UNITED STATES BANKRUPTCY COURT
MIDDLE DISTRICT OF ALABAMA

In re

BILLY J. MORGAN,

Debtor.

Case No. 03-80369-DHW
Chapter 7

THE FINANCIAL STORE, INC.,

Plaintiff,

v.

BILLY J. MORGAN,

Defendant.

Adv. Proc. No. 03-8017-DHW

OPINION

The Financial Store, Inc. commenced this adversary proceeding to determine the dischargeability of its claim against the debtor, Billy J. Morgan, under 11 U.S.C. § 523(a)(4) and (6). A trial was held on February 4, 2004 at which Mark D. Owsley represented the plaintiff, and Charles G. Reynolds, Jr. represented the debtor/defendant.

JURISDICTION

The court's jurisdiction in this proceeding stems from 28 U.S.C. § 1334 and from the general order of the United States District Court for the Middle District of Alabama referring title 11 matters to the United States Bankruptcy Court. Further, because this is a core proceeding under 28 U.S.C. § 157(b)(2)(I), this court's jurisdiction extends to the entry of a final order or judgment.

FINDINGS OF FACT

Billy J. Morgan had a series of at least four loans with the Financial Store beginning in late 1999 and concluding in the summer of 2002.[1] His involvement in each of these transactions, however, was limited to signing the required documents. Dena Morgan, Billy J. Morgan's then spouse, handled most of the family's financial affairs, and it was she who initiated the contacts with and provided information to the Financial Store concerning each of Billy J. Morgan's loans.[2] In each instance Dena Morgan dealt with Lorilee Knight or Christina Gros who were employees of the Financial Store.[3] Both Ms. Knight and Ms. Gros considered the Morgans to be good customers.

Throughout its dealings with Morgan, the Financial Store's policy was to make only secured loans. In other words, the Financial Store required that property be pledged as collateral for each loan. However, that is not to imply that the value of the collateral pledged always equaled or exceeded the amount of the loan.

Billy J. Morgan obtained the first loan on November 29, 1999 (Plaintiff's Exhibit 5) in the amount of $2,669.05 and pledged his 1989 bass boat, motor, and trailer as security.[4] The note reflects that the boat had a loan and retail value of $4,000.

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[1] There may have been five loan transactions between these parties during this time period. When offering Plaintiff's Exhibit 3 into evidence, plaintiff's counsel described the document as a May 17, 2002 note. Plaintiff's Exhibit 3, however, is a note dated July 26, 2001. If there was a note dated May 17, 2002, there were actually five transactions between these parties.

[2] Billy J. and Dena Morgan were divorced in January 2003 after 17 years of marriage.

[3] Ms. Knight and Ms. Gros were both loan officers for the Financial Store during the time of the Morgan transactions. Further, Ms. Knight was, until her own divorce, related by marriage to Dena Morgan.

[4] The note evidencing the November 29, 1999 loan (Plaintiff's Exhibit 5) lists only a serial number under the column headed "Description Of Collateral." Morgan, however, acknowledged that this was the serial number of his bass boat and that he intended to pledge the boat as collateral for the loan.

Sometime the next year, Morgan sold his boat to Dustin Murphy for between $4,000 and $5,000. From the sale proceeds Dena Morgan made a lump sum payment of $2,600 to the Financial Store to pay off the November 29, 1999 note.

Dena Morgan does not recall whether she told anyone at the Financial Store that the bass boat had been sold at that time. Although Ms. Knight contends that she did not learn of the boat's sale until early 2003 (Plaintiff's Exhibit 9), Ms. Gros cannot recall whether or not she was told about the sale in 2000.

Nevertheless, Billy J. Morgan borrowed $400 from the Financial Store on September 8, 2000. This note (Plaintiff's Exhibit 6) is secured by the previously-sold bass boat. The note reflects both the loan and retail value of the boat at $4,500. Billy J. Morgan testified that he signed the note but did not read the document and did not notice that the boat was listed as collateral.

The third transaction between these parties was a $4,085.11 loan dated July 26, 2001 (Plaintiff's Exhibit 3). In addition to the sold bass boat this loan is further secured by a travel trailer. The note reflects that the loan and retail values of both pieces of collateral is zero. Again, as with the earlier notes, Billy J. Morgan testified that he did not read the note and did not notice that the bass boat was listed as collateral.[5]

The fourth and final transaction is a $4,573.50 note dated July 9, 2002 secured by the sold bass boat plus a 1983 Ford truck.[6] The note reflects the boat's value, both loan and retail, at $4,000. The accompanying credit application shows the value of the Ford truck at $650 but leaves blank the space where the boat's value was to have been inserted. Here, too, Billy J. Morgan

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[5] As previously noted, plaintiff's counsel described Exhibit 3 as a note dated May 17, 2002, but it is not. Coupled with Exhibit 3, plaintiff offered into evidence Exhibit 4, which is a credit application accompanying the purported May 17, 2002 note. Interestingly, this credit application lists the travel trailer as having a $3,700 value, but leaves blank the space where the value of the bass boat was to have been inserted.

[6] See the note and the accompanying credit application (Plaintiff's Exhibits 1 and 2, respectively).

stopped by the Financial Store offices to sign the documents and testified that he did not read the notes and did not notice that the bass boat was listed as collateral.

Billy Morgan personally received only $500 of the July 9, 2002 loan proceeds. Except for incidental charges, the remainder of the loan proceeds were applied to the balance of his previous account.

Morgan filed a petition under chapter 7 of the Bankruptcy Code on March 8, 2003, at which time he owed the Financial Store $4,231.88. The Financial Store subsequently repossessed and sold the 1983 Ford truck and applied the net proceeds to the loan, leaving a balance of $3,806.88. Therefore, it follows that all of Morgan's loans from the Financial Store have been paid except for the last note dated July 9, 2002.

CONCLUSIONS OF LAW

The plaintiff contends that Morgan's debt should be held nondischargeable under 11 U.S.C. § 523(a)(4) and (6). The preponderance of the evidence standard applies to all of the discharge exceptions of § 523(a). *Grogan v. Garner*, 498 U.S. 279, 288, 111 S. Ct. 654, 660, 112 L. Ed. 2d 755 (1991). Further, exceptions to discharge are to be strictly construed. *Schweig v. Hunter (In re Hunter)*, 780 F. 2d 1577, 1579 (11th Cir. 1986), *abrogated on other grounds*, 111 S. Ct. 654 (1991).

§ 523(a)(4) Count

Under 11 U.S.C. § 523(a)(4), a debt is not discharged if such debt is "for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny."

At trial the court granted the defendant's motion for summary judgment on the count under § 523(a)(4). In order to fall within the nondischargeability scope of 523(a)(4), it must be shown that a fiduciary relationship existed between the parties. Further, that fiduciary relationship must have resulted from the creation of either an express or a technical trust. Nothing in these facts shows that an express or technical trust existed between the parties. Rather, the

relationship between the Financial Store and Morgan was merely that of debtor and creditor. The debtor/creditor relationship is simply not sufficient to impose a fiduciary obligation upon the debtor within the scope of subsection (a)(4). *Farmers and Merchants Bank v. Brinsfield (In re Brinsfield),* 78 B.R. 364, 369 (Bankr. M.D. Ga. 1987). If such were the case, no debt could be discharged in bankruptcy. Therefore, as a matter of law, the debt cannot be held nondischargeable under the breach of fiduciary duty prong of § 523(a)(4).

Neither do these facts establish embezzlement or larceny. Both embezzlement and larceny entail the fraudulent appropriation of the property of another.[7] The plaintiff argues that Morgan fraudulently appropriated the boat. The plaintiff relies on *Charles R. Hall Motors, Inc. v. Lewis (In re Lewis)*, 137 F. 3d 1280 (11th Cir. 1998), to support its contention that the boat belonged to the plaintiff.

In re Lewis held that the defaulting debtor, whose car was repossessed prior to the filing of the chapter 13 petition, did not retain any functional equivalent of ownership in the vehicle and that the bankruptcy estate's statutory right of redemption in the repossessed vehicle was insufficient to render the vehicle property of the estate. The *Lewis* court decided this issue, not under Alabama's version of the Uniform Commercial Code, *Ala. Code* § 7-1-101 *et seq.* (1975), but rather under the state's conversion law. Quoting *American National Bank & Trust Co. v. Robertson*, 384 So. 2d 1122, 1123 (Ala. Civ. App. 1980), the *Lewis* panel concluded that "[u]pon a debtor's default, title and right of possession pass to the creditor." *Lewis*, 137 F.3d at 1283.

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[7] Larceny is defined in Alabama as 1) the felonious (and trespassory) taking and carrying away of 2) the personal property of another 3) with the intent to convert it or deprive the owner of it. *Livingston v. State*, 44 Ala. App. 559, 564, 216 So. 2d 731, 736 (1968). For § 523(a) purposes, "[l]arceny is proven . . . if the debtor has wrongfully and with fraudulent intent taken property from its owner." *Kaye v. Rose (In re Rose)*, 934 F. 2d 901, 903 (7th Cir. 1991). Embezzlement on the other hand is a form of larceny distinguished principally by how and from whom the property was obtained. For embezzlement the property must have come into the defendant's hands lawfully by reason of "some office or employment or position of trust." *Black's Law Dictionary* 468 (5th ed. 1979). *See Barr v. State*, 10 Ala. App. 111, 65 So. 197 (1914) (employment relationship). Further, the defendant must appropriate the property for his own use. *Hurst v. State*, 21 Ala. App. 361, 108 So. 398 (1926).

Here, however, the facts do not evidence a default with respect to Morgan's indebtedness prior to his sale of the collateral. It follows that absent a default, the Financial Store could not have had title or the right of possession to the boat. Thus, the boat was never the property of the Financial Store, and its sale by Morgan cannot form the basis of an embezzlement or larceny claim.

In short, the Financial Store had a security interest in the boat, at least until the first note (November 29, 1999) was paid, but it never owned the boat under Alabama conversion law theory or otherwise.[8] Hence, as a matter of law, Morgan cannot be liable for the embezzlement or larceny of his own property.

§ 523(a)(6) Count

Under 11 U.S.C. § 523(a)(6), a debt is not dischargeable if such debt is "for willful and malicious injury by the debtor to another entity or to the property of another entity." 11 U.S.C. § 523(a)(6).

It is settled law that collateral conversion may form the basis of a claim under § 523(a)(6), but a willful and malicious injury "does not follow as of course from every act of conversion, without reference to the circumstances." *Davis v. Aetna Acceptance Co.*, 293 U.S. 328, 332, 55 S. Ct. 151, 153, 79 L. Ed. 393 (1934); *Wolfson v. Equine Capital Corporation* (*In re Wolfson*), 56 F. 3d 52, 54 (11th Cir. 1995) (holding that "[w]illful and malicious injury includes willful and malicious conversion, which is the unauthorized exercise of ownership over goods belonging to another to the exclusion of the owner's rights").

Further, as used in § 523(a)(6), willful injury means a deliberate or an intentional injury and not merely a deliberate or intentional act that leads to injury. *Kawaauhau v. Geiger*, 523 U.S. 57, 61, 118 S. Ct. 974, 977, 140 L. Ed. 2d 90 (1998); *Hope v. Walker (In re Walker)*, 48 F. 3d 1161, 1164 (11th Cir. 1995). Malice, under the (a)(6) exception, means "'wrongful and without just cause or excessive even in the absence of personal hatred, spite or ill-will.'" *Id.*

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[8] Although the boat was listed as collateral on Morgan's subsequent loans, the Financial Store did not have a security interest in the property because Morgan could not pledge property as collateral in which he had no ownership interest.

at 1164 (quoting *Sunco Sales, Inc. v. Latch (In re Latch)*, 820 F.2d 1163, 1166 n.4 (11th Cir. 1987)).

The facts of the case at bar do not lead to a conclusion that Morgan converted collateral pledged to the Financial Store. Instead, Morgan sold the collateral and from the proceeds of the sale paid his obligation to the Financial Store in full. By paying off the underlying note, Morgan did not act to the exclusion of the Financial Store's rights in the boat. Hence, by its very definition there was no conversion. For the same reason (that he paid the underlying debt in full) Morgan did not intentionally and deliberately injure the Financial Store by selling the collateral.

Neither does Morgan's later pledge of the sold boat as collateral for subsequent loans constitute conversion. If Morgan had no interest in the boat at the time of the subsequent loans, he could not have given the Financial Store an interest in the property through the grant of a security interest. *Ala. Code* § 7-9A-203(b)(2) (1975). It follows not only that Morgan could not convert what he did not then have but also that the Financial Store's rights to the property, which were then none, could not in any way be excluded.

§ 523(a)(2) Evidence

Plaintiff's complaint did not contain a count under § 523(a)(2). That subsection makes a debt nondischargeable if such debt was:

> for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by–
>
> > (A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition.

11 U.S.C. § 523(a)(2)(A).

Although there was no § 523(a)(2) count alleged in the complaint, much of the evidence at trial centered upon Morgan's pledge of the sold boat as

collateral for his subsequent loans from the Financial Store.[9] Even so, plaintiff has not proven by a preponderance of the evidence that it justifiably relied upon Morgan's alleged false pretense or false representation. A showing of justifiable reliance, not the more stringent reasonable reliance, is required of a plaintiff in a proceeding under § 523(a)(2)(A). *Field v. Mans*, 516 U.S. 59, 73-74, 116 S. Ct. 437, 445-46, 133 L. Ed. 2d 351 (1995).

The court reaches this conclusion based upon the notes and credit applications themselves. The July 26, 2001 note (Plaintiff's Exhibit 3) lists both the loan and retail value of the boat at $0. Similarly, the May 17, 2002 and July 9, 2002 credit applications (Plaintiff's Exhibits 4 and 2, respectively) list the boat as collateral for the loans but leave blank the spaces for the valuation of the boat. That these failures to list a valuation were mere omissions is belied by the fact that a value is assigned to other collateral securing both of these loans. How could the Financial Store even actually rely, much less justifiably rely, upon a collateral pledge to secure its loan when from time to time its own records reflected that the collateral was without value? In short, plaintiff has failed to persuade the court by a preponderance of the evidence that it justifiably relied upon the boat pledge in making the loan.

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[9] Bankruptcy Rule 7015, which incorporates Rule 15 Fed. R. Civ. Proc. in adversary proceedings, provides in relevant part:

> (b) Amendments to Conform to the Evidence. When issues not raised by the pleadings are tried by express or implied consent of the parties, they shall be treated in all respects as if they had been raised in the pleadings. Such amendment of the pleadings as may be necessary to cause them to conform to the evidence and to raise these issues may be made upon motion of any party at any time, even after judgment; but failure so to amend does not affect the result of the trial of these issues. If evidence is objected to at the trial on the ground that it is not within the issues made by the pleadings, the court may allow the pleadings to be amended and shall do so freely when the presentation of the merits of the action will be subserved thereby and the objecting party fails to satisfy the court that the admission of such evidence would prejudice the party in maintaining the party's action or defense upon the merits. The court may grant a continuance to enable the objecting party to meet such evidence.

Rule 15(b) Fed. R. Civ. Proc. Plaintiff, however, has not moved to amend the complaint pursuant to this rule.

Further, under § 523(a)(2), plaintiff has the burden of proving, again by a preponderance of the evidence, that the defendant had the intent to defraud at the time the promise was made. This, too, plaintiff has failed to do.

Intent to defraud is rarely openly admitted, and often, such intent is not apparent on its face. Therefore, courts must look to the surrounding circumstances to determine whether fraudulent intent should be inferred. In this case those circumstances include a debtor whose wife made all the arrangements for the debtor's loans. The debtor's role in each transaction was merely to sign the loan documents. While the debtor's signature on a contract may bind him to its terms, even though he has not read the contract, it does not, without more, impute fraudulent intent.

For these reasons, had the plaintiff included a § 523(a)(2) count in its complaint or moved to amend the complaint pursuant to Fed. R. Bankr. Proc. 7015(b), it would not have prevailed.

CONCLUSION

For the foregoing reasons the Financial Store's complaint to except its claim from discharge fails. Pursuant to Fed. R. Bankr. Proc. 9021, a separate judgment consistent with this opinion will enter in favor of the defendant Billy J. Morgan holding the debt dischargeable.

Done this 24th day of March, 2004.

/s/ Dwight H. Williams, Jr.
United States Bankruptcy Judge

c: Mark D. Owsley, Attorney for Plaintiff
Charles G. Reynolds, Jr., Attorney for Debtor/Defendant