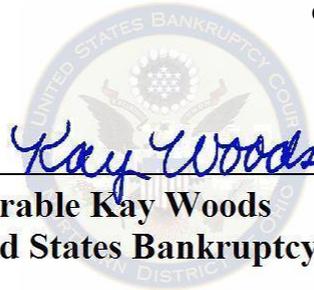


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CLERK U.S. BANKRUPTCY COURT
NORTHERN DISTRICT OF OHIO
YOUNGSTOWN

IT IS SO ORDERED.



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 REGARDING AMOUNT
OF NON-DISCHARGEABLE DEBT TO GMAC

The following Memorandum Opinion is not intended for national publication and carries limited precedential value. The availability of this Opinion by any source other than www.ohnbuscourts.gov is not the result of direct submission by this Court. The Opinion is available through electronic citation at

www.ohnb.uscourts.gov pursuant to the E-Government Act of 2002 (Pub. L. No. 107-347).

This matter is before this Court on remand from the United States District Court for the Northern District of Ohio ("District Court"). Plaintiff General Motors Acceptance Corporation ("GMAC") appealed this Court's July 24, 2007, Memorandum Opinion and Order (collectively, "Previous Opinion") (Doc. ## 22 and 23), which found a portion of the debt owed to GMAC by Defendant/Debtor Clayton D. Cline ("Debtor") in the amount of \$444,105.94 not to be dischargeable, pursuant to 11 U.S.C. § 523(a)(4). GMAC appealed only the Previous Opinion's finding that GMAC had not satisfied its burden of establishing that the remainder of the debt ("Debt")¹ to be non-dischargeable under 11 U.S.C. § 523(a)(4). The District Court's Memorandum Opinion and Order ("Appellate Opinion") (Doc. # 37) held that it was error to base the determination of dischargeability on whether Debtor's conduct in incurring the Debt was within the ordinary course of business. The District Court (i) found that, with respect to the Debt, GMAC had satisfied its burden under § 523(a)(4) regarding the first two elements of embezzlement; and (ii) remanded the matter for determination whether Debtor possessed the necessary intent to satisfy the third element of embezzlement.

GMAC waived the opportunity for an additional evidentiary hearing by filing, on October 17, 2008, Plaintiff GMAC's Motion to Cancel October 21, 2008 Hearing and Have the Court Decide the Remanded Issue on the Existing Record (Doc. # 43). Based on the

¹GMAC asserts that Debtor is liable to it in the total amount of \$2,486,996.77, leaving \$2,042,890.03 to be considered in this Opinion.

record before it, the Court finds that the entire Debt owed to GMAC is non-dischargeable.

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

Debtor filed his voluntary chapter 7 petition on April 17, 2006. Debtor listed GMAC on Schedule F as the holder of an unsecured nonpriority claim in the amount of \$2,400,000.00.

GMAC filed the above-captioned adversary case against Debtor on August 7, 2006. Service of the summons and complaint was perfected by certified mail on December 1, 2006. (Doc. # 12.) On January 16, 2007, GMAC filed Motion of Plaintiff GMAC for Default Judgment Against Defendant ("Motion for Default Judgment") (Doc. # 13), which requested (i) "an Order directing that all liability of [Debtor] to GMAC be declared nondischargeable, as being the product of fraud and/or misrepresentation under 11 U.S.C. § 523(a)(4)[;]"² and (ii) "a hearing to determine the amount of damages." (Mot. for Default J. at 5.) On February 26, 2007, this

²GMAC's Complaint alleges four causes of action: (i) impairment of security interest in collateral; (ii) conversion; (iii) fraud/misrepresentation; and (iv) violation of Ohio Fraudulent Transfer Act. GMAC asserted that the basis for each of the counts is §§ 523(a)(4) and/or (6). In the Motion for Default Judgment, however, GMAC alleged that it was entitled to default judgment only under 11 U.S.C. § 523(a)(4). The Court found in the Previous Opinion that GMAC had not alleged any facts - only legal conclusions - concerning malice on the part of Debtor, which is one of the elements of a cause of action under § 523(a)(6). GMAC did not appeal that part of the Previous Opinion.

Court entered Judgment Entry Granting Default Judgment Against Defendant Clayton D. Cline ("Order of Default") (Doc. # 16), based upon the failure of Debtor to answer, move or otherwise respond to the complaint or to respond to the Motion for Default Judgment. On April 25, 2007, the Court scheduled an evidentiary hearing ("Hearing") for June 13, 2007, to determine the amount of damages.

At the Hearing, Debtor appeared, *pro se*. GMAC appeared through counsel and stated that it was prepared to present evidence, through witness testimony and documents. Despite the Order of Default, Debtor was permitted to participate in the Hearing. At the Hearing, the Court received testimony of (i) Anthony C. Zimmer ("Zimmer"), who was employed by GMAC as a loan specialist at all times relevant to the complaint, and (ii) Debtor.

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

Effect of Failing to Deny. An allegation - other than one relating to the amount of damages - is admitted if a responsive pleading is required and the allegation is not denied. If a responsive pleading is not required, an allegation is considered denied or avoided.

FED. R. CIV. P. 8(d) (West 2008). Here, the result of the Order of Default is that the allegations in GMAC's complaint are deemed admitted. GMAC obtained a default judgment as to Debtor's liability prior to the Hearing, but there were no facts in the complaint to establish the amount of damages, if any, to which GMAC would be entitled. Therefore, for purposes of this Opinion, the

Court will consider Debtor's testimony only in regard to the amount of damages.³

II. Facts

The following facts are taken from the Complaint and the relevant testimony at the Hearing.

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

On October 10, 2002, Mountain executed a Wholesale Security Agreement⁵ which provided that, in exchange for GMAC's financing of vehicle inventory, Mountain would provide GMAC with a security interest in the vehicle inventory:

³The Court explained its position to Debtor before receiving any testimony at the Hearing, telling him that default liability had already been entered against him, so the Hearing only concerned the amount of damages. (Hearing Trans. at 9:56:26.)

⁴Mountain filed a chapter 11 petition (Case No. 06-40187) 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 case in the amount of \$2,486,699.77. (Pl. Ex. 12.) GMAC did not file an adversary proceeding in the Mountain bankruptcy case to determine the dischargeability of its debt.

⁵This type of agreement is generally known as a "floor plan" arrangement. On March 3, 2005, Mountain also executed a General Security Agreement in favor of GMAC pursuant to which Mountain granted a security interest to GMAC in "any and all of the following described property in which [Mountain] 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." (Pl. Ex. 2.)

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.

(Pl. Ex. 1.) Zimmer testified that he was the loan specialist who prepared and executed GMAC's wholesale floor plan arrangement with Mountain.

Pursuant to the Wholesale Security Agreement, the parties agreed that Mountain "may sell and lease the vehicles at retail in the ordinary course of business" and that, upon sale of a vehicle, Mountain would "faithfully and promptly remit to [GMAC] the amount [GMAC] advanced or have become obligated to advance on [Mountain's] behalf to the manufacturer, distributor or seller[.]" (*Id.* unnumbered ¶ 7.) Debtor conceded that, by late 2005, this meant Mountain had to remit the money owed to GMAC within 48 hours after the sale or lease of a vehicle. (Hearing Trans. at 11:24:33.)

GMAC conducted periodic audits in order to determine whether Mountain was in compliance with the terms of the Wholesale Security Agreement. In the course of an audit, GMAC employees reviewed Mountain'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.

Beginning in late December 2005 and continuing throughout January 2006, Mountain transferred 131 vehicles (collectively, "Vehicles") without forwarding to GMAC any of the amounts due and owing under the Wholesale Security Agreement. Most of the Vehicles

were transferred for less than their value to either (i) Debtor's family and friends, allegedly to settle antecedent debts⁶ (owed by either Mountain or Debtor, although Debtor testified that no written loan agreements existed for some of these loans)⁷ or (ii) other companies associated with Mountain. (Pl. Ex. 5.)

Specifically, Mountain transferred 13 of the Vehicles to Debtor's friends, employees, and/or family members for \$112,176.00 although Mountain owed GMAC \$429,332.91 for such Vehicles. (*Id.* at 1.) Although nine of the Vehicles were transferred without receipt of cash payment, Zimmer testified that the retail sales contracts for six of those Vehicles indicated that the transferee had paid cash at delivery. Debtor did not dispute Zimmer's testimony. GMAC introduced into evidence three of these contracts, which were all signed by Debtor. (Pl. Ex. 7-9.)

Defendant testified that the transfer of three Vehicles to Newell Central Services and 14 Vehicles to Fuller Auto Sales were also in satisfaction of loans. Mountain collected no cash for any of these transfers, although it owed GMAC \$380,376.82 for the transferred Vehicles. (Pl. Ex. 5 at 1-2.)

Eight of the Vehicles were sold to retail customers in the ordinary course of business for a total of \$179,145, but Mountain did not remit to GMAC the \$180,185.77 it owed for those Vehicles. (*Id.* at 5.)

⁶During a one-week period in early January 2006, Debtor also wrote 16 checks to seven friends or family members for a total amount of \$470,024.37. (Pl. Ex. 6.)

⁷For example, Debtor stated at the Hearing that the transfer of two Vehicles to his parents were made in satisfaction of preexisting debts owed to his parents. 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.

The rest of the Vehicles were transferred to other dealerships for less than market value. For example, six Vehicles were transferred to Mountain Used Car Outlet for \$9,500.00, although Debtor conceded Mountain owed GMAC \$68,756.25 for those Vehicles. (*Id.* at 1.) Similarly, Mountain accepted \$508,000.00 for "bulk wholesale" Vehicles for which it owed GMAC \$567,738.75. (*Id.* at 2-4.) Finally, the Vehicles which GMAC categorized as dealer trades were transferred in exchange for \$744,227.00, despite Mountain owing GMAC \$762,779.22 for those Vehicles. (*Id.* at 4-5.)

III. Analysis

A. Non-dischargeability under 11 U.S.C. 523(a)(4)

Section 523(a) provides several exceptions to the general rule that pre-petition debts are dischargeable under the Bankruptcy 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 (1991)). Exceptions to discharge are narrowly construed. *See Id.* (*citing Grogan*, 498 U.S. at 286-87).

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[,] . . . embezzlement, or larceny." 11 U.S.C. § 523(a)(4) (West 2008). The District Court expressly remanded this case for the limited purpose of completing an embezzlement analysis, so this Opinion will not review the elements of either fraud or larceny.

B. Embezzlement

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.

As set forth, above, the District Court held that GMAC satisfied the first two elements of embezzlement, *i.e.*, that (i) GMAC entrusted its property to Debtor, and (ii) Debtor appropriated the property. (App. Op. at 9 and 11.)

The third element of embezzlement is that "the circumstances indicate fraud." *Brady*, 101 F.3d at 1173. "The 'fraud' required under § 523(a)(4) is 'fraud in fact, involving moral turpitude or intentional wrong.' Accordingly, embezzlement claims under § 523(a)(4) require 'proof of the debtor's fraudulent intent in taking the [creditor's] property.'" *Cash Am. Fin. Servs., Inc. v. Fox (In re Fox)*, 370 B.R. 104, 116 (B.A.P. 6th Cir. 2007) (internal citations omitted). The intent required under § 523(a)(4) "is something less than the malicious intent requirement for conversion under 11 U.S.C. § 523(a)(6) since Congress chose to create an exception to discharge for embezzlement without the additional requirement of proof of malice."⁸ *Nat'l Bank of Commerce of Pine*

⁸The District Court noted this Court made a factual finding in the Previous Opinion that there was no evidence Debtor intended to harm GMAC. The District Court stated that this finding "would appear to be an obstacle to any finding that Cline possessed the requisite fraudulent intent for purposes of embezzlement. However since the finding was made with respect to the § 523(a)(6)

Bluff v. Hoffman (In re Hoffman), 70 B.R. 155, 163 (Bankr. W.D. Ark. 1986).

The debtor's fraudulent intent may be shown by circumstantial evidence. *In re Fox*, 370 B.R. at 116-117 ("[A] creditor may establish circumstances indicating a debtor's fraudulent intent, even if the debtor did not make a misrepresentation or misleading omission on which the creditor relied."). For example, in a case similar to the instant case, a debtor "sold the vehicles and pocketed the proceeds without remitting payment to plaintiff. This, along with the debtor's false representations to the plaintiff concerning reasons for delay in payment, g[ave] rise to an inference of fraudulent intent." *Hall v. Blanton (In re Blanton)*, 149 B.R. 393, 394-95 (Bankr. E.D. Va. 1992).

Here, there are four circumstances that indicate fraud. First, Debtor misrepresented "that he would (1) sell the Converted Vehicles in the ordinary course of business in accordance with the usual custom and practices in the industry; (2) remit to GMAC the amounts due and owing upon the sale of each vehicle; and (3) protect GMAC's collateral and its security interest in the collateral." (Compl. ¶¶ 37.) Instead, the Vehicles were transferred to either (i) Debtor's family and friends, allegedly to settle antecedent debts or (ii) other companies associated with Mountain, for far less than the value of the Vehicles. Just as in another dealership case, Debtor's "fraud was his representation, intention and conduct regarding compliance with the Floor Plan Agreements." *Universal Pontiac-Buick-GMC Truck, Inc. v. Routson (In*

analysis, rather than under the § 523(a)(4) embezzlement analysis," the District Court remanded the case for further proceedings. (App. Op. at 13.) As the *Hoffman* case demonstrates, the analysis under these two sections is different.

re Routson), 160 B.R. 595, 610 (Bankr. D. Minn. 1993) (Finding that the dealership-owning Debtor had embezzled funds due the manufacturer by depositing the sales proceeds in his personal account even though he had "every intention" of paying the manufacturer back.)

Second, as principal of Mountain, Debtor transferred all 131 Vehicles within an approximately four-week period preceding the month Mountain filed for bankruptcy, without paying GMAC a penny. Debtor's conduct is similar to that found to constitute embezzlement in *In re Blanton*, 149 B.R. 393 (debtor committed embezzlement by failing to remit proceeds from the sale of 21 vehicles).

Third, during the same time period, Debtor wrote checks worth a total of \$470,024.37 to repay loans from friends and family members, many of which Debtor admitted were not yet due and owing.⁹ (Hearing Trans. at 11:56:40-11:58:36.) This circumstance is similar to that in *Nat'l City Bank, v. Imbody (In re Imbody)*, 104 B.R. 830, 841 (Bankr. N.D. Ohio 1989), where the Court found a defaulted fully secured loan to be non-dischargeable under § 523(a)(4) in part because Debtors "made a deliberate decision to pay the I.R.S. instead of [Creditor]. Despite [Debtors'] knowledge

⁹This differentiates the instant case from *Florida Outdoor Equip. v. Tomlinson (In re Tomlinson)*, 220 B.R. 134, 136 (Bankr. M.D. Fla. 1998) where the court held that a defendant who failed to remit inventory proceeds did not demonstrate intent to embezzle because he used the funds for the survival of his corporation. However, other courts have found that Debtor's intention is irrelevant. See, e.g., *Peavy Elec. Corp. v. Sinchak (In re Sinchak)*, 109 B.R. 273, 277 (Bankr. N.D. Ohio 1990) ("Despite the fact that the Debtor may have deposited the proceeds of sale in a business bank account and used these funds for business purposes, that use, however well-intentioned, was without the consent of the Creditor.").

of [Creditor's] security interest in the proceeds, they used those funds to satisfy what they believed was their tax obligation." *Id.*

Finally, and most telling, many of the sales agreements for the Vehicles, "which were prepared by, on behalf of, or at the direction of Debtor, stated that cash was paid" for the Vehicles at the time of purchase, while in reality "those representations were intentionally false and misleading, and no money whatsoever was paid" for the Vehicles. (Compl. ¶ 13.) Falsification of documents is the final step in moving Debtor's actions from breach of contract into actual fraud. *See, e.g., Peavy Elec. Corp. v. Sinchak (In re Sinchak)*, 109 B.R. 273, 276 (Bankr. N.D. Ohio 1990) ("Embezzlement necessarily involves some form of fraud or deceit.").

Given the totality of the evidence, this Court finds that GMAC has proven the third element of embezzlement - Debtor's fraudulent intent regarding the transfers at issue. Debtor intended to deprive GMAC of its rightful property, whether permanently or temporarily. Even if Debtor intended to repay GMAC from another source of funding, this is no defense to the offense of embezzlement. *Hoffman*, 70 B.R. at 163-64. GMAC had a property right in the proceeds from the Vehicles and was not obliged to be paid from another source. *Id.* at 164. *See also, Routson*, 160 B.R. at 610.

This conclusion is in accordance with that reached by other courts in similar cases. *See, e.g., Ford Motor Credit Co. v. Marinko (In re Marinko)*, 148 B.R. 846 (Bankr. N.D. Ohio 1992) (Debt owed under floor plan financing arrangement was non-dischargeable under § 523(a)(4) where Debtor failed to remit sales proceeds and

engaged in deceitful conduct to mislead Creditor's auditors.). "Many courts hold that a debtor commits an embezzlement under section 523(a)(4) when the debtor sells mortgaged property and fails to remit the proceeds to a properly perfected, secured creditor[.]" *Jones v. Hall (In re Hall)*, 295 B.R. 877, 882 (Bankr. W.D. Ark. 2003) (citing *In re Blanton*, 149 B.R. 393, 394-95 (Bankr. E.D. Va. 1992); *In re Rebhan*, 45 B.R. 609, 614 (Bankr. S.D. Fla. 1985); *In re Freeman*, 30 B.R. 704, 708 (Bankr. W.D. La. 1983); *In re Beasley*, 62 B.R. 653, 655 (Bankr. W.D. Mo. 1986); *In re Routson*, 160 B.R. 595, 611 (Bankr. D. Minn. 1993) and *In re Marinko*, 148 B.R. at 850-51).

C. Damages

GMAC alleges that Mountain owes it \$2,486,996.77, which includes (i) \$2,356,948.99 for 130 transferred Vehicles (one transferred Vehicle having been recovered); (ii) \$89,970.74 for 13 Vehicles sold at auction; and (iii) \$55,571.29 in wholesale charges; less (iv) \$15,431.25 in funds recovered through settlement or by other means. (Pl. Ex. 12.) Based upon the Guaranty, GMAC asserts Debtor also owes it \$2,486,996.77. GMAC further asserts that the entire debt is non-dischargeable pursuant to 11 U.S.C. § 523(a)(4).

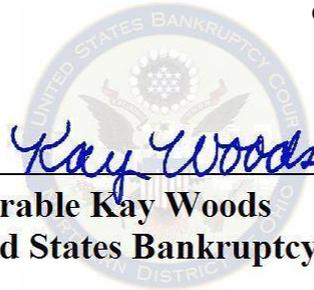
Debtor offered no evidence to contradict or dispute GMAC's claim of damages in the amount of \$2,486,996.77. Even when shown Plaintiff's Exhibit 12 at the hearing and asked if he had "any information or records to dispute GMAC's claim of damages in the amount of \$2,486,996.77," Debtor answered in the negative. (Trans. at 12:10:13.)

IV. Conclusion

GMAC demonstrated that Mountain owes it \$2,486,996.77. GMAC also established that, pursuant to the Guaranty, Debtor is liable to GMAC for an amount equal to the amount of Mountain's debt to GMAC. GMAC has established all elements under § 523(a)(4) that Debtor's debt to GMAC in the amount of \$2,486,996.77 is not dischargeable. The Previous Opinion held that a portion of the debt in the amount of \$444,105.94 was not dischargeable. By this Opinion, the Court finds that the remainder of the debt in the amount of \$2,042,890.83 is also not dischargeable. An appropriate order will follow.

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IT IS SO ORDERED.



Honorable Kay Woods
United States Bankruptcy Judge

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF OHIO

IN RE:	*	
	*	
CLAYTON D. CLINE,	*	
	*	CASE NUMBER 06-40484
Debtor.	*	
	*	

	*	
GENERAL MOTORS ACCEPTANCE	*	
CORPORATION,	*	
	*	ADVERSARY NUMBER 06-4141
Plaintiff,	*	
	*	
vs.	*	
	*	
CLAYTON D. CLINE,	*	
	*	THE HONORABLE KAY WOODS
Defendant.	*	
	*	

ORDER REGARDING AMOUNT OF NON-DISCHARGEABLE DEBT TO GMAC

For the reasons stated in the Memorandum Opinion entered on this date, the Court finds that GMAC has established all elements under § 523(a)(4) that Debtor's debt to GMAC is not dischargeable. Accordingly, Debtor's debt to GMAC in the amount of \$2,486,996.77

is not dischargeable. The Court's Order of July 24, 2007, held that a portion of the debt in the amount of \$444,105.94 was not dischargeable. By this Order, the Court holds that the remainder of the debt in the amount of \$2,042,890.83 is also not dischargeable.

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