In the United States Bankruptcy Court

for the Northern District of Iowa

RANDY L. MCCLEAN *Debtor(s).*	Bankruptcy No. 96-12592-C Chapter 7
GREEN TREE FINANCIAL CORP. *Plaintiff(s)* vs. RANDY L. MCCLEAN *Defendant(s)*	Adversary No. 96-1214-C

ORDER RE: OBJECTION TO DISCHARGE

The above-captioned matter came on for trial on July 15, 1997. The matter before the Court is Plaintiff's Complaint objecting to discharge under 11 U.S.C. § 523(a)(6) alleging willful and malicious injury. Present were Defendant/Debtor Randy McClean with his attorney John Titler, and Gregory J. Epping representing Plaintiff Green Tree Financial Corporation. The parties agree that the Court is to decide this case based upon the stipulated facts, exhibits and the trial testimony. Debtor was the only person to testify. This is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(I), (J).

FINDINGS OF FACT

Debtor was in the business of selling and installing manufactured homes. He was the 100% stockholder, principal director, and general manager of a corporation named E-Z Homes. He was also its president. E-Z sold manufactured homes to the general public. Debtor ran E-Z's day to day operations.

E-Z acquired homes from a number of manufacturers and utilized a "floor plan" financing arrangement with Green Tree Financial Corporation (Green Tree). Under the floor plan agreement, Green Tree provided financing for E-Z's inventory of sample manufactured homes, advanced money to the manufacturer when the home was received by E-Z, and received payment from E-Z when the home was sold. While Green Tree's funds were outstanding, it maintained possession of the Manufacturer's Statement of Origin (MSO), a document comparable to an automobile title, without which the home could not be transferred or titled to its ultimate purchaser. The transaction sequence was described in testimony as follows: 1) the manufacturer shipped the home to seller (E-Z), 2) the manufacturer sent the MSO to Green Tree, 3) Green Tree sent payment for the home to the manufacturer, 4) E-Z paid interest to Green Tree on the amount advanced, and 5) when the home was sold, E-Z repaid the principal to Green Tree in return for release of the MSO.

Debtor, as president of E-Z, signed a Floorplan Financing and Security Agreement with Green Tree on February 21, 1994. Debtor personally guaranteed any debts incurred by E-Z under the Floorplan

Agreement pursuant to the terms of a Guaranty signed by Debtor on March 9, 1994. The Floorplan Agreement called for Green Tree to advance funds on E-Z's behalf to manufacturers of homes. According to the agreement, E-Z was to "promptly notify [Green Tree] of any sale" and "immediately pay [Green Tree] the amount of the total indebtedness allocable thereto." This excerpt is largely included in the stipulations except for the word "immediately."

Trial testimony establishes that the procedure followed by E-Z since a November 1, 1995 agreement with Green Tree was to pay Green Tree and get Green Tree's permission before moving any home off E-Z's sales lot. The procedure pursuant to the November 1, 1995 agreement, as understood and followed by Debtor, did not call for immediate notice or payment, only for payment to Green Tree prior to removal of the sold home from E-Z's lot. Debtor testified that this procedure was utilized for four or five cash sales since November 1, 1995, and that it was used until July 10, 1996. This testimony is undisputed.

E-Z's continued operations were dependent on a short term (90 day) note with Perpetual Bank (Perpetual), which Debtor personally guaranteed, and which was also guaranteed by Wick Building Systems, Inc. (Wick), E-Z's principal supplier of manufactured homes. Wick also had Debtor's personal guarantee. The Perpetual note came due on July 10, 1996. Debtor testified that he expected the note to be renewed on that date, based upon Wick's continued guarantee, without which Perpetual would call in the note.

On June 26, 1996, E-Z sold Jane and Matthew Hahn a 1995 28' by 60' Marshfield Excelsior manufactured home on which Green Tree held the first security interest and the MSO. The Hahns did not require financing for their home and their checks totaling $57,434 were deposited into E-Z's regular business checking account on June 27, 1996.

Debtor testified that Green Tree was to be paid out of the deposited funds shortly before delivery of the home, and that was the normal procedure involving sales since November 1, 1995. The home was to be delivered to the Hahns' site at the end of July, 1996, after E-Z completed site preparation. However, on July 10, 1996, Wick and Green Tree closed down E-Z's operation. Wick cancelled its guarantee of E-Z's note at Perpetual and an injunction was issued to bar E-Z from having any contact with the homes on E-Z's lot. E-Z was not to show the homes, talk to customers, or represent Wick in any way. Green Tree took possession of the homes on the lot. Due to the cancellation of the loan guarantee by Wick, Perpetual applied the entire balance of E-Z's corporate checking account toward the short term note. As of July 10, 1996, E-Z was shut down. It had a zero balance in its checking account and no inventory.

Debtor filed his voluntary individual Chapter 7 petition on October 9, 1996, listing, among others, Green Tree Financial as an unsecured, nonpriority creditor. Debtor seeks discharge of the balance owed Green Tree by E-Z, which Debtor personally guaranteed. On November 13, 1996, Green Tree filed its Complaint objecting to discharge, claiming that the actions of Debtor in his official capacity at E-Z were "unjustified and tantamount to a willful and malicious injury to the property of Green Tree." Green Tree requests that its claim be excepted from discharge under § 523(a)(6), and that judgment be entered in its favor.

Green Tree also included in its Complaint an Objection to Discharge under § 727(a)(3) for concealing, destroying, or mutilating business records. Green Tree filed a Dismissal of § 727 Complaint on April 11, 1997, and the Court granted the dismissal on May 27, 1997 after notice and without objection.

CONCLUSIONS OF LAW

Green Tree contends Debtor's actions as president of E-Z constitute grounds to except the debt to Green Tree from discharge under 11 U.S.C. § 523(a)(6). Under § 523(a), Green Tree has the burden to prove the elements of the claim by a preponderance of the evidence. Grogan v. Garner, 111 S.Ct. 654, 661 (1991). "Exceptions to discharge must be narrowly construed against the creditor and liberally construed against the debtor." In re Kondora, 194 B.R. 202, 207-208 (Bankr. N.D. Iowa 1996) (citations omitted).

Section 523(a)(6) provides an exception from discharge for any debt arising out of "willful and malicious injury by the debtor to another entity or to the property of another entity." A willful and malicious conversion, as is alleged by Green Tree, is an "injury" under § 523(a)(6). In re Ewing, No. 92-11343LC, Adv. No. 92-1231LC, slip op. At 6 (Bankr. N.D. Iowa Nov. 3, 1993); In re Holtz, 62 B.R. 782, 785 (Bankr. N.D. Iowa 1986). "Bankruptcy Courts must look to state law to define conversion. Iowa defines conversion as the act of wrongful control or dominion over chattels in derogation of another's possessory right thereto." Holtz, 62 B.R. at 785 (citations omitted).

A mere technical conversion, however, does not satisfy § 523(a)(6). Id. at 786. "[N]ondischargeability turns on whether the conduct is (1) headstrong and knowing ("willful") and, (2) targeted at the creditor ("malicious"), at least in the sense that the conduct is certain or almost certain to cause financial harm." In re Long, 774 F.2d 875, 881 (8th Cir. 1985). A willful and malicious conversion under § 523(a)(6) occurs when the debtor knowingly converts a creditor's interest in property, knowing the conversion would almost certainly harm the creditor. In re Foust, 52 F.3d 766, 768 (8th Cir. 1995). The knowledge of virtually certain harm is critical: "[A]n intentional breach of contract, without more, is not sufficient to establish a willful and malicious injury for the purposes of § 523(a)(6)." In re Pasek, 129 B.R. 247, 252 (Bankr. D. Wyo. 1991).

ANALYSIS

Green Tree contends Debtor's actions in his capacity as president of E-Z rise to the level of "willful and malicious" as referred to in § 523(a)(6). Green Tree refers to the Floorplan Financing and Security Agreement which states: "We (E-Z) agree to hold all the goods and proceeds in trust until our complete payment of indebtedness to you (Green Tree)." E-Z was holding, maintaining, and insuring the home at the time of the sale to the Hahns and was continuing to do so pending its delivery to the Hahns. E-Z was completely responsible for the well being and upkeep of the home in which Green Tree held a security interest. Debtor testified that E-Z planned complete payment of the amount due Green Tree on this home before removing the home from E-Z's lot for delivery, and that Perpetual's seizure of the balance in E-Z's account was the only thing that blocked such payment.

Green Tree also relies on the following sentence from the Floorplan Agreement: "We (E-Z) shall promptly notify you (Green Tree) of any sale, and we shall immediately pay you the amount of the total indebtedness allocable thereto." Green Tree contends it was neither "promptly notified" nor "immediately paid" by E-Z in relation to the sale of the home to the Hahns. Debtor's undisputed testimony indicates that, pursuant to an agreement made November 1, 1995 between E-Z and Green Tree, the procedure to be followed by E-Z was being followed in the Hahn sale. E-Z's only responsibility, per Debtor's testimony, was to pay over to Green Tree the total balance due to Green Tree on the home in question prior to removing the home from E-Z's lot. Upon receipt of such payment, Green Tree would release the MSO allowing for the transfer of title of the home, and would give its permission for E-Z to remove the home from E-Z's sales lot. The exhibits submitted to the Court do not include a copy of any November 1, 1995 agreement. The omission, however, of the

word "immediately" in item 10 of the stipulated facts may indicate a change in the course of business agreed between the parties. Debtor's testimony regarding such November 1, 1995 agreement was not challenged.

Green Tree relies on In re Owens, 807 F.2d 1556 (11th Cir. 1987), in which a corporate officer was held liable for tortious acts of the corporation. His debt in relation to these acts was deemed nondischargeable in bankruptcy under § 523(a)(6) because his deliberate acts "did not have any good faith reason" and he "presumptively knew that harm would result." Id. at 1559. Debtor in the present case did have a good faith reason for accepting the sale proceeds for the manufactured home: the purpose of his business was to sell homes. Debtor testified that the procedure of depositing the proceeds of a cash sale in the E-Z account for payment to Green Tree prior to removing the home from E-Z's lot had been followed prior to the Hahn sale, in accordance with the November 1, 1995 agreement.

Discounting the November 1, 1995 agreement entirely and relying on the words of the Floorplan Agreement which state E-Z "shall pay immediately," the deposit of the Hahn sale proceeds into E-Z's business account represents a "mere technical conversion." Holtz, 62 B.R. at 786. "Failure to apply the proceeds received from the sale of secured [property], standing alone, is not sufficient to establish willful and malicious injury." Id. On the evidence submitted, Debtor's deposit of the Hahn sale proceeds into E-Z's business checking account is "standing alone" before this Court. It does not, in and of itself, establish willful and malicious conduct on the part of Debtor.

Green Tree contends that Debtor, being aware of the short term note with Perpetual which would come due on July 10, 1996, should not have deposited the sale proceeds in an account at Perpetual, where it could be subject to seizure upon default on the note. Green Tree attempts to impute malice into E-Z's continued use of its corporate checking account at the same bank that issued the note. Debtor testified that he understood that the note was to be renewed on July 10, 1996, and that Wick's guarantee would continue. He stated that he found out from Perpetual about Wick's guarantee withdrawal on the morning of July 10, 1997, and that the assets in E-Z's checking account were seized immediately and completely. Debtor also stated that each of these actions came as a surprise to him.

No evidence is presented that Debtor was aware of harm which might result from E-Z's continued use of their corporate checking account, or that Debtor intended such harm. "A finding of malice requires finding intent to do the claimed harm; a finding that the harm was caused through negligence or recklessness does not meet that high standard." In re Zentz, 157 B.R. 145, 148 (Bankr. W.D. Mo. 1993), aff'd 81 F.3d 166 (8th Cir. 1996); In re Minihan, 794 F.2d 340, 344 (8th Cir. 1986). Debtor's use of the checking account in question did not involve malice.

CONCLUSION

Debtor failed to follow the Floorplan Agreement procedures calling for the immediate payment of sale proceeds. He states there was a subsequent agreement, which the Court has not seen but which Green Tree has not disputed, which allows such a procedure. The outcome is the same under either set of facts. "Debtors who willfully break security agreements are testing the outer bounds of their right to a fresh start, but unless they act with malice by intending or fully expecting to harm the economic interests of the creditor, such a breach of contract does not, in and of itself, preclude a discharge." Long, 774 F.2d at 882. The Court is presented with no evidence which would indicate the requisite malice necessary to cause this debt to be excepted from discharge under § 523(a)(6).

Green Tree maintains the burden of proving the elements of its claim under § 523(a)(6). However, Green Tree has failed to establish malicious intent on the part of the Debtor by a prepondereance of the evidence and has, therefore, failed to carry its burden.

WHEREFORE, Green Tree's Objection to Discharge is DENIED.

FURTHER, the above described debt owed to Green Tree by Debtor is DISCHARGED.

SO ORDERED this 5th day of August, 1997.

Paul J. Kilburg
U.S. Bankruptcy Judge