Plaintiff General Motors Acceptance Corporation ("GMAC") filed the above-captioned adversary case against Defendant Clayton D. Cline ("Defendant") on August 7, 2006. Service of the summons and complaint was perfected by certified mail on December 1, 2006.

On January 16, 2007, GMAC filed Motion of Plaintiff GMAC for Default Judgment Against Defendant (Doc. # 13) ("Motion for Default Judgment"). On February 26, 2007, this Court entered Judgment Entry Granting Default Judgment Against Defendant Clayton D. Cline (Doc. # 16) ("Order Granting Default"), based upon the failure of Defendant to answer, move or otherwise respond to the complaint or to respond to the Motion for Default Judgment. The record of the hearing reflects that the Court informed GMAC that it was not making any findings, but was granting a technical default based upon the failure of the Defendant to answer, move or otherwise plead.

The Order Granting Default specified that "a separate hearing will be held on GMAC's damages, and will be scheduled at a later date by separate Order." (Order Granting Default at 2.) On April 25, 2007, the Court scheduled an evidentiary hearing ("Hearing") for June 13, 2007 at 9:30 a.m. Notice of the Hearing was provided to Defendant.

At the Hearing, GMAC appeared through counsel and stated that it was prepared to present evidence, through witness testimony and documents. Defendant appeared, *pro se*, and stated that notice of the Hearing was his first notice of the instant Adversary

Proceeding. The Docket reflects, however, that Defendant was served with a copy of the summons and complaint by registered mail, which was signed as received by the mother of Defendant.¹

Despite the Order of Default, Defendant was permitted to participate in the Hearing. This appears to be a novel situation. The Court could not find any case where a motion for default judgment had been granted based upon the defendant's failure to answer, followed by the defendant's appearance and participation at a hearing to determine the amount of damages after entry of default judgment.

FED. R. BANKR. P. 7008 incorporates FED. R. CIV. P. 8, which provides:

Effect of Failure to Deny. Averments in a pleading to which a responsive pleading is required, other than those as to the amount of damage, are admitted when not denied in the responsive pleading. Averments in a pleading to which no responsive pleading is required or permitted shall be taken as denied or avoided.

FED. R. CIV. P. 8(d) (West 2006). An "averment" is a "positive declaration or affirmation of fact; esp., an assertion or allegation in a pleading[.]" BLACK'S LAW DICTIONARY 146 (8th ed. 2004). Absent Defendant's appearance at and participation in the Hearing, all facts in the complaint would be deemed admitted by Defendant's failure to file an answer or other response to the complaint. Legal conclusions arising from those facts, however, must still be determined by the Court.

"If the important issues were not actually litigated in the prior proceeding, as is the case with a default judgment, then collateral estoppel does not bar relitigation in the bankruptcy

¹Defendant stated at the Hearing that he was living with his parents at all times relevant to this case.

court." *Spilman v. Harley*, 656 F.2d 224, 228 (6th Cir. 1981). Since collateral estoppel does not preclude parties from raising issues that were not actually litigated in a prior case, where, as here, the default occurred in the case still pending before the Court, the parties are not foreclosed from litigating the legal issues.

In the same way that a state court default judgment does not have preclusive effect if the issues were not fairly litigated, the Order of Default here does not have any preclusive effect since Defendant appeared at the Hearing and participated therein. GMAC did not raise any objection to proceeding with the Hearing or complain that it was prejudiced in any way or unprepared to go forward based upon Defendant's appearance at the Hearing. Indeed, GMAC was prepared to present and actually presented evidence not only of damages, but also regarding elements of the two causes of action set forth in the complaint.

In *Valley Oak Credit Union v. Villegas (In re Villegas)*, 132 B.R. 742 (9th Cir. B.A.P. 1991), the bankruptcy court was presented with a similar - although not identical - situation. In *Villegas*, plaintiff credit card company filed a complaint objecting to discharge of the debtors. The *pro se* debtors did not file an answer. At the first hearing on the complaint, the court entered a default against the debtors although the debtor-wife was present. The hearing was continued to a date when the court would take testimony as to the "amount of elements of the § 727 complaint." *Id.* at 743. Prior to the scheduled evidentiary hearing, the credit card company filed a motion for judgment on the pleadings. As a consequence, the original evidentiary hearing was continued for

three weeks. Both of the debtors appeared at the rescheduled hearing in response to subpoenas. The court conducted an examination of the debtors and the credit card company cross-examined them. The bankruptcy court took the matter under advisement on the condition that, if it denied plaintiff's motion for judgment on the pleadings, the credit card company would have the "right to request time to rebut, conduct discovery or amend the complaint." *Id.* at 744. The court filed an intended decision with findings of fact and conclusions of law.² The court denied the motion for judgment on the pleadings and objection to discharge and provided the plaintiff with fifteen days to file a motion to request leave to amend its complaint or to request additional time for discovery. The credit card company failed to file any motion and the court's intended judgment became a final judgment.

On appeal, the BAP affirmed, in part, and reversed, in part, the bankruptcy court's order. The BAP affirmed the court's denial of judgment on the pleadings because such motion is only available when the pleadings are closed and pleadings are not closed until an answer is filed.³ However, the BAP reversed the bankruptcy court's order on the basis that the credit card company was entitled to a full and fair trial on the allegations in its complaint.⁴ The BAP held that "[t]o enter such a judgment against the non-defaulting

²An intended decision appears to be a preview of the decision that the court intends to issue.

³The BAP stated that the motion for judgment on the pleadings was more properly treated as an application for default judgment pursuant to FED. R. CIV. P. 55, made applicable to bankruptcy proceedings by FED. R. BANKR. P. 7055.

⁴The BAP noted that the "bankruptcy court entered a default against the [debtors] at the April 30, 1990 hearing on [plaintiff's] complaint. The court made it clear at that hearing that testimony would then be taken for entry of a default judgment." *Id.* at 745.

party because of the failure of that party to sustain its burden of proof would make the hearing under Rule 55(b)(2) the same as a trial on the merits. In this regard, the appellants were, in essence, forced to trial without having the benefit of the procedural protection offered by the Federal Rules of Civil Procedure, including the opportunity to conduct discovery in accordance with these rules." *Id.* at 746-47.

Although similar, the instant case is distinguishable from the *Villegas* case in several respects. In *Villegas*, the credit card company was not prepared to go forward at the hearing first scheduled following entry of default because it assumed that a default judgment would be entered on the basis that the complaint had not been contested. The BAP noted that "entry of default does not automatically entitle the non-defaulting party to entry of a default judgment regardless of the fact that the effect of entry of a default is to deem allegations admitted." *Id.* at 746.

Here, the Court previously entered an Order of Default, as opposed to a mere entry of default. The result of the Order of Default is that the specific factual allegations in GMAC's complaint are deemed admitted; however, there were no facts in the complaint to establish the amount of damages, if any, to which GMAC would be entitled. As a result of Defendant's appearance at the Hearing, the Court, in essence, conducted the Hearing as if it were a trial on the merits. GMAC did not complain that it was not prepared to go forward in light of Defendant's appearance. Nor did GMAC request additional time to conduct discovery or otherwise prepare. To the contrary, GMAC asserted that it was ready to present its evidence and seemed fully prepared to proceed with all

issues. Having not made any findings of fact with respect to the Order of Default, the Court permitted GMAC to question its witness, Anthony C. Zimmer, regarding both bases for the nondischargeability complaint, *i.e.*, 11 U.S.C. § 523(a)(4) and (6). The procedural effect of the Order of Default is that, unless Defendant presented evidence at the Hearing to contradict a specific fact in GMAC's complaint, this Court finds that the facts as pled are sufficient for GMAC to carry its burden of proof - even in the absence of any affirmative evidence in support of a fact. However, because only the factual allegations in the complaint are deemed admitted, application of the law to such facts is still within the province of this Court.

Last, as will be discussed, *infra*, this opinion is limited to the nondischargeability of the debt based on the Guaranty signed by Defendant. To the extent GMAC's complaint attempts to assert that all or part of the debt owed by Mountain Chevrolet Buick, Inc. ("Mountain Chevrolet" or "Dealership") to GMAC is nondischargeable based upon Defendant's conduct, such cause of action cannot be properly litigated in this adversary proceeding because: (i) such cause of action belongs solely to the Chapter 7 Trustee of Mountain Chevrolet, and (ii) neither Mountain Chevrolet nor its Chapter 7 Trustee are parties herein.

II. Facts

At the Hearing, the Court received testimony of (i) Zimmer, who was employed by GMAC as a loan specialist at all times relevant to the complaint, and (ii) Defendant. The following facts are taken from the testimony at the Hearing and the complaint.

Defendant was the President and majority owner of Mountain Chevrolet, an automobile dealership doing business at 415 E. Sixth Street, East Liverpool, Ohio. On October 4, 2002, Defendant executed an unconditional guaranty in favor of GMAC ("Guaranty") for "the payment of all indebtedness of [Mountain Chevrolet] to GMAC . . . together with all costs, expenses or attorney's fees incurred by GMAC in connection with any default of [Mountain Chevrolet]." (Guaranty dated October 4, 2002, Ex. 3, unnumbered ¶ 1.)

On October 10, 2002, Mountain Chevrolet executed a Wholesale Security Agreement which provides that, in exchange for GMAC's financing of vehicle inventory, Mountain Chevrolet would provide GMAC with a security interest in the vehicle inventory:

The collateral subject to this Wholesale Security Agreement is new vehicles held for sale or lease and used vehicles acquired from manufacturers or distributors and held for sale or lease, and all vehicles of like kinds or types now owned or hereafter acquired from manufacturers, distributors or sellers by way of replacement, substitution, addition or otherwise, and all additions and accessions thereto and all proceeds of such vehicles, including insurance proceeds.

(Wholesale Security Agreement dated October 10, 2002, Ex. 1, unnumbered ¶ 4). Zimmer testified that he was the loan specialist who prepared and executed GMAC's wholesale floor plan arrangement with Mountain Chevrolet.

Pursuant to the Wholesale Security Agreement, the parties agreed that Mountain Chevrolet "may sell and lease the vehicles at retail in the ordinary course of business" and that, upon sale of a vehicle, Mountain Chevrolet would "faithfully and promptly remit to [GMAC] the amount [GMAC] advanced or have become obligated to

advance on [Mountain Chevrolet's] behalf to the manufacturer, distributor or seller[.]” (*Id.*, unnumbered ¶ 7.)

Zimmer testified that the Dealership had a two-day grace period following the sale of a vehicle to complete the necessary paperwork, but that Mountain Chevrolet's failure to remit payment on a vehicle within the grace period would place the Dealership "out of trust" with GMAC pursuant to the Wholesale Security Agreement.

GMAC conducted periodic audits in order to determine whether Mountain Chevrolet was in compliance with the terms of the Wholesale Security Agreement. In the course of an audit, GMAC employees reviewed Mountain Chevrolet's "dealer jackets," which contained documents memorializing the sale of each vehicle, including a cover sheet summarizing the transaction and a copy of the retail sales agreement.

On March 3, 2005, Mountain Chevrolet executed a General Security Agreement in favor of GMAC pursuant to which Mountain Chevrolet granted a security interest to GMAC in the following property:

any and all of the following described property in which [Mountain Chevrolet] now or hereafter acquires an interest, wherever located, in whatever form, and in any and all proceeds thereof: inventory, equipment, fixtures, accounts receivable, contract rights, securities, cash, general intangibles, documents, instruments, chattel paper; investment property and commercial tort claims.

(General Security Agreement dated March 3, 2005, Ex. 2, unnumbered ¶ 1.)

Beginning in late December 2005 and continuing throughout January 2006, Mountain Chevrolet transferred 131 vehicles without forwarding to GMAC any of the amounts due and owing under the

Wholesale Security Agreement. GMAC contends that the transferees fall into the following categories: (i) family, (ii) insiders/employees, (iii) affiliated companies, (iv) corporate insiders, (v) bulk wholesale, (vi) dealer trades, and (vii) retail. (Vehicle Chart, Ex. 5, pp. 1-5.)⁵

Because the transfers in the first two categories garnered the lion's share of the testimony regarding the vehicle transfers, they are set forth in their entirety below:

Family:

Vehicle	Transferee	Amount Owed to GMAC	Amount Paid
2006 Silverado	Cleo and Cassandra Cline	35,222.98	0
2006 Lucerne	Floyd and Cassandra Cline	36,653.58	0
2006 Rendezvous	Kimberly Cline	32,220.73	0
2006 Tahoe	Leigh Cline	42,536.73	0
2005 Terraza	Leigh Cline	30,539.85	0
2004 Silverado	Floyd Cline, II	21,315.00	26,995.00

⁵The Court's use of GMAC's categories and terms is solely for the purpose of clarity and does not constitute legal findings regarding the nature of the transferees or the transactions.

Insiders/Employees:

2006 Silverado	Charles George	30,395.08	0
2006 K1500	Charles George	44,287.48	0
2006 Lacrosse	Heidi Hoyt	24,912.98	0
2006 Trailblazer	Kathy Osborne	34,128.43	0
2006 Silverado	Peter George	32,894.67	20,000.00
2006 Silverado	Terry Byerly	32,584.85	32,201.00
2005 Rendezvous	William McHenry	31,640.55	32,980.00

Although Defendant initially testified that all of the transfers in the family and insiders/employees categories were made to satisfy Dealership debts, GMAC produced several promissory notes executed by Defendant in his individual capacity.

Adding to the confusion is the fact that, throughout Defendant's testimony, he used the words "we" and "us" and it was not clear whether he was referring to: (i) himself and his brother, Floyd Cline II, who was a 40% shareholder of Mountain Chevrolet, (ii) himself personally, or (iii) the Dealership. For instance, Defendant stated that "We had a lot of people who loaned us money when the embezzlement occurred to keep the [Dealership] open."⁶ Moreover, when GMAC's counsel inquired as to why one of the promissory notes, which Defendant testified was for a corporate debt, did not bear Mountain Chevrolet's name, Defendant responded, "All the moneys received and stuff, proceeds, were deposited into the [Dealership]. It doesn't state Mountain Chevrolet's name on it, it says my name, which is the same thing, to me anyway." Based

⁶Defendant testified that he discovered that an employee was embezzling money from the Dealership in late 2002, which circumstances are unrelated to the causes of action before the Court in this adversary proceeding.

upon Defendant's failure to distinguish his personal debts from Mountain Chevrolet's corporate debts, the Court must closely examine the testimony and exhibits to determine the nature of the debts satisfied by the transfers at issue in this case.

At the Hearing, Defendant stated the transfers to his parents, Floyd and Cleo Cline, and his sister, Cassandra Cline,⁷ were made in satisfaction of preexisting debts owed to his parents. However, Zimmer testified that the dealer jackets indicate that Defendant's parents paid cash on delivery for the vehicles. When GMAC's counsel asked Defendant to explain the misrepresentation, he testified that "the moneys [sic] was already received when we got the store. We agreed with my parents to pay them back, I agreed to pay them back over the course of time." When GMAC's counsel asked Defendant whether a loan agreement or promissory note exists memorializing his parents' loan, he responded "no" explaining that his word was his bond with his parents.

Although Defendant's testimony is ambiguous with respect to the nature of the debt satisfied by the transfers to his parents, it can be inferred from his testimony regarding his personal debt to his aunt and uncle, Barbara and Harlan Wolfe, discussed *infra*, that the loan from his parents was a personal loan. Defendant testified that the Wolfes, like his parents, provided the loan "at the beginning of the Dealership." Because the loan was executed in the early stages of the operation of Mountain Chevrolet, the Court finds that the loan was more likely than not a personal loan to Defendant. This conclusion is supported by the lack of any

⁷Based upon GMAC's inquiries, it appears that the vehicles were initially transferred to Defendant's parents, then transferred by his parents to Cassandra as gifts or her "inheritance."

documentation of the loan. Although there was no testimony establishing the amount of the loan from Defendant's parents, Defendant transferred two vehicles to his parents valued at over \$70,000.00.

Defendant conceded the transfers to Leigh Cline, his ex-wife, were made in lieu of spousal support. The retail sales agreements for the vehicle transfers to Leigh Cline, which were both signed by Defendant, misrepresented that Leigh Cline had paid cash on delivery for the two vehicles. (Leigh Cline Dealer Jackets, Exs. 7 and 8, p. 2.)

GMAC conceded that the transfer to Defendant's brother, Floyd Cline II, was made for value, and the vehicle that was transferred to Defendant's sister-in-law, Kimberly Cline, was ultimately returned to GMAC.

Accordingly, with respect to the transfers in the family category, the Court finds that the vehicle transfers to Floyd Cline, Cleo Cline, and Leigh Cline were made in satisfaction of Defendant's personal debts.

Defendant characterized all of the transfers in the insiders/employees category as repayment of corporate debts. Defendant stated that Charles George and Heidi Hoyt accepted vehicles as payment for accounting services rendered for the benefit of Mountain Chevrolet.⁸ Heidi Hoyt's dealer jacket misrepresented that she paid cash on delivery for the vehicle. (Heidi Hoyt Dealer Jacket, Ex. 9, p. 2.)

Defendant testified that Kathy Osborne accepted a vehicle as payment for money loaned to the Dealership, although he conceded

⁸Defendant testified that Mountain Chevrolet owed \$98,000.00 to Packer Thomas (Charles George's accounting firm) and \$25,000.00 to Heidi Hoyt.

that she had made personal loans to him as well, and that he still owes Osborne between \$60,000.00 and \$70,000.00 on the personal obligations.⁹ The only documents before the Court are two promissory notes executed by Defendant in his individual capacity in favor of Osborne for loans in the amounts of (i) \$35,000.00 (Loan Agreement dated January 11, 2005, Ex. 15) and (ii) \$75,000.00. (Loan Agreement dated June 16, 2005, Ex. 16.)¹⁰

The only testimony regarding the transfer to Peter George was provided by Zimmer, who stated that George paid \$20,000.00 for a vehicle but was also given a credit for services provided to Mountain Chevrolet. Zimmer testified that, at Peter George's deposition, George admitted that he had never performed any work for the Dealership.¹¹ There was no testimony that the credit given to George was based upon an antecedent debt owed by either Defendant or Mountain Chevrolet.

GMAC conceded that the remaining transferees in the insiders/employees category, i.e., Terry Byerly and William McHenry, were employees of Mountain Chevrolet who gave value for the vehicles.

Consequently, with respect to the transfers in the insiders/employees category, the Court finds that the vehicle transfer to Osborne was made in satisfaction of Defendant's personal debts.

⁹Defendant represented that the personal loans made by Osborne were intended to facilitate Defendant's investment in a Chevrolet Crosslander franchise.

¹⁰Defendant stated that he believed the loan proceeds from the Osborne loans were invested in Mountain Used Car Outlet.

¹¹The Court recognizes the hearsay nature of this testimony. Defendant raised no objection to the testimony and offered no contradictory testimony on this issue.

Defendant testified that the transfers to Newell Central Service in the corporate insiders category were in satisfaction of a loan made to Mountain Chevrolet by Basil Mangano. A notation on a Wholesale Sales Order confirms that the vehicles transferred to Newell Central Service were "exchanged for money loaned on 8/31/2005," (Wholesale Sales Order, Ex. 10), but does not reveal whether the loan was a personal loan or a corporate loan.

Defendant explained that the remainder of the transfers in the affiliated companies, corporate insiders, bulk wholesales, and dealer trade categories were made in the ordinary course of business. Defendant stated GMAC was acutely aware of his business practices as many of those practices were necessitated by GMAC's demands regarding the Dealership's liquidity. He explained that Mountain Chevrolet had historically sold more cars wholesale than retail, stating that (i) the Dealership had wholesaled cars to Scott Fuller/Fuller Auto Sales from "Day One in 2002;" and (ii) why would he go to auction for Mountain Used Car Outlet when he could purchase used cars from Mountain Chevrolet.

Defendant testified that the transfers to Fuller Auto Sales were in satisfaction of a loan to the Dealership. However, the six vehicles transferred to Mountain Used Car Outlet were transferred for only \$9,500.00, whereas Mountain Chevrolet owed GMAC \$68,756.25 for those vehicles.¹² Similarly, in the bulk wholesale category, Mountain Chevrolet accepted \$508,000.00 for vehicles for which it owed GMAC \$567,738.75. The vehicles in the dealer trade category were transferred in exchange for \$744,227.00, while Mountain

¹²Defendant testified that, at the time the vehicles transferred to Mountain Used Car Outlet, he believed that the floor plan financing amounts had been paid to GMAC.

Chevrolet owed GMAC \$762,779.22 for those vehicles. There was no evidence from any source concerning whether any of the foregoing transfers were made to satisfy any preexisting debt - to either the Dealership or to Defendant personally.

The eight vehicles listed in the retail category were sold to customers of Mountain Chevrolet, none of whom appear to have any relationship with the Dealership or the Defendant. GMAC conceded that the transfers in the retail category were transfers in the ordinary course of business.

The transfer of the 131 vehicles are not the only transfers at issue in this case. Between January 3, 2005 and January 11, 2005, several checks were drawn on Mountain Chevrolet's account, by either Dealership check or cashier's check, to various payees:

Transferee	Relationship to Defendant	Date of Payment	Amounts
Gary Coleman	Used Car Manager, Mountain Chevrolet	January 3	25,000.00
Kathy Osborne	Friend	January 10	50,000.00
Carl Calhoun	Friend	January 10	29,000.00
Terry & Cheryl Byerly	Sales Manager, Mountain Chevrolet and his wife	January 10	50,000.00 45,341.06 40,247.64 28,435.67
William McHenry	Service Manager	January 10	25,000.00
Barbara Wolfe	Aunt	January 11	72,000.00
Floyd Cline, II	Brother	January 10	11,939.60 12,420.89 9,094.72 21,000.00 26,744.79 12,800.00 11,000.00

(Proceeds Chart, Ex. 6.)

GMAC produced three investment agreements executed by Defendant on behalf of Mountain Chevrolet that established three of the payments listed above were made to satisfy corporate debts as follows: (i) Gary and Sherry Coleman ("the Colemans") for a loan in the amount \$25,000.00 (Investment Agreement dated January 25, 2005, Ex. 18); (ii) Terry and Cheryl Byerly ("the Byerlys") for a loan in the amount of \$50,000.00 (Investment Agreement dated January 25, 2005, Ex. 19); and (iii) William and Lisa McHenry ("the McHenrys") for a loan in the amount of \$25,000.00 (Investment Agreement dated March 29, 2005, Ex. 20). Defendant testified that when he paid the first investors in full, the other investors demanded payment in full as well.

Although Defendant issued checks in the precise amounts owed to the Colemans and the McHenrys by Mountain Chevrolet pursuant to their Investment Agreements, Defendant transferred \$114,024.37 over and above the amount owed to the Byerlys by Mountain Chevrolet under their Investment Agreement. Because the Byerlys executed an Investment Agreement to document the \$50,000.00 loan to Mountain Chevrolet, the Court finds that the remainder of the transfers were made to satisfy Defendant's personal obligations to the Byerlys.

In response to an inquiry by the Court, Defendant testified that Calhoun made a loan to the Dealership. However, Zimmer testified that the payments made to Osborne and Calhoun were made to satisfy Defendant's personal obligations. Based upon Defendant's admitted difficulty distinguishing his personal debts from the debts of the Dealership, the Court credits Zimmer's testimony with respect to the Calhoun transfer.

In addition to the promissory notes to Osborne that Defendant signed in his individual capacity, GMAC produced a promissory note signed by Defendant individually to Harlan and Barbara Wolfe for a loan in the amount of \$50,000.00 (Promissory Note dated June 7, 2002, Ex. 17). Therefore, the Court finds that the transfers to the Byerlys (less the \$50,000.00 subject to the Investment Agreement), Osborne, Calhoun, and Wolfe were made in satisfaction of Defendant's personal debts.

There was no specific testimony regarding the numerous transfers to Defendant's brother, Floyd Cline, II. However, Defendant testified that his brother loaned \$150,000.00 to the Dealership. The transfers to Floyd Cline, II total \$105,000.00.

At the Hearing, Defendant explained that he was engaged in negotiations for a \$1.9 million dollar loan for Mountain Chevrolet in late 2005. He stated that an announcement in November 2005 by General Motors of a possible bankruptcy dramatically devalued the Dealership in the eyes of the lender. Defendant further stated that he made the transfers at issue in this case in order to consolidate Mountain Chevrolet's debts, and that he intended to pay the floor plan financing to GMAC with the loan proceeds. However, according to Defendant's testimony, the loan never materialized.

Mountain Chevrolet filed a chapter 11 petition on February 27, 2006; by Order dated July 6, 2006, the case was converted to a case under chapter 7. On December 20, 2006, GMAC filed a proof of claim in the Mountain Chevrolet case in the amount of \$2,486,699.77. (Proof of Claim dated December 20, 2006, Ex. 12.) Defendant filed his chapter 7 petition on April 17, 2006. In Schedule F, Defendant lists GMAC as the holder of an unsecured nonpriority claim in the

amount of \$2,400,000.00. Because GMAC did not file a proof of claim in Defendant's case, the scheduled claim stands.

Based upon the Guaranty, GMAC alleges that the debt it is owed by Mountain Chevrolet in the amount of \$2,486,996.77, which resulted from the alleged conversion of GMAC's collateral in the 131 transferred vehicles and the subsequent transfer of GMAC's proceeds, is nondischargeable pursuant to 11 U.S.C. §§ 523(a)(4) and (6).

III. Law

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 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. § 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 fraud . . . while acting in a fiduciary capacity, embezzlement, or larceny." 11 U.S.C. § 523(a)(4)(West 2006).

To satisfy section 523(a)(4) in the context of fraud, the debtor must hold funds in trust for a third party pursuant to an express or technical trust. *Commonwealth Land Title Co. V. Blaszk (In re Blaszk)*, 397 F.3d 386, 391 (6th Cir. 2005) (*citing Davis v. Aetna Acceptance Co.*, 293 U.S. 328, 333, 55 S.Ct. 151, 79 L.Ed. 393

(1934)). Because GMAC failed to establish the existence of an express or technical trust in this case, the Court will limit its analysis to the allegations of embezzlement and larceny.

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 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.

Larceny is distinguishable from embezzlement in that the original taking must have been unlawful. 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, 166 (Bankr. N.D. Ohio 2003).

B. § 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 (West 2006).

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 injury for the purposes of satisfying section 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 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 section 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.

IV. Analysis

To except a debt owed by Mountain Chevrolet to GMAC from discharge in Defendant's bankruptcy case, GMAC must first establish that Defendant can be held personally liable for the debts of Mountain Chevrolet. *Cash America v. Fox (In re Fox)*, __ B.R. __, 2007 WL 1693036 *5 (6th Cir. B.A.P. 2007). Here, GMAC relies exclusively upon the Guaranty to establish Defendant's personal liability for the debt of Mountain Chevrolet.

At the Hearing, GMAC argued that Defendant, acting individually and on behalf of Mountain Chevrolet, converted GMAC's collateral and proceeds, which constitutes (i) embezzlement or larceny, and (ii) willful and malicious injury to GMAC's property. As a consequence, GMAC contends that the corporate debt that resulted from the alleged conversion of GMAC's collateral and proceeds is nondischargeable in Defendant's bankruptcy case based upon the Guaranty. More succinctly, GMAC asserts that the debt resulting from Defendant's guarantor liability is nondischargeable based upon Defendant's allegedly tortious conduct while acting both individually and on behalf of Mountain Chevrolet.

Despite arguing that the entire debt owed by Mountain Chevrolet to GMAC is nondischargeable in Defendant's bankruptcy case, GMAC appears to recognize the fundamental distinction between the transfers made by Defendant as a representative of Mountain Chevrolet versus the transfers made by Defendant in his individual capacity. GMAC argues that Defendant has committed both embezzlement and larceny, that is, embezzlement when he was acting

on behalf of Mountain Chevrolet and larceny when he was acting in his individual capacity. However, GMAC fails to recognize that, to the extent Defendant was acting as a representative of Mountain Chevrolet when he made the transfers, his actions, at most, constitute breaches of the Wholesale Security Agreement and the General Security Agreement.

Ohio courts have consistently held that a cause of action cannot be classified as both breach of contract and a tort. Specifically, "[w]here the duty allegedly breached by the defendant is one that arises out of a contract, independent of any duty imposed by law, the cause of action is one of contract." *Schwartz v. Bank One*, 84 Ohio App.3d 806, 810, 619 N.E.2d 10 (1992). Even if the acts alleged would be tortious conduct under non-contractual circumstances, those acts do not convert a breach of contract into a tort. "It is not a tort to breach a contract, no matter how willful or malicious the breach." *Salvation Army v. Blue Cross and Blue Shield*, 92 Ohio App.3d 571, 578, 636 N.E.2d 399 (1993).

In an effort to establish willfulness and malice, GMAC argued at the Hearing that Defendant knew of Mountain Chevrolet's obligations, he knew what he was doing was wrong, and he did it anyway. However, the foregoing argument ignores the contractual nature of Mountain Chevrolet's debt. Mountain Chevrolet was contractually obligated to sell vehicles in the ordinary course of business pursuant to the Wholesale Security Agreement. Mountain Chevrolet was contractually obligated to remit GMAC's advances pursuant to the Wholesale Security Agreement. Accordingly, the damages asserted by GMAC from Mountain Chevrolet's transfer of the 131 vehicles are the result of Mountain Chevrolet's breach of the

Wholesale Security Agreement. See *Bd. Of Trustees of the Ohio Carpenters' Pension Fund v. Bucci (In re Bucci)*, __ F.3d __, 2007 WL 1891736, *7 (6th Cir. (Ohio))("A breach on contract without more is not embezzlement").

The same is true with respect to the transfer of GMAC's proceeds. The General Security Agreement prohibits Mountain Chevrolet from "sell[ing], transfer[ing], or otherwise dispos[ing] of any Collateral other than in the ordinary course of [Mountain Chevrolet's] business" without GMAC's written consent, (Ex. 2, unnumbered ¶ 3.) Consequently, Defendant's actions in transferring the proceeds, to the extent that he was acting on behalf of Mountain Chevrolet, constitute a breach of the General Security Agreement.

GMAC essentially concedes that the corporate debt guaranteed by Defendant is premised upon breach of contract, because GMAC's damage calculation makes no distinction between the vehicles that were transferred to satisfy Defendant's personal debts and the vehicles that were transferred to satisfy Mountain Chevrolet's debts. In other words, GMAC's damage calculation is not predicated solely upon the allegedly tortious transfers, but, instead, upon all of the transfers for which Mountain Chevrolet failed to forward the amounts due and owing to GMAC under the Wholesale Security Agreement.¹³

By its own admission, GMAC acknowledges that at least part of the debt it asserts is a result of pure breach of contract on the part of Mountain Chevrolet. GMAC concedes that the eight transfers it characterized as "retail" were to buyers in the ordinary course

¹³Exhibit 5 is captioned, "131 Vehicles Transferred Without Payment to GMAC".

of business. Mountain Chevrolet's failure to pay GMAC for at least these eight vehicles can be nothing more than breach of contract.

Defendant testified that, in the ordinary course of business, Mountain Chevrolet transferred vehicles in bulk. This testimony was uncontroverted. As a consequence, the transfers categorized by GMAC as "corporate insiders," "bulk sales," and "affiliated company" are, according to Defendant, normal and ordinary for Mountain Chevrolet. GMAC pointed out the following portion of the Wholesale Security Agreement (Ex. 1) to argue that the vehicles could only be transferred at retail rather than in bulk sales. "[Mountain Chevrolet] understand[s] that we may sell and lease the vehicles at retail in the ordinary course of business." (Ex. 1, unnumbered ¶ 7.) This language, however, does not limit Mountain Chevrolet to leasing and selling vehicles only "at retail." The General Security Agreement (Ex. 2) provides support for Defendant's testimony that Mountain Chevrolet sold vehicles on a wholesale basis in the ordinary course of business. "Unless GMAC provides written consent, [Mountain Chevrolet] must not sell, transfer or otherwise dispose of any Collateral other than in the ordinary course of [Mountain Chevrolet's] business. (Ex. 2, unnumbered ¶ 3.) This language appears to contemplate more than retail sales as part of Mountain Chevrolet's ordinary course of business.

As a consequence, since the transfers categorized as "affiliated company," "corporate insider," and "bulk wholesale" appear to be within the ordinary course of business for Mountain Chevrolet, the damages arising from Mountain Chevrolet's failure to remit monies to GMAC for these transfers constitute breach of contract rather than fraud, embezzlement, larceny, or willful and

malicious injury. Accordingly, the Court rejects GMAC attempts to bootstrap a simple breach of contract claim for these damages into a tort claim.

On the other hand, the vehicle transfers that Defendant made to benefit himself personally, i.e., transfers made to satisfy his personal debts, do not constitute a breach of the Wholesale Security Agreement or the General Security Agreement.

Although Defendant signed the Wholesale Security Agreement and the General Security Agreement as a representative of Mountain Chevrolet, he did not bind himself personally. Accordingly, his "duty" with respect to GMAC's security interest in the vehicles and the proceeds did not arise out of contract, but was imposed by law.

Defendant, under the guise of acting on behalf of Mountain Chevrolet, fraudulently and wrongfully took GMAC's collateral with the intent of converting that collateral to his own use. Defendant attempted to conceal his acts from GMAC by misrepresenting that Mountain Chevrolet received cash on delivery for a number of the vehicle transfers. Therefore, when Defendant transferred vehicles and proceeds that were subject to GMAC's security interest to satisfy his personal debts, he committed larceny.

GMAC has proved by a preponderance of the evidence that the transfers to Floyd and Cassandra Cline, Cleo Cline and Cassandra Cline, Leigh Cline, Osborne, Calhoun, and Wolfe were made in satisfaction of Defendant's personal obligations. Because GMAC has the burden of proof in this case and has provided no testimony or documentary evidence regarding the other transfers in this case, the Court finds that the remaining transfers were made by Defendant

in satisfaction of Dealership debts, and, therefore, are dischargeable.

Finally, GMAC supplied no evidence that Defendant caused malicious and willful injury to it by virtue of the transfers. The only testimony in this regard was from Zimmer, who testified that GMAC was injured because it no longer had the collateral or the proceeds of the collateral and it was not paid for the vehicles. There is no evidence¹⁴ before the Court that Defendant intended to harm GMAC or that he knew an injury to GMAC was substantially certain to result from his actions. Although GMAC proved Defendant's fraudulent intent in secreting the nature of the transfers at issue in this case, Defendant's testimony that he intended to pay the floor plan financing with the loan proceeds directly contradicts GMAC's § 523(a)(6) claim.

V. Conclusion

GMAC demonstrated that Mountain Chevrolet owes it a debt in the approximate amount of \$2.4 million. GMAC also established that Defendant is liable to GMAC on the Guaranty for an amount equal to the amount of Mountain Chevrolet's debt to GMAC. GMAC premised its argument in favor of nondischargeability on Defendant's decision to pay the loans of family, friends, and employees before paying GMAC. However, to the extent that Defendant was acting on behalf of Mountain Chevrolet in satisfying corporate debts, Defendant's actions merely constitute a breach of contract, regardless of the willful and/or malicious nature of the breach.

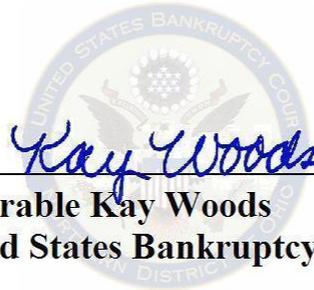
¹⁴The complaint alleges no facts to substantiate malice and intent. Paragraph 21 of the complaint states that Defendant "willfully and maliciously diverted GMAC's collateral[.]" Paragraph 27 of the complaint states, "[Defendant's] conduct in this regard had been malicious, deliberate, gross, and egregious." These are the only two references to "malice" in the complaint - both of which are conclusions of law rather than factual allegations.

On the other hand, to the extent that Defendant was acting individually, that is, transferring GMAC's collateral and proceeds in satisfaction of his personal debts, he has committed larceny. Accordingly, the amount of Defendant's debt that is nondischargeable is \$444,105.94, pursuant to 11 U.S.C. § 523(a)(4).

An appropriate order will follow.

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IT IS SO ORDERED.



Dated: July 24, 2007
09:59:44 AM

Honorable Kay Woods
United States Bankruptcy Judge

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF OHIO

IN RE:

CLAYTON D. CLINE,
Debtor.

CASE NUMBER 06-40484

GENERAL MOTORS ACCEPTANCE
CORPORATION,

Plaintiff,

ADVERSARY NUMBER 06-4141

vs.

CLAYTON D. CLINE,

Defendant.

THE HONORABLE KAY WOODS

O R D E R

For the reasons stated in the Memorandum Opinion entered on this date, the Court finds that, to the extent that Defendant transferred GMAC's collateral and proceeds in satisfaction of his personal debts, he committed larceny. Accordingly, the amount of

Defendant's debt that is nondischargeable is \$444,105.94, pursuant to 11 U.S.C. § 523(a)(4).

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